Parts of an Income Statement, part 1

The first and most important part of an income statement is the line reporting sales revenue. Businesses need to be consistent from year to year regarding when they record sales. For some business, the timing of recording sales revenue is a major problem, especially when the final acceptance by the customer depends on performance tests or other conditions that have to be satisfied. For example, when does an ad agency report the sales revenue for a campaign it's prepared for its client? When the work is completed and sent to the client for approval? When the client approves it? When the ads appear in the media? Or when the billing is complete? These are issues a company must decide on for reporting sales revenue, and they must be consistent each year, and the timing of reporting should be noted on the financial statement.

The next line in an income statement is the cost of goods sold expense. There are three methods of reporting cost of goods sold expense. One is called "first in-first out" (FIFO); another is the "last in-last out" (LIFO) method and the last is the average cost method. Cost of goods sold expense is a huge item in an income statement and how it's reported can make a substantial impact on the reported bottom line.

Other items in an income statement include inventory write-downs. A business should regularly inspect its inventory carefully to determine any losses due to theft, damage and deterioration, and to apply the lower of cost or market (LCM) method. Bad debts are also an important component of the income statement. Bad debts are those owed to a business by customers who bought on credit (accounts receivable) but are not going to be paid. Again the timing of when bad debts are reported is crucial. Do you report it before or after any collection efforts are exhausted?