

Income Statement

- Reports increase in shareholders' equity due to operations over a period of time
- Income statement equation:
 - $\text{Net Income} = \text{Revenue} - \text{Expenses}$
 - 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