

# Income Statement

---

- Reports increase in shareholders' equity due to operations over a period of time
- Income statement equation:
  - Net Income = Revenue – Expenses
  - Net income is also called “earnings” or “net profit”
- All income statement items are based on Accrual Accounting principles

# Accrual Accounting

---

- Accounting recognition of revenues and expenses are tied to business activities, not to cash flows
  - Revenues are recognized when goods or services are provided (revenue recognition criteria)
    - => Revenues  $\neq$  Cash inflows
  - Expenses are recognized in the same period as the revenues they helped to generate (matching principle)
    - => Expenses  $\neq$  Cash outflows
- => Net income  $\neq$  Net cash flow

# Revenue

---

- Revenue is an increase in shareholders' equity (not necessarily cash) from providing goods or services
- Revenue is recognized when both:
  - It is earned (i.e. goods or services are provided) and
  - It is realized (i.e. payment for goods or services received in cash or something that can be converted to a known amount of cash)
- These conditions are called revenue recognition criteria

# Expenses

---

- Expenses are decreases in shareholders' equity (not necessarily cash) that arise in the process of generating revenues
- Expenses are recognized when either:
  - Related revenues are recognized (product costs) or
  - Incurred, if difficult to match with revenues (period costs and unusual events)
- The underlying recognition concepts are the
  - Matching principle (product vs. period costs)
  - Conservatism principle (unusual events): recognize anticipated losses immediately, recognize anticipated gains only when realized

## How Much Revenue Is Recognized in December?

---

- BOC delivers \$500,000 worth of washing machines in December to customers who don't have to pay until February

**\$500,000**

- BOC collects \$300,000 cash in December for washing machines delivered in October

**\$0**

- BOC Realty leases space to a tenant for the months of December and January for \$20,000, all of which is paid for in cash in December

**\$10,000**

## How Much Revenue Is Recognized in December?

---

- BOC Aerospace receives an order for a \$400,000 jet in December to be delivered in July

\$0

- BOC Bank is owed \$100,000 of interest on a loan for December and receives the payment in January

\$100,000

- BOC issues 20,000 shares of stock in December and receives \$10/share, which is \$2/share more than they expected

\$0

## How Much Expense Is Recognized in December?

---

- BOC Automotive buys engines worth \$2,000,000 in December for cash

\$0

- BOC Automotive uses the engines to make cars at a total cost of \$10,000,000 in December

\$0

- BOC Automotive sells cars costing \$8,000,000 in December for \$15,000,000

\$8,000,000

## How Much Expense Is Recognized in December?

---

- BOC Automotive incurs \$180,000 in salaries for its marketing staff in December  
\$180,000
- BOC Automotive pays its auditor \$50,000 in December for services to be rendered in December and January  
\$25,000
- BOC Automotive pays \$1,200,000 in cash dividends in December  
\$0