2. The Income Statement

2.1 Presentation Format Issues

2.2 Recognition of Revenue and Expenses

2.3 Cost of Goods Sold

2.4 Irregular Items (e.g. Discontinued Operations, Extraordinary Items, etc.)

2.5 Profitability Analysis

2.6 Summary

2.1 Presentation Format Issues

B1
7.89
-0.51
1.40
-0.30
93.00
9.35
88.00
0.38
Ba3
B-
0.21
Ba3
5.04
-0.01
BBB- 113.06
3.86
-0.02
Baa3
BBB- 125.50
3.79
-0.12
Baa3
BBB- 117.63
4.31
0.01

- **Multiple components of formatting accounting Income Statements, and other financial statements**

- All of which affect the Income Statement, based on performance

- Affecting the Business itself, as an entity

- **Organization and Alignment = Key Factor**

- **Accounting = Oversight**


FINANCIAL STATUS REPORT
FAIR TRADE
FIND THE MONEY
FLAT VALUE
FUTURE VALUE
FACTORY WHOLESALE PRICE
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES
GENERALLY ACCEPTED AUDITING STANDARDS
GENERALLY ACCEPTED PRINCIPLES PRACTICES

- To re-iterate:
  - Financial Accounting = Business Operations, not Individual Owners

- **Income Statement**

Income Statement

- **The financial report that shows the results of business operations over a period of time.**

- **This period of time can vary: Owner’s discretion, or Fiscal Period**

- **A month, a quarter or a year.**

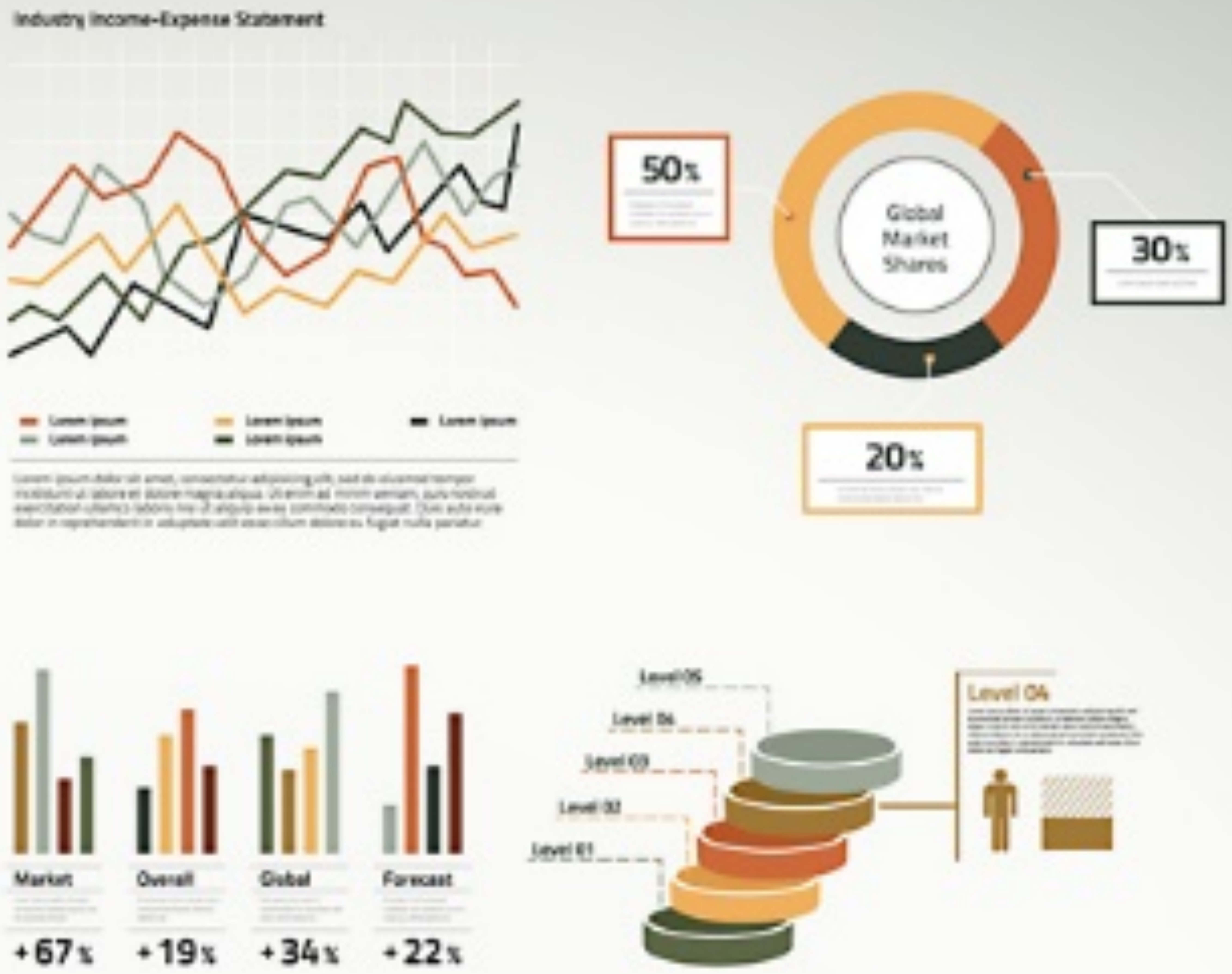
- **Statement that measures the outcomes**

- **Gauges Growth**

- **Growth occurs over time**

Growth

Information vector graphics



- Time period documentation:
  - Can conflict with a Balance Sheet

- **Balance Sheet: account balances for one exact date, by majority.**

- Hence, a formatting “issue”


ACCOUNTING
Taxes
Personal
Financial
statements
Small Business
Bookkeeping
Payroll

- **Book keeping = Paramount**


PAYROLL

- **Net Income:**

- **Core of the Income Statement**


3m
6m
1y
3y
YTD
All
To
Feb 19,
CLOSE
EMA15
RSI
26
25
UNITED STATES OF AMERICA

- **Accounts that explain why Assets went Up**

- **Stems from business operations**

- **Assets “Up”:**

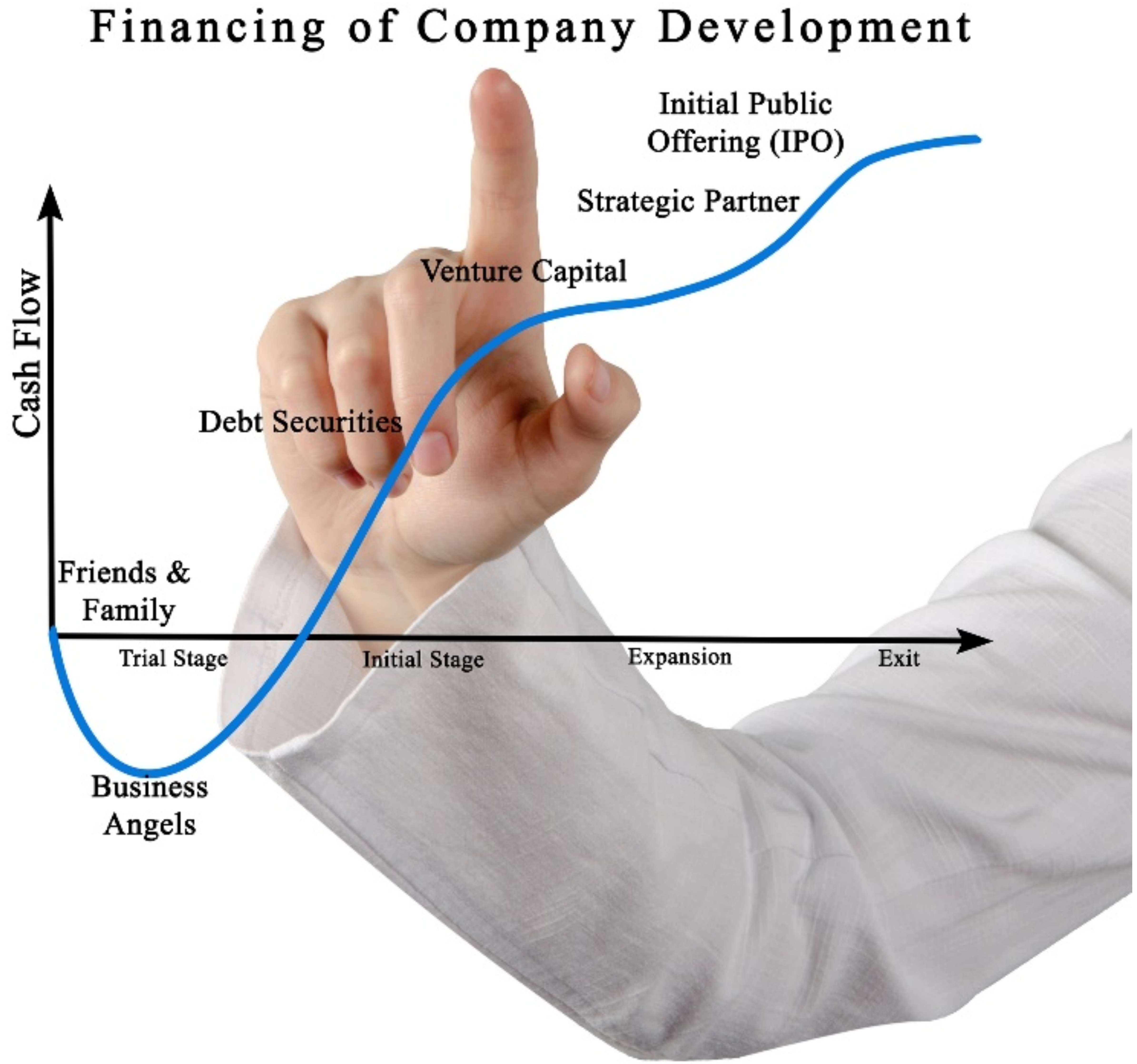
- **Profit Sales**


INVOICE

- **Liquidity**

- **And even possibly:**

- **Investments**


Financing of Company Development
Cash Flow
Initial Public Offering (IPO)
Strategic Partner
Venture Capital
Debt Securities
Friends & Family
Business Angels
Trial Stage
Initial Stage
Expansion
Exit

- **Another account goes up as well:**

- **Owner’s Equity**
  - **Must be accounted for**
  - **Most important: Owner/Investors**

- **Both accounts = Value**


Net Profit

- **Alleviating formatting issues**

- **Accountants simply use a historical, yet traditional diagram, or chart, of sorts:**


CHART
OF
ACCOUNTS

- **T-Account**

- **This is a tool to keep track of the ups and downs in accounts, often called a:**


Accounts
Payable Ledger

- **General ledger**

- **Debtor’s ledger**

- **Wage Expense ledger**

- **Payroll ledger**

- The Ups go on one side of the T
- The Downs on the other side of the T

- Here’s an example:

2.2 Recognition of Revenue and Expenses


Net
Earnings
margin
finance
profit
tax
amount
result
sold
strategy
economy
plan
cashflow
money
vision
cash
flow
investment
income
period
assets
report
return
equity
cost
dividend
success
calculation
line
retained
budget
future
residual
accounting
statement
expenses
corporate
gross
increase
liabilities
annual
revenue
business

- **The income statement is essentially, as Summary.**

- **It summarizes all the revenue, and expense accounts, into a single number.**

- **This number is vital, as previously mentioned:**

- **“Net Income” = Revenue**

- **Income and Expense accounts are actually just part of Owner's Equity**

- Each help explain increases in Equity, based on earnings

- Income Statement:
  - Take the number that appears in the Statement of Owner’s Equity

- Income Statement:
  - gets combined into the Final number for Income and Expenses

- Income Statement:
  - called “owner’s equity—end of period”

- “Owner’s equity—End of period”
  - Appears in the Balance Sheet simultaneously

- **Liability section**

- **Expenses are accounts that explain why assets went down from operations.**


EXPENSE REPORT
PRODUCTION
Direct materials
Rent of production facilities
Depreciation
Repair and Maintenance
Utility costs
Property taxes
COMPENSATION
Payroll
Benefits
Pension plan
Health & safety
Sales commissions
599,878.65
45,000.00
67,090.21
47,879.02
62,344.36
12,887.90
127,544.29
33,243.00
32,549.28
15,749.25
SALES
161,891.69
147,449.77
166,428.29
168,747.22
142,769.47
148,861.71
130,377.73
EXPENSE REPORT
COMPENSATION
Payroll
1,220.35
10,987.22
2,768.78

- **Expense accounts explain the decreases in equity as a result of using up assets.**

- **The final part of the liability section includes accounts called Deferred Revenues**

- **Deferred Revenues are liabilities that result from receiving cash prior to earning the income.**

- **Annuities**

- **Charges**


TAXES
#
3
$
4
%
5
^
6
&
7
*
8
(
9
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0
—
-
+
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- **Other income**

2.3 Cost of Goods Sold


2014
2015
2016
budget 2017
2018
2019
2020

- Cost of goods sold (CGS)
  - Accounting concept
  - Businesses calculate on the Income Statement

- For businesses that buy and resell goods
  - Cost of goods sold
  - A single number on the Income Statement

- **Cost of goods sold**
  - **The actual cost to the business =**
    - **“Goods” that it sells**

- Other Businesses
  - Doctors and Lawyers
  - Sell services
    - They do not calculate cost of goods sold

- Manufacturers
  - Cost of goods sold usually includes:
    - Three amounts (3)

- **Materials**

- **Labor**

- **Overhead**

- **Cost of Goods Sold:**
  - **Two (2) important formulas**

1. Gross Profit Formula:

2. Income Statement Formula:

2.4 Irregular Items (e.g. Discontinued Operations, Extraordinary Items, etc.)


MANAGE
YOUR
RISK

- **Discontinued operations:**

- Both the income and expenses from discontinued operations =
    - Netted into a single number

- **Then reduced by income tax expense, or income tax savings.**

- **Extraordinary gains and losses:**

- **Losses lower income taxes at a certain point**

- **In this section, gains and losses:**
  - **On business equipment, or;**
  - **Per results of lawsuits:**
    - **NOT included**

2.5 Profitability Analysis


CRISIS
SELL
SELL
SELL
BUSINESS STRATEGY
IDEA
MARKETING
SK
PLAN
ANALYZE
QUALITY
Profits
€+$=?
OIL

- **Profitability analysis**

- **Allows businesses to forecast the lucrativeness of an existing project**

- **Profitability analysis also:**
  - **Permits an anticipation of sales potential specific to such elements, like:**

- **Customer age**

- **Geography**

- **Product types**

- **3 Types of Profitability Analysis**

- **Horizontal Analysis**

- **Ratio Analysis**

0.6
-4.50
72
+0.70
3.38
0.00
16.7
+2.45
5.05
+1.00
4.6
-0.86
4.6
-0.86
3.26
-2.40
4,294,800
4,248,800
4,232,200
4,218,000
4,140,000
4,140,000
4,029,900
4,009,000
14,405
69,707
21,306
19,106
19,106
13,462
91,360
1,916
13,360
34,665
29,687
29,687
1,352
19,814
1,342
38.00
37.47
231.91
231.91
15.61
25.02

- **Vertical Analysis**

2.6 Summary

- **PROFITABILITY ANALYSIS**

- **Allows businesses to forecast the lucrativeness of an existing project**
- **Permits an anticipation of sales potential specific to such elements**
- **BOTH are applicable to Financial Statements and Business Operations**

Sales potential:

1. **Specific to formula that I will display for the exam in a few minutes, and;**

2. **Three particular Elements**

Customer Age

- Trends per ages (toys, technology, clothing)
- Needs (infants, toddlers, pre-teen, adult, elderly)
- Motivations (based: Education level/Social Status)

Geography:

- Urban
- Suburban
- Rural

Each type of jurisdiction has the potential to drive sales, and allow for forecasting

Product Types

- What business activity is geared towards

Example: Fidget Spinner (Patented)

- Side Note: That means it will also have a specific LIFE SPAN
- Selling for $5-$10 a pop
- 1,500 specialty retail shops in the nation
- By May, each gross $130,000-$150,000 revenue, each!
- $500,000,000 in profits

3 Types of Profitability Analysis

<u>Horizontal analysis</u>:

- Used when a company compares its current results to a previous year
- LESS COMPUTATION

Ratio analysis:

- **Used when a company computes a ratio from various numbers on the financial statements in order to analyze results.**
- **INVOLVES THE MOST MATH AND COMPUTATION**

Vertical analysis:

- Used when a company compares all the numbers of a financial report with a key number from the report
- SECOND MOST COMPUTATION

Gross margin tells you about the profitability of your goods and services. It tells you how much it costs you to produce the product.

It is calculated by dividing your gross profit (GP) by your net sales (NS) and multiplying the quotient by 100:

Exam Question:

Gross profit margin is useful for evaluating….?

Answer: Profitability

Gross Margin = Gross Profit/Net Sales * 100

GM = GP / NS * 100

Example: Imagine that you run a company that sold $50,000,000 in running shoes last year and had a gross profit of $7,000,000. What was your company's gross margin for the year?

GM = $7,000,000 / $50,000,000 * 100
GM = .14 * 100
GM = 14%

For every dollar in shoe sales, you earned 14 cents in profit but spent 86 cents to make it.