Income Statements

What are accounts and why are they necessary?

- Accounts are the financial records of a firm's transactions
- Accountants are the professionally qualified people who have the responsibility for keeping accurate accounts and for producing the final accounts
- Final accounts are produced at the end of the financial year and give details of the profit and loss made over the year and the worth of the business
- Limited companies are required by law to publish their final accounts

Recording accounting transactions

- Too long and cumbersome to be written out by hand, and so are stored on computers. Computer files store records of all financial transactions and information can be printed out when required

How a profit is made

$$Profit = sales\ revenue - cost\ of\ making\ products$$

Why is profit important?

Why profit is important	Explanation
Reward for enterprise	Successful entrepreneurs have many important qualities and characteristics and profit gives them a reward for these
Reward for risk taking	Entrepreneurs and investors take considerable risks when they provide capital to a business-profits reward them for taking these risks by allowing payments to be made
	These payments provide incentives: to business owners to try make their business even more profitable; to investors to put more capital into a profitable business
Source of finance	Profits after payments to owners (retained profit) are a very important source of finance for the business-this allows for expansion
Indicator of success	When some businesses are very profitable, other businesses or new entrepreneurs are given a signal that investment inti producing similar goods or services would be profitable.

Understanding income statements

- An income statement is a document that records the income of a business and all costs incurred to earn that income over a period of time. It is also known as a profit and loss account
- A gross profit is made when sales revenue is greater than the cost of goods sold
- The sales revenue is the income to a business during a period of time from the sale of goods and services

- The cost of goods sold is the cost of producing or buying in the goods actually sold by the business during a time period
- A trading account shows how the gross profit of a business is calculated

Gross profit

- Gross profit is calculated before costs are considered

$$Gross\ profit = sales\ revenue - cost\ of\ goods\ sold$$

- Gross profit does not make any allowances for overhead costs or expenses
- Cost of goods sold is not necessarily the same as the total value of goods bought by the business
- In a manufacturing business, rather than a retailing one, labour costs ate directly incurred in making the products sold and will also be deducted before arriving at the gross profit total
- The gross profit is not the final profit for the business because of all the other expenses that have to be deducted
- Costs such as salaries and utilities need to be subtracted from the gross profit

Net profit

- Net profit is the profit made by all businesses after all the costs have been deducted from sales revenue. It is calculated by subtracting overhead costs from gross profits
- Net profit will also include any non-trading income such as rent
- Depreciation is the fall of the value of a fixed asset over time
- Retained profit is the net profit reinvested back into the company after deducting tax and dividends

The income statement for limited companies will contain:

- Corporation tax paid on the company's net profit
- The dividends paid out to shareholders
- The retained profits left after these two deductions
- Results from the previous year to allow for easy comparison