

The Company Income Statement

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SUBJECT(S): Accounting, Management, Personal Finance

GRADE LEVEL(S): 9, 10, 11, 12

≡ OVERVIEW:

This lesson delves into financial documents. In particular, the lesson focuses on the income statement. Students will learn the definition of an income statement (and its component parts). Students will learn to read and decode an actual income statement from a 10-K filing. Finally, students will use income statements to reason about the well being of individual companies.

≡ NBEA STANDARD(S):

- Personal Finance, I. Personal Decision Making
- Accounting, II. Financial Reports
- Accounting, III. Financial Analysis
- Management, IX. Industry Analysis
- Accounting, VI. Interpretation and Use of Data

≡ RELATED ARTICLES:

- [“Why Spotify’s Unusual Business Move Is Capturing Headlines”](#)
- [“Research Strategies for New Investors”](#)
- [“Portfolio Managers: The Challenge Is Picking More than One Winning Stock”](#)
- [“Portfolio Management: Making Decisions about Your Investments”](#)
- [“Behind the Puppy Dog Lenses, Snapchat Is a Living, Breathing Business”](#)

- “10 Terms New Investors Should Know”

Common Core Standard(s): Comprehension and Collaboration, Vocabulary Acquisition and Use, A-CED

Objectives/Purposes: The purpose of this lesson is for students to understand an income statement and why it is useful for investment analysis. Following this lesson, students should be able to 1) define, 2) read, and 3) analyze the income statement of a publicly traded company.

Tying It All Together:

The lesson is divided into five parts: (1) Introduction, (2) Definitions, (3) Guided Reading, (4) Practice, and finally (5) Closing

Introduction (5 mins)

Remind students that investors must think about many things when choosing where to invest their money. Investors cannot think about just one investment, but rather their larger portfolio. Moreover, within this portfolio, investors must think about issues of diversity and risk management. Finally, when adding to a portfolio, investors must be able to analyze specific companies. This means thinking about the company in context (i.e. SWOT analysis), but also looking closely at the company itself. Financial documents provide data on the inner-workings of publicly traded companies.

If your class worked through the previous lesson, have students revisit the final lesson activity. Have each of the groups discuss their respective financial statements (income statement, balance sheet, cash flow statement). If your class did not work through the previous lesson, remind students that all publicly traded companies must submit SEC filings providing financial documents. These filings (known as 10-K and 10-Q) contain three very important types of financial statements (income statement, balance sheet, cash flow statement) and each serves a different purpose.

Decisions (10-20 mins)

Today we will be looking specifically at the income statement. Using the 10-K filings from Apple Incorporated (available [online](#)), have students in the class look at the income statement. In this filing, the income statement is under the heading “Statement of Operations,” on page 43.

NOTE: The 10-K and 10-Q filings are very long documents that contain large amounts of information. For this and all other lessons, students only need to focus on the three financial documents (income statement, statement of cash flow and balance sheet). In the Apple filing, these span ONLY pages 43-46. If you plan to print these documents out for class, print only pages 43-46.

Give students 3-5 minutes to look over the Statement of Operations. Provide students with some guiding questions: “What kinds of things are listed on the income statement? Why might these be important for an investor?”

After students read through the income statement, start providing them with definitions for each of the items on the sheet. **Net sales** refers to all of the money made from selling products and services. Ask students what this means for a company like Apple. What is being sold? To whom? **Cost of sales** refers to the cost of the goods being sold — this includes raw materials, labor and overhead. **Gross Margin** equals Net Sales minus Cost of Sales.

Operating expenses refer to all other costs of operating, not associated with cost of sales. This includes Research and Development costs, as well as selling, general and administrative expenses. **Research and Development** costs are the costs of researching and building new products. **Selling, General, and Administrative Expenses (SG&E)** refers to the cost of operating the company day-to-day, costs beyond the cost of goods produced. In the Apple filings, this is referred to as “Operating Costs.”

Income refers to revenue minus cost. Income is the difference between money taken in (by selling goods and services) and money spent (on producing those goods and running the company). Have students calculate the **Gross Income** of Apple Inc. by subtracting cost of sales and SG&E from the net sales. This gross income is different than net income. **Net Income** is equal to gross income minus taxes and dividends.

Earnings per share is a measure of total profit divided by (average) total number of shares held. In other words, how much of the total profit is associated with each share of stock.

Later in this unit, students will be looking at specific financial ratios based on the income statement, balance sheet and statement of cash flows. While that lesson will focus on specific calculations, teachers may want to have students start thinking about these ideas earlier rather than later. After covering major items on the income statement, teachers should encourage students to think about numbers *in relationship to one another*, rather than as raw numbers. For example, instead of looking just at Net Sales, we can look at a ratio of net income to net sales. Similarly, one could compare gross margin to net sales. While gross margin may be increasing,

perhaps it is decreasing as a percentage of net sales. These comparisons are important tools for understanding the information on financial documents.

Guided Reading (5-10 mins)

After working through the income statement for Apple Inc., have students read through the article “[Pandora: The Building Blocks of an Innovative Internet Radio Station.](#)” As students read, provide them with an overarching, guiding question: Would you buy shares of Pandora? Why or why not? Presumably by now, students will be savvy enough to ask for more information before answering. In the next section, students will find that information on their own by looking through Pandora’s SEC filings.

Practice (10-15 mins)

After students have read about Pandora’s IPO, have students break into small groups. During this activity, students will take on the role of financial analysts. Provide each group with a copy of pages 3-5 of Pandora’s Q2 10-Q filing (available [here](#)) and a copy of pages 3-5 of Pandora’s Q3 10-Q filing (available [here](#)). Using these two documents, each group must decide whether they would like to invest in Pandora.

Groups will have 10-15 minutes to look at both sets of income statements. Encourage students to compare and contrast the two documents. Are things getting better or worse for Pandora? How do they know? Which items are they looking at?

After looking through the two 10-Q forms, each group will have to prepare a 2-3 minute “pitch.” During this pitch, the group must convince me (their customer) whether I should invest in Pandora. Regardless of the group’s decision (invest or not invest), the group must provide **evidence** based on the income statement to support their claims.

Closing (5 mins)

Close the lesson by discussing the main purpose of an income statement. The income statement lets investors see how profitable a company is by looking at its sales, expenses and income. Moreover, by looking at specific pieces of the sales and expenses, investors can understand where the company is successful and where there is room for improvement.

Practice Outside of the Classroom:

In the last lesson, students were encouraged to go find 10-K forms from companies of their choosing as a homework assignment. For this lesson, students should compare the income statement of their chosen company to the income statement from Pandora's 10-Q filing. Compare and contrast the two companies. Which one is a better investment? Why?

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