

Introduction to Income Statement

Introduction to the Income Statement

(also called the Statement of Earnings or Profit & Loss Statement)

1. What Is an Income Statement?

- **Purpose:** Shows a company's financial performance over a specific period (month, quarter, year).
 - **Key Question it Answers:** *Did the business generate profit or incur a loss during the reporting period?*
 - **Placement in Financial Reporting:** One of the three core financial statements, together with the Balance Sheet and Cash Flow Statement.
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2. Core Components (in order of presentation)

Section	Typical Line Items	What It Represents
Revenue (Sales) / Net Sales	Gross sales, sales returns & allowances, discounts	Total amount earned from core business activities before any expenses.
Cost of Goods Sold (COGS)	Direct material, direct labor, manufacturing overhead	The cost directly tied to producing the goods or services sold.
Gross Profit	<i>Revenue – COGS</i>	Profit after covering production costs; indicates efficiency of core operations.
Operating Expenses	• Selling, General & Administrative (SG&A) • Research & Development (R&D) • Depreciation & Amortization (if not included in COGS)	Costs required to run the business that are not directly linked to production.
Operating Income (EBIT)	<i>Gross Profit – Operating Expenses</i>	Earnings before interest and taxes; measures profitability from core operations.

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Section	Typical Line Items	What It Represents
Non-Operating Items	- Interest expense / interest income - Gains or losses on asset sales - Other miscellaneous income/expenses	Items that arise from activities outside the primary business.
Income Before Taxes (EBT)	<i>Operating Income ± Non-Operating Items</i>	Profit before the impact of income taxes.
Income Tax Expense	Current tax + deferred tax	Taxes owed on the period's earnings.
Net Income	<i>EBT – Income Tax Expense</i>	Bottom-line profit (or loss) attributable to shareholders.

3. Presentation Formats

Format	Description	When Used
Single-Step	All revenues are grouped together, all expenses are grouped together; the difference is net income.	Simpler businesses, educational examples.
Multi-Step	Separates operating from non-operating items; highlights gross profit and operating income.	Most public-company reports; provides more analytical detail.
Condensed	Summarized version for interim reports or brief disclosures.	Quarterly filings, management summaries.

4. Key Concepts & Ratios

Concept	Formula	Insight
Gross Margin	$\text{Gross Profit} \div \text{Revenue}$	Efficiency of production; higher = better cost control.
Operating Margin	$\text{Operating Income} \div \text{Revenue}$	Profitability of core operations before financing costs.
Net Profit Margin	$\text{Net Income} \div \text{Revenue}$	Overall profitability after all expenses and taxes.

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Concept	Formula	Insight
Earnings Per Share (EPS)	$\text{Net Income} \div \text{Weighted average shares outstanding}$	Profit attributable to each common share; key metric for investors.
EBITDA	$\text{Operating Income} + \text{Depreciation} + \text{Amortization}$	Cash flow proximate measure, excludes non-cash and financing effects.

5. How the Income Statement Connects to Other Statements

1. Balance Sheet

- Net income flows into **Retained Earnings** (equity section).