

# Preparing Income Statements

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## WHAT'S COVERED

This tutorial will cover how to prepare a multi-step income statement.

Our discussion breaks down as follows:

1. [Income Statement: A Review](#)
2. [Multi-Step Income Statement: Example](#)

## 1. Income Statement: A Review

To review, the income statement is a financial statement that provides information about the revenue, expenses, and net profit or loss of a business for a given time period. A key phrase in that definition is "a given time period," because it is activity-based.

Let's break down the net profit or loss idea. The income statement helps to identify the business's profitability, which is a key component of the purpose of the income statement:

- The income statement reports on one year or less of a time period.
- The income statement helps to assess the health or strength of a business, which is important information for shareholders and potential investors, as well as banks.

As you may recall, the income statement formula is revenues minus expenses equals net income, revenues being the inflows from the business operations and expenses being the outflows or the use of assets from the business operations.



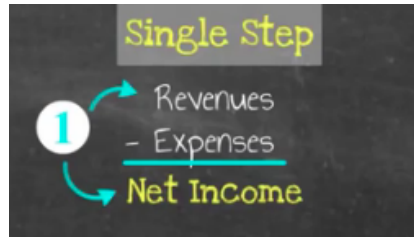
### FORMULA TO KNOW

#### Income Statement Formula

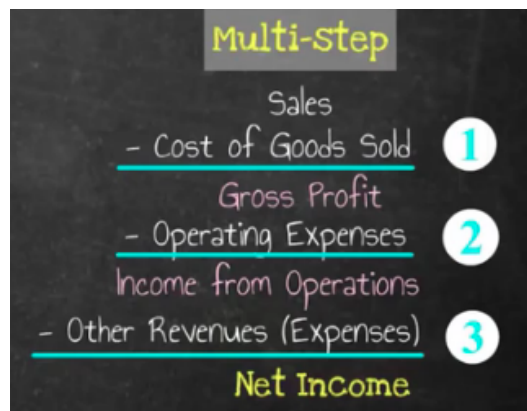
$$\text{Revenues} - \text{Expenses} = \text{Net Income}$$

There are two types of income statement formats:

- Single step, because there is only one step: you take the total revenues and subtract the total expenses to get to net income.



- Multi-step, which is a little more complex.
  1. Start with your sales and subtract the cost of goods sold to get your gross profit.
  2. Take that gross profit and subtract all of your operating expenses from the business operations to get to income from operations.
  3. Once you have income from operations, you subtract the other revenues and expenses to ultimately arrive at your net income.



At the end of the day, the single step and multi-step income statements arrive at the same place, but the multi-step statement has several individual steps that involve calculating gross profit and separating out income from operations, as well as other revenues and expenses.

## 2. Multi-Step Income Statement: Example

Now we're going to cover a detailed example of a multi-step income statement. However, before we begin, let's take a look at our adjusted trial balance on the trial balance worksheet, which is going to help us prepare that multi-step income statement.

Accounts	Adjusted Trial Balance				
	Dr.	Cr.			
Cash	120,000				
Accounts Receivable	10,000				
Supplies	500				
Prepaid Insurance	4,000				
Buildings	50,000				
Accumulated Depreciation - Buildings		11,000			
Accounts Payable		5,000			
Notes Payable		25,000			
Common Stock		100,000			
Retained earnings, 1/1/12		12,000			
Owner Drawings	2,000				
Sales		300,000			
Interest Revenue		20,000			
Cost of Goods Sold	150,000				
Salaries Expense	121,500				
Advertising Expense	10,000				
Interest Expense	2,500				
Depreciation Expense-Buildings	1,000				
Insurance Expense	1,000				
Supplies Expense	500				
Totals	473,000	473,000			

As you can see above, we've identified our adjusted trial balance, which is what is used to prepare financial statements.

Since we are working on the income statement, we need to identify the accounts used to prepare it. In preparing the income statement, we select all of our revenues and expenses; these are the accounts we are going to use for the income statement.

Accounts	Adjusted Trial Balance		Income Statement		
	Dr.	Cr.	Dr.	Cr.	
Cash	120,000				
Accounts Receivable	10,000				
Supplies	500				
Prepaid Insurance	4,000				
Buildings	50,000				
Accumulated Depreciation - Buildings		11,000			
Accounts Payable		5,000			
Notes Payable		25,000			
Common Stock		100,000			
Retained earnings, 1/1/12		12,000			
Owner Drawings	2,000				
Sales		300,000		300,000	Revenues
Interest Revenue		20,000		20,000	
Cost of Goods Sold	150,000		150,000		
Salaries Expense	121,500		121,500		
Advertising Expense	10,000		10,000		
Interest Expense	2,500		2,500		
Depreciation Expense - Buildings	1,000		1,000		Expenses
Insurance Expense	1,000		1,000		
Supplies Expense	500		500		
Totals	473,000	473,000	286,500	320,000	
Net Income			33,500		
Totals			320,000	320,000	

Note, there is a difference between the total debits and total credits--they don't equal each other. This difference is our net income.

Now that we've used our trial balance worksheet to identify what the income statement needs to look like, let's move on to the income statement preparation. Referring back to the information from our adjusted trial balance, do we need all of these accounts for the income statement? The answer is no; we don't need the permanent accounts. All we need are the temporary accounts, the revenues and expenses. As you can see below, we only need the items at the bottom of the adjusted trial balance, starting with sales through the end of expenses.

Accounts	Adjusted Trial Balance	
	Dr.	Cr.
Cash	120,000	
Accounts Receivable	10,000	
Supplies	500	
Prepaid Insurance	4,000	
Buildings	50,000	
Accumulated Depreciation - Buildings		11,000
Accounts Payable		5,000
Notes Payable		25,000
Common Stock		100,000
Retained earnings, 1/1/12		12,000
Owner Drawings	2,000	
Sales		300,000
Interest Revenue		20,000
Cost of Goods Sold	150,000	
Salaries Expense	121,500	
Advertising Expense	10,000	
Interest Expense	2,500	
Depreciation Expense-Buildings	1,000	
Insurance Expense	1,000	
Supplies Expense	500	
<b>Totals</b>	<b>473,000</b>	<b>473,000</b>

Using this information, let's start building our income statement. As you see below, we have the header, starting with the company name, "Income Statement," and the important phrase "For the period ending...", which in this case is December 31, 2012. This indicates that this is a period-based and activity-based statement.



#### STEP BY STEP

*Step 1:* Starting with sales, we pull the sales out and place them on top. We subtract the cost of goods sold to arrive at our gross profit. Therefore, sales minus cost of goods sold equals gross profit.

*Step 2:* Next, we detail our operating expenses. Using our adjusted trial balance, we have salaries, advertising, insurance, supplies, and depreciation, for a total operating expenses of \$134,000. We can then calculate our income from operations, which is gross profit minus total operating expenses. From there, we look at our other revenue and expense items. In this case, we have interest revenue, as well as interest expense. Therefore, the total "other" revenue is \$17,500.

*Step 3:* Now we can calculate our net income. We take our income from operations of \$16,000 and add our total "other" revenue of \$17,500 to arrive at our net income of \$33,500.

Best Company LLC Income Statement For the period ending December 31, 2012	
Sales	\$ 300,000
Cost of Goods Sold	150,000
Gross Profit	<u>150,000</u>
Operating Expenses:	
Salaries expense	121,500
Advertising expense	10,000
Insurance expense	1,000
Supplies expense	500
Depreciation expense	<u>1,000</u>
Total operating expense	<u>134,000</u>
Income from operations	<u>16,000</u>
Other revenue (expense):	
Interest revenue	20,000
Interest expense	<u>(2,500)</u>
Total other	<u>17,500</u>
Net income	<u><u>\$ 33,500</u></u>

So, this is what the multi-step income statement looks like. Again, remember that you don't need the permanent accounts from your adjusted trial balance; you just need the temporary accounts--the revenues and expenses.



## SUMMARY

Today we discussed a **review of the income statement**, which is a financial statement that provides information about the revenue, expenses, and net profit or loss of a business for a given time period. We also explored a comprehensive **example of a multi-step income statement**.

Source: Adapted from Sophia instructor Evan McLaughlin.

