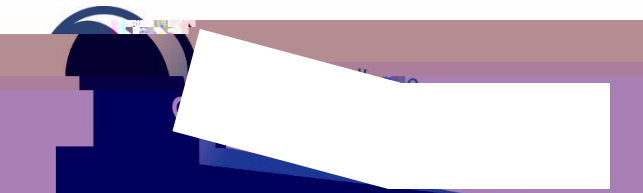


# A Level Accounting

## 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



Knowledge

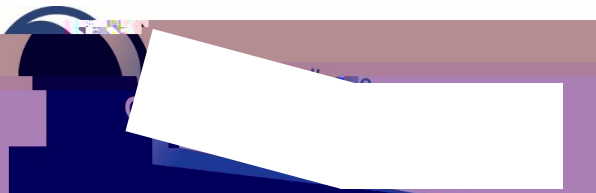
Application

Analysis

Evaluation

# 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.





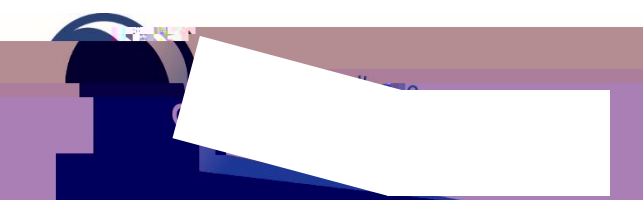


# Key Terms

- ‡ 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

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



# 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



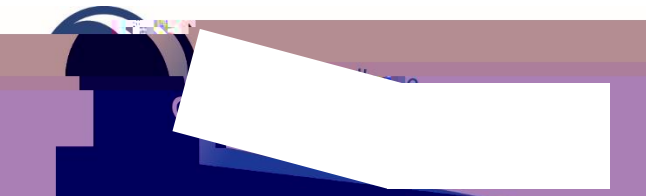
# Example

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 <sup>st</sup> 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 31<sup>st</sup> December 2018.



Knowledge

Application

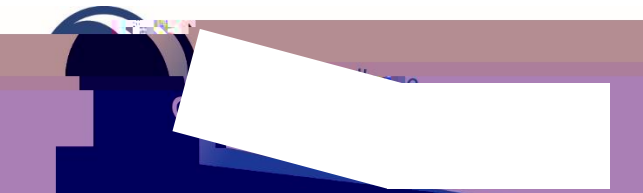
Analysis

Evaluation

# Answer - Checkpoint

|                        | £            | £             |
|------------------------|--------------|---------------|
| 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     |              |               |
|                        |              |               |
|                        |              |               |

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



Knowledge

Application

Analysis

Evaluation

# 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

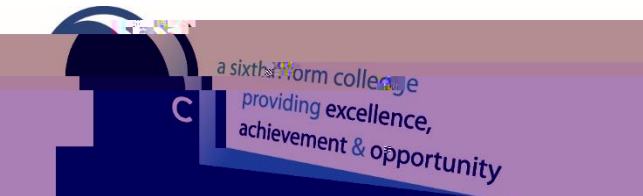
$$\frac{\text{Gross Profit}}{\text{Revenue}} \times 100 = \frac{37,490}{125,890} \times 100 = 29.78\%$$

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

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

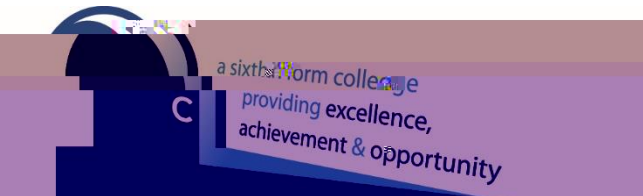
A margin of 42% means for every £100 of purchases made, the business makes £42 gross



Knowledge

Application

Analysis



Knowledge

Application

- ‡ 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