

9.16: Profit-and-Loss Statements

Learning Objectives

- Analyze a profit-and-loss statement

The income statement is an accounting tool that reports a company's financial performance over a specific period, providing a summary of the business's revenues and expenses from operations and non-operational activity. Below, you'll find a sample income statement for XYZ Retailers. We will use this statement to analyze and understand the importance of financial statements for retailers.

XYZ Retailer		
Income Statement		
Year Ended 30 June 2011		
REVENUE		
Sales		\$250,000
Cost of Goods Sold		
Opening inventories (as of 1 July 2010)	40,000	
Add purchases	100,000	
Add freight-in and customs duty	10,000	
Less closing inventory (as at 30 June 2011)	60,000	
Less Cost of Goods Sold		90,000
Gross Profit		160,000
Add other operating revenue		
Rent received	3,000	
Commission received	2,000	
Total Revenue		\$165,000
LESS OTHER OPERATING EXPENSES		
Selling & Distribution expense		
Advertising	5,000	
Public Relations	2,000	
Website marketing	7,500	
General and Administrative expenses		
Depreciation	10,000	
Electricity	1,500	
Insurance	1,000	

Rent expense	30,000
Wages & salaries	46,500
Financial expenses	
Bad debts	1,500
Total expenses	105,000
NET PROFIT (EBIT)	\$60,000

As you can see, XYZ has net sales revenue of \$250,000, given that there are no discounts or allowances to apply to reduce their sales. But, it may be more difficult to understand how to determine COGS (cost of goods sold). In truth, we have to understand how the XYZ operates and what the accounting entries mean.

In this case, XYZ had \$40,000 in inventory on-hand, when the accounting period opened on 7/1/17. That simply means they had product in their inventory, such as boxes and cans sitting on their shelves and in their backroom. During the period, they made \$100,000 in additional purchases to bring in more inventory. To this they add freight and customs expenses of \$10,000. So, for the period, their total accumulated inventory would have been \$150,000 (\$40,000 + \$100,000 + \$10,000).

But, at the end of the period, they have only \$60,000 of inventory on-hand. What happened to the rest? Easy. It was sold. So, we now know the COGS is \$90,000 (\$150,000 accumulated inventory – \$60,000 ending inventory). Thus, we can see that sales net of COGS is \$160,000 (\$250,000 in revenue – \$90,000 in COGS). Further, we see that XYZ has some non-traditional revenue streams: rent (\$3,000) and commissions (\$2,000). We add these to get a total net revenue of \$165,000.

However, as we learned earlier, businesses incur other operating expenses. For XYZ, these are related to selling and distribution, general and administrative, and financial. In total, they sum to \$105,000 (\$14,500 in selling and distribution + \$89,000 in general and administrative + \$1,500 in financial) and are deducted from the total net revenue to show \$60,000 in net profit (EBIT or earnings before interest and taxes).

While the numbers are straight forward, it's the meaning behind them that's most important and telling for a decision-maker, looking to improve the financial performance of the organization. That is, they reflect what is happening in the business' operations for better or for worse. For example, the closing inventory is \$20,000 greater than the opening inventory. Does this reflect a slow down in sales or a ramp-up in inventory on-hand to accommodate seasonality? If we compared these results against past periods, what we would learn about changes selling and distribution expenses? Wages? Are these costs increasing or decreasing? And, at what rate are they increasing/decreasing relative to revenue and profit?

As you can see, the income statement provides important information about the financial performance of the firm, helping decision-makers understand where to focus to improve going forward. The following video, which uses Walmart as an example, may be a helpful tutorial to broaden your understanding of income statements.

Practice Questions

<https://assessments.lumenlearning.co...sessments/9233>

Video -- How to analyze an income statement - Walmart example (case study)



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