Chapter 23 Income Statement

Key terms

1. Accounts: the financial records of a firm's transactions.
2. Accountants: the professionally qualified people who have responsibility for keeping accurate accounts and for producing the final accounts.
3. Final accounts: produced at the end of the financial year and give details of the profit or loss made over the year and the worth of the business.
4. Income statement: a document that records the income of a business and all costs incurred to earn that income over a period of time. It is also known as a profit and loss account.
5. Gross profit: when sales revenue is greater than the cost of goods sold.
6. Sales revenue: the income to business during a period of time from the sales of goods or services.
7. Cost of goods sold: the cost of producing or buying in the goods actually sold by the business during a time period.
8. Trading account: shows how the gross profit of business is calculated.
9. Net profit: the profit made by a business after all costs have been deducted from sales revenue. It is calculated by subtracting overhead costs from gross profits.
10. Depreciation: the fall in the value of a fixed asset over time.
11. Retained profit: the net profit reinvested back into a company, after deducting tax and payments to owners such as dividends.

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1. What profit is and why it is important:

How a profit is made:

Profit = sales revenue - cost of making products

Why is profit important:

- Reward for owners or shareholders
- Reward for risk taking
- Source of fund for reinvestment
- Indicator of success

Difference between profit and cash:

Profit ≠ Cash

- Profit = sales revenue - cost of making products
- Sales revenue includes selling on cash and credit and cost includes cost of production already paid by cash or bought on credit.
- Higher profits do not mean higher cash gained if the business sells on credit.

2. Income statement:

Income statement: record income and expense over the period and it shows performance of the business.

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Main features of an income statement

Sales revenue	$55,000
Opening inventories	$10,000
Purchases	$25,000
Total inventory available (Opening inventories + Purchases)	$35,000
Less closing inventories	$12,000
Cost of goods sold (Total inventory available - Closing inventories)	$23,000
Gross profit (Sales revenue - Cost of goods sold)	$32,000
Other income	$5,000 $37,000
Less expense:	
Wages and salaries	$12,000
Electricity	$6,000
Rent	$3,000
Depreciation	$5,000
Selling and advertising expense	$5,000 $31,000
Net profit (Gross profit + Other income - Expense/overhead)	$6,000
Corporate tax	$500
Profit after tax (Net profit - Corporate tax)	$5,500
Dividend	$2,000
Retained profit for the year (Net profit after tax - Dividend)	$3,500

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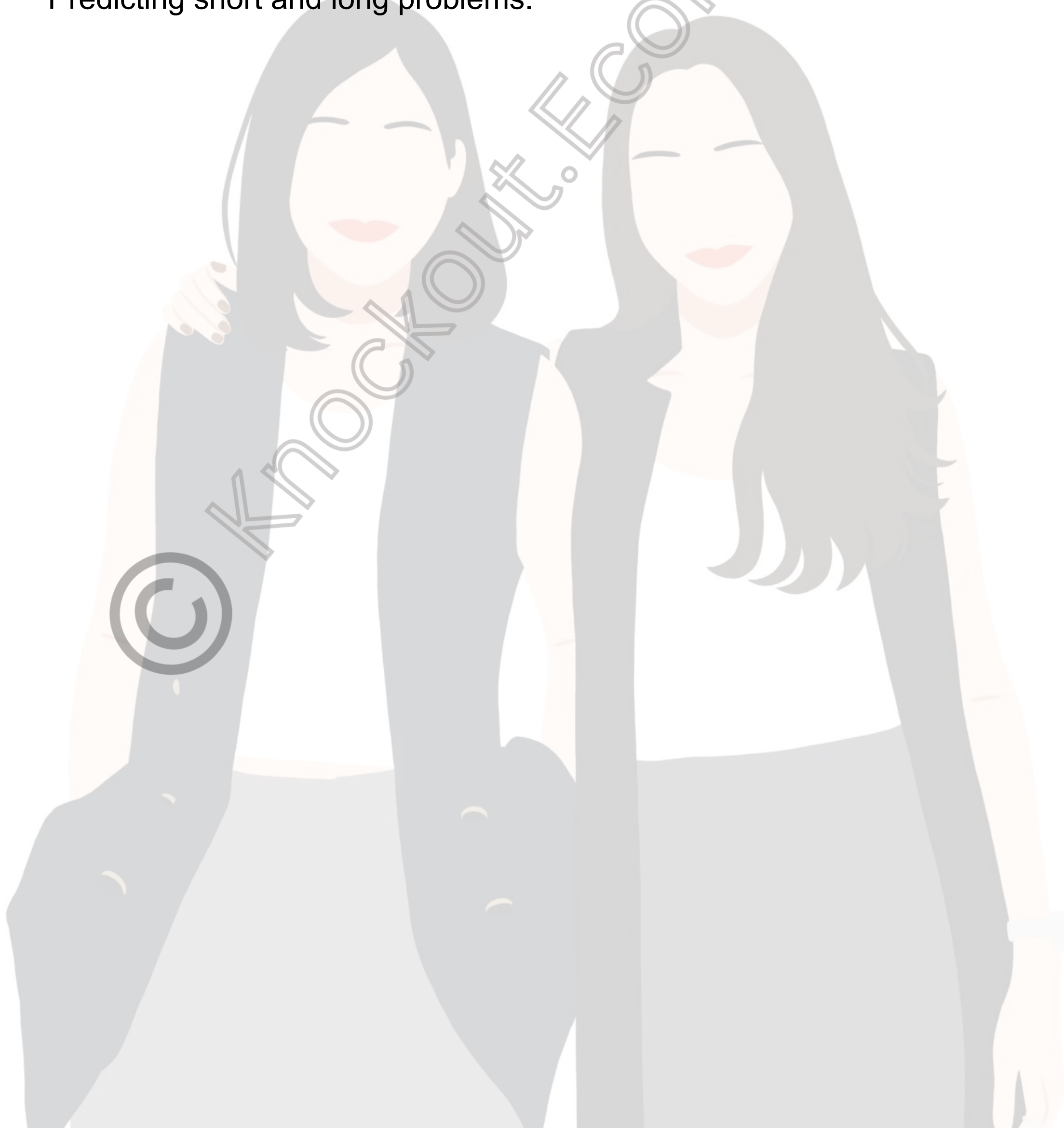
Summary

- **Total inventory available =** Opening inventories + Purchases
- **Cost of goods sold =** Total inventory available - Closing inventories
- **Gross profit =** Sales revenue - Cost of goods sold
- **Net profit =** Gross profit + Other income - Expense/overhead
- **Profit after tax =** Net profit - Corporate tax
- **Retained profit for the year =** Net profit after tax - Dividend

3. **How to use income statement**:

- Comparing performance with last year/industry average/competitors
- Predicting short and long problems.



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