

Ask Irene

Advice for the Entrepreneur



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Q. *How do I use the income statement to help me run my business?*

A. The income or profit and loss statement provides financial information for a defined period of time. It can be done monthly, quarterly, semi-annually or annually. This statement calculates your profit or loss based on total sales and expenses during the time period chosen.

The income statement consists of the following categories:

- **Sales or Revenue** – any sales you generated within the period of the statement. If your business is divided into different divisions, or if you can group your sales into categories, it is advisable to do so. For example: Parts Sales, Services, Accessories, Supplies, etc. By categorizing your sales, you will be able to better understand your sales mix and your profit centers within your company.

- **Cost of Sales or Cost of Goods Sold** – any expense that is directly attributed to the sales of merchandise or services. These expenses are variable, determined by sales volume and are only incurred when sales are made. The cost of the products sold, shipping, sales commissions and packaging materials are part of cost of sales. The more you can align these costs with sales categories, the clearer your picture of what's working and what's not.

- **Gross Profit** – is the difference between your sales and cost of sales. This is the amount available to pay for your operating/fixed expenses.

- **Operating Expenses/Working Capital** – expenses you incur to keep your business open, such as rent, insurance, payroll, telephone, travel, utilities, depreciation of assets, legal and accounting services, equipment leasing, maintenance agreements, etc. Depreciation is an expense that also will show up in your balance sheet as a negative number under your assets. Depreciation reduces the value of your assets over time. For tax purposes the rate of asset depreciation is determined by the Internal Revenue Service.

- **Profit/Loss** – the difference between the Gross Profit and the Operating Expenses.

The relationship between the income statement and the balance sheet is that the bottom line in the income statement is posted in the owners' equity section of the balance sheet as either an addition (profit) or subtraction (loss) to retained earnings.

By understanding your financial statements and monitoring them frequently, you can watch for signs of trouble for your business, before it gets out of hand. By calculating each of your expenses as percentages of sales you will be able to see any major expenses that are out of line.

Next month, we will discuss several financial ratios as a tool to determine the financial health of your company. 🗨️