

# 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.
- 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



C

# 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:

See Slide 8 for  
formulae to  
calculate A B C D

## 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         |

C

# 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)

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



# 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> |                      |
| <b>(E)</b>                           |   |              | <u>59,400</u>        |
| <b>Profit for the Year (F)</b>       |   |              | <u><b>42,850</b></u> |



# Calculations

**(E)**

**Total Expenses =**  
 $3,700 + 46,000 + 3,000 +$   
 $2,000 + 4,700 = 59,400$

**(F)**

**Profit for the Year**  
 $102,250 - \text{total expenses } 59,400 =$   
profit for the year of 42,850

C

# 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        |   |   |
| <b>Gross Profit</b>        |   |   |
| Less Expenses:             |   |   |
| Office Rent                |   |   |
| Heating and Lighting       |   |   |
| Wages and Salaries         |   |   |
|                            |   |   |
| <b>Profit for the Year</b> |   |   |

C

# 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 31 <sup>st</sup> December 2018<br>(Closing Inventory) | 5 950   |
| 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)
7. Calculate profit for the year (See slide 8 for how to do it)

# Give it a go!

## Instructions:

1. 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>        |               | <b>37,490</b>        |
| Less Expenses:             |               |                      |
| Office Rent                | 4,850         |                      |
| Heating and Lighting       | 2,120         |                      |
| Wages and Salaries         | <u>10,350</u> |                      |
|                            |               | <u>17,320</u>        |
| <b>Profit for the Year</b> |               | <b><u>20,170</u></b> |



C

# What next?

- 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



# 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!