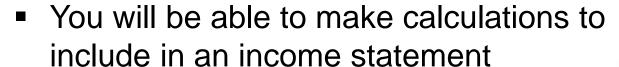
## A Level Accounting

# **Guide to preparing Income Statements**



## 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.







#### Challenge

You will be able to calculate profitability ratios to analyse business performance





### 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.
- The main income the business makes is from sales of goods or services. This is called revenue, sales revenue, sales or turnover.

## What do I need to know?

 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)		148,800	
		161,150	
Less Closing Inventory (31 December 20-1		<u>16,300</u>	



# **Key Terms**

- Revenue money coming into the business from selling goods or services.
- Purchases This is the amount spent to buy goods or inventory that the business will sell on or trades with.
- Inventory these are the goods that the business has in stock or available to sell.
- Cost of Sales cost to the business of the goods or inventory which have been sold in the financial year.
- Carriage in the expense or cost to the business of having purchases or inventory delivered.

• **Slide 5** showed an example of an Income Statement.

 Certain calculations will need to be carried out. These are labelled A B C and D.

To calculate A B C D see the next slide.

## How to find the figures for A B C and D

Cost of Sales (C)	Gross Profit (D)
Opening inventory + Purchases + Carriage in - Purchase Returns - Closing inventory = Cost of Sales	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

## How to calculate Profit for the Year

 Businesses have many other costs or expenses they will have to pay. They need to pay rent, electricity, salaries and insurance, etc.

 We now need to include these costs or expenses on the income statement by subtracting them from the gross profit or total income (gross profit + other income)

See next slide for how to calculate total expenses and profit for the year

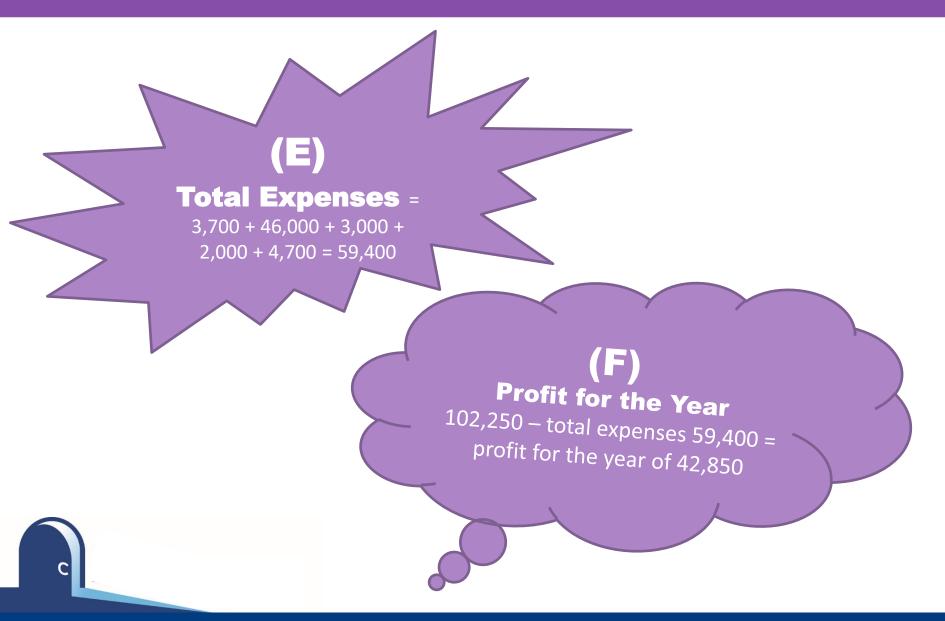
# Income Statement for Wyvern Wholesalers For the Year Ended 31 December 20-1

	£	£	£
Gross Profit			99,750
Add discount Received (other income)			<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>	
(E)			<u>59,400</u>



Profit for the Year (F) 42,850

## Calculations



# Layout of Income Statement

#### Name of owner or business

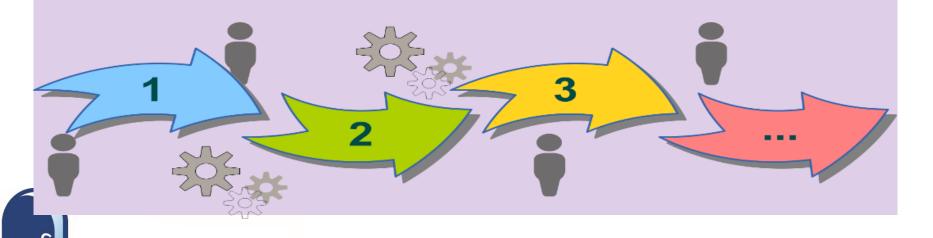
INCOME STATEMENT FOR YEAR ENDED (date)

	£	£
Revenue		
Opening Inventory		
Purchases		
Less Closing Inventory		
Less: Cost of Sales		
Gross Profit		
Less Expenses:		
Office Rent		
Heating and Lighting		
Wages and Salaries		
Profit for the Year		



## Example

- The following 3 slides will show you how to create an income statement. The question is on slide 14.
- Follow the steps given on slide 15



The following information has been extracted from the business accounts of **Matthew Lloyd** from his first year of trading which ended on 31st December 2022. (\*\* there is no opening inventory! \*\*)

#### Question

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



Use information above to prepare the **Income Statement** of Matthew Lloyd for the year ended 31<sup>st</sup> December 2022.

#### Steps to follow to complete the Income Statement

- 1. Include the title showing the business name, statement name and date the financial year ends (see slide 5 for example)
- 2. Layout the income statement as shown on slides 5 and 10
- 3. Insert the figures next to the description of the figures (See question on slide 14)
- 4. Calculate cost of sales (See slide 8 for how to do it)
- 5. Calculate gross profit (See slide 8 for how to do it)
- 6. Add up total expenses (See slide 11 for how to do it)
- Calculate profit for the year (See slide 8 for how to do it)

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## Give it a go!

#### **Instructions:**

- Get a blank sheet of lined paper and draw up the layout of an income statement using the example on slide 12 to guide you.
- 2. Using steps 1 to 7 on the previous slide (slide 15), prepare the income statement of Matthew Lloyd using question on slide 14.
- 3. Check your answer on slide 17 after you have attempted the question and note any errors you might have made.
- 4. Now go to the SIL document and complete tasks 2, 3 and 4.

## 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>
<b>Gross Profit</b>		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		20,170

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## What next?

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

C

## **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	Gross Profit Mark Up
Gross Profit x 100 Revenue	Gross Profit x 100 Cost of Sales
The higher the percentage the better	A margin of 25% means for every £100 of purchases made, the business makes £25 gross profit
Expenses in relation to Revenue	Profit in relation to Revenue
Expenses in relation to Revenue  Expenses x 100  Revenue	Profit in relation to Revenue  Profit for the Year x 100  Revenue

## Using our Example – Matthew Lloyd

#### **Gross Profit Margin**

Gross Profit x 100 = 37,490 x 100 = 29.78%Revenue 125,890

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**

Gross Profit x  $100 = 37,490 \times 100 = 42\%$ 

Cost of Sales 88,400

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

С

#### **Expenses in relation to Revenue**

Expenses x 100 17,320 x 100 = 14%

Revenue 125,890

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

С

#### **Profit in relation to Revenue**

Profit for the Year x 100

Revenue

 $20,170 \times 100 = 16\%$ 

125,890

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

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## Final Task

- 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 Bradford!