

FINANCE AT A GLANCE

Presenting the Income Statement

Lesson 30

Income Statements come in various formats. Regardless of format, the purpose of the *Income Statement* remains the same, which is to disclose how much of the revenues is left, after paying for all expenses of the business.

One typical presentation is shown in the sample income statement on the right side of this page. Most of the items in the sample have been defined in previous lessons. The discussion here will be limited to new terminology and concepts associated with such terms.

Gross Margin represents what is left of the Net Sales after paying for the cost of acquisition of the goods sold to customers, in the case of trading businesses; or after paying for the cost of producing the goods sold, in the case of manufacturing businesses; or after paying for expenditures that can be directly ascribed to services rendered to customers, in the case of service businesses. (In service businesses, the term Cost of Sales is used in lieu of Cost of Goods Sold, for the obvious reason that they do not sell goods.)

If the Gross Margin is a negative figure, it shows that sales proceeds do not cover what the company spent directly on the goods or services sold to the customers.

Operating Profit represents what is left of Net Sales after paying for all business expenses. If the Operating Profit is a negative figure, despite a positive Gross Margin, then it shows that there are not enough sales proceeds to cover some or all of the expenditures incurred to sell, distribute, etc., the products (or services), and to run the business in general.

What amount of the Net Sales is used up by each of the expense items delves into the interesting realm of analyzing profitability as a responsibility of the different departments within a company. This will be discussed in future lessons.

ABC Inc.

Income Statement

For the Year Ending on December 31, 2008

	\$ 000
Sales	10,000
Less: Returns and Allowances	200
Less: Sales Discounts	500

Net Sales	9,300
Less: Cost of Goods Sold	4,200

Gross Margin	5,100
Less: Operating Expenses	
Sales and Marketing Expenses	800
Research and Development Expenses	400
General and Administrative Expenses	700

Operating Profit	3,200
Less: Interest Expense	300
Plus: Other Income	500
Less: Extraordinary Items	200

Net Profit Before Tax	3,200
Less: Income Tax	800

Net Profit After Tax	2,400

From the Operating Profit, the **Interest Expense** is deducted, and Other Income is added. Interest Expense is incurred for having borrowed money. **Other Income** includes revenues that are not necessarily related to the company's main product or service lines. This includes interest income on bank deposits, income from investments in securities, etc. They may be unrelated to the main business, but they are not unusual.

Sometimes there are **Extraordinary Items**, which can be revenues or expenses that are unusual and unrelated to the regular operations of the business. They include sale of a business segment, gains or losses resulting from major revaluation or devaluation of foreign currencies, etc. (In the example, there is an extraordinary expense.)

The **Net Profit Before Tax** is reached after taking into consideration all Revenues and Expenses, except for the corporate income tax. The **Income Tax** is calculated as a percentage of the figure represented by Net Income Before Tax after adjusting it for Expenses (and Revenues) that are not approved by the tax authorities for inclusion in the computation of corporate income taxes. (In the example, the tax rate is 25%, and the tax base equals the Net Profit Before Tax with no adjustments.)

The so-called bottom line or **Net Profit (After Tax)** is the figure arrived at after deducting the Income Tax from Net Profit Before Tax. Most income statements stop at this point.

If there were **Dividends** released to the shareholders, they would not be part of the expenses. They are presented in another statement called *Statement of Retained Earnings* (which is an extension of the income statement). This will be presented in the next lesson.

Until then,

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