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Financial Workbook

FOR SMALL BUSINESS

Your Income Statement

After completing this section, you should be able to:

- Prepare a detailed Income Statement
- Recognize how an Income Statement differs from a Cash Flow Statement

For the manager of a small business, the Income Statement is a "report card." It shows you how well your company has done during a given period (usually one year). Revenues are seen as "plus" points and expenses "minus" points. If you have done well, your revenues minus your expenses will leave positive income. If not—if your expenses exceed revenues—your Income Statement will show a loss.

You will see that the Income Statement and the Cash Flow Statement are quite similar. Some of the key differences are:

- Cash Flow is often a projection into the future so you can try and determine the future financial picture of the business
- Cash Flow includes a running tally of the account balance
- Income Statement is often a summary of money in and money out for a specific period in time (often the fiscal year)
- Income Statement includes depreciation expenses, which is not included on the Cash Flow

All items on the Income Statement are recorded as they occur, not when money actually changes hands. For example, if you allow a customer 30 days to pay an invoice (Accounts Receivable), you would record the sale as of the day it was made, not the day the customer actually paid the bill.

A simple Income Statement looks like the following:

Sales (or Revenues)
Less: Cost of Sales
Less: Operating Expenses
Equals: Net Profit or Net Loss

Definitions

- **Sales:** All revenue-producing transactions in which goods and services are provided to customers in exchange for payment. Sales and revenues are terms used interchangeably, but it is also said that making a sale produces revenue. Remember, on the Income Statement, sales are recorded as they occur—not when customers pay.
- **Cost of Goods Sold (COGS):** These are the costs incurred due to sales of your product or service. Only the costs directly associated with the goods or services you are providing to customers are included in Cost of Goods Sold (COGS). This is the same as on your Cash Flow Statement.
- **Gross Profit (or Gross Margin):** This is calculated as sales minus Cost of Goods Sold (COGS). It shows how much is left after you have subtracted all direct costs of production from the total sales revenue generated. The amount left over is what the business has available to cover its operating expenses.

  Service businesses that do not sell products or bill based on time only need to consider revenues. This figure will equal the Gross Profit.

- **Operating Expenses:** These are all the expenses incurred in running your business that do not relate directly to the products/services being produced. These will include all costs associated with running your office, paying staff, bank charges and interest, etc.
- **Net Income or Net Loss:** This is your bottom line, or the amount of money your business made after subtracting Cost of Goods Sold (COGS) and expenses from revenues. If this amount is positive, it will be referred to as Net Income or Profit and if it is negative, it is a Net Loss.
- **Depreciation Expense:** This is not included in your Cash Flow Statement (for more information on Depreciation, see the Balance Sheet section on page 31).

Below is a sample Income Statement showing the basic statement structure:

COMPANY NAME INCOME STATEMENT FOR THE YEAR ENDED DEC 31		
Revenues (or Sales)	$45,000	
Less: Cost of Goods Sold	12,500	
Gross Margin		**$32,500**
Fixed Expenses		
Wages	$15,000	
Rent	6,000	
Utilities	2,500	
Supplies	1,200	
Depreciation	250	
Total Fixed Expenses		**$24,950**
NET INCOME		**$7,550**

Cash Flow Statement/Income Statement

Remember, there are a few key differences between a Cash Flow and an Income Statement.

- Cash Flow is often a projection into the future so you can try and determine the future financial picture of the business
- Cash Flow includes a running tally of the account balance
- Income Statement is often a summary of money in and money out for a specific period in time (often the fiscal year)
- Income Statement includes depreciation expenses which is not included on the Cash Flow

EXERCISE 2.4

Cash Flow vs. Income Statement

Identify which statement (Cash Flow or Income Statement) contains each of the items listed below:

	CASH FLOW	INCOME STATEMENT
Loan Proceeds	☐	☐
Owner's Investment	☐	☐
Sales as they are made	☐	☐
Cash paid for assets purchased	☐	☐
Depreciation	☐	☐
Total loan repayments	☐	☐
Profit or loss for the business	☐	☐
Running total carried over every month	☐	☐

Answers can be found under the Solutions section (p. 62).