

A Level Accounting

Income Statements

Please turn on the slide
show



By the end of these tasks...

- You will be able to define and explain the purpose of an income statement
- You will know the layout of an income statement and what to include within the statement.
- You will be able to make calculations to include in an income statement
- **Challenge**
- You will be able to calculate profitability ratios to analyse business performance

OPTIC



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Introduction to Income Statements

- The main activity of a trading business is to buy goods at one price and sell the same goods at a higher price. The difference between the two prices represents a profit known as **gross profit**. The gross profit for each item is totalled to show one figure.
- At the end of the financial year, the business needs to produce an income statement, showing the trading of the business and showing the gross profit for the year.



- As a student, you need to know the layout of the income statement
- The layout of the income statement is as follows:



Income Statement for Wyvern Wholesalers For the Year Ended 31 December 20-1

	£	£	£
Sales (Revenue)			250,000
Less Sales Returns			<u>5,400</u>
Net Revenue (A)			244,600
Opening Inventory (1 January 20-1)		12,350	
Purchases	156,000		
Carriage In	-		
Less Purchase Returns	<u>7,200</u>		
Net Purchases (B)		<u>148,800</u>	
		161,150	
Less Closing Inventory (31 December 20-1)		<u>16,300</u>	
Cost of Sales (C)			<u>144,850</u>
Gross Profit (D)			99,750



Key Terms

- **Revenue** – money coming into the business from sales
- **Purchases** – only include items that the business trades with; sells on.
- **Inventory** – these are the goods that the business has in stock
- **Cost of Sales** – cost to the business of the goods which have been sold in the financial year
- **Carriage in** – the expense to the business of having purchases delivered



- With viewing slide 5, certain calculations need to be carried out.
- To calculate A B C D see the next slide



Formulae

Cost of Sales (C) Opening inventory + Purchases + Carriage in - Purchase Returns - Closing inventory = Cost of Sales	Gross Profit (D) Revenue - Sales Returns = Net Revenue - Cost of Sales = Gross Profit or Loss
Net Revenue or Turnover (A) Revenue (Sales) - Sales Returns = Net Revenue	Net Purchases (B) Purchases + Carriage In - Purchase Returns = Net Purchases

Profit for the Year

- Obviously, businesses have many other costs other than buying goods to sell on. They need premises, electricity, salaries and insurance, etc.
- We now need to include these expenses on the income statement by subtracting them from the gross profit



Income Statement for Wyvern Wholesalers For the Year Ended 31 December 20-1

	£	£	£
Gross Profit			99,750
Add discount Received			<u>2,500</u>
			102,250
Less Expenses			
Discount allowed		3,700	
Salaries		46,000	
Electricity and Gas		3,000	
Business Rent and Rates		2,000	
Sundry Items		<u>4,700</u>	
			<u>59,400</u>
Profit for the Year			<u>42,850</u>



Example

The following 3 slides show you how to create an income statement



The following information has been extracted from the business accounts on Matthew Lloyd from his first year of trading which ended on 31st December 2018. (** there is no opening inventory! **)

	£	£
Purchases	94 350	
Revenue (Sales)		125 890
Inventory at 31 st December 2018 (Closing Inventory)	5 950	5 950
Office Rent	4 850	
Heating and Lighting	2 120	
Wages and Salaries	10 350	
Office Equipment	8 500	

You are to prepare the Income Statement of Matthew Lloyd for the year ended 31st December 2018.



Steps to complete the Income Statement

1. Include the title showing the business name, statement name and date the financial statement ends (as slide 5)
2. Layout the income statement as shown on slides 5 and 10
3. Insert the figures (from slide 12)
4. Calculate cost of sales (from slide 8)
5. Calculate gross profit (from slide 8)
6. Add up total expenses (from slide 10)
7. Calculate profit for the year (from slide 10)



Answer - Checkpoint

MATTHEW LLOYD
INCOME STATEMENT FOR YEAR ENDED 31 DECEMBER 2018

	£	£
Revenue		125,890
Opening Inventory	-	
Purchases	94,350	
Less Closing Inventory	<u>5,950</u>	
Cost of Sales		<u>88,400</u>
Gross Profit		37,490
Less Expenses:		
Office Rent	4,850	
Heating and Lighting	2,120	
Wages and Salaries	<u>10,350</u>	
		<u>17,320</u>
Profit for the Year		<u>20,170</u>



Now go to the SIL document and complete tasks
2 3 and 4



Profitability Ratios

- A business uses the income statement to analyse its progress by comparing its performance from one year to the last. It can then see whether it is improving, by making more profit, or deteriorating by making less profit. This analysis helps the business to make decisions.



• It does this by calculating some ratios

Profitability Ratios

Gross Profit Margin

$$\frac{\text{Gross Profit}}{\text{Revenue}} \times 100$$

The higher the percentage the better

Gross Profit Mark Up

$$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100$$

A margin of 25% means for every £100 of purchases made, the business makes £25 gross profit

Expenses in relation to Revenue

$$\frac{\text{Expenses}}{\text{Revenue}} \times 100$$

Profit in relation to Revenue

$$\frac{\text{Profit for the Year}}{\text{Revenue}} \times 100$$

The higher the better

Using our Example – Matthew Lloyd

Gross Profit Margin

$$\frac{\text{Gross Profit}}{\text{Revenue}} \times 100 = \frac{37,490}{125,890} \times 100 = 29.78\%$$

This shows that for every £1 of revenue coming into the business, it make over 29p in gross profit. The higher the figure the better.



Gross Profit Mark Up

$$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100 = \frac{37,490}{88,400} \times 100 = 42\%$$

A margin of 42% means for every £100 of purchases made, the business makes £42 gross profit



Expenses in relation to Revenue

$$\frac{\text{Expenses}}{\text{Revenue}} \times 100 = \frac{17,320}{125,890} \times 100 = 14\%$$

For every £1 of revenue, the business spends 14p on expenses



Profit in relation to Revenue

Profit for the Year x 100
Revenue

$$\frac{20,170}{125,890} \times 100 = 16\%$$

Shows the percentage of profit made after all expenses have been considered



- Now complete the last task on the SIL sheet
- Bring your work for tasks on sources of finance and income statements, tasks 2, 3, 4 and 6 to college on your first day

Good luck and see you soon



The Accounting Team at New College
Learning Trust

