Income Statement

Study Notes: Business Finance & Accounting

Income statement (overview)

The income statement is **a historical record of the trading of a business over a specific period** (normally one year). It shows the **profit or loss made by the business** – which is the **difference between the firm's total income and its total costs.**

The income statement serves several important purposes:

- Allows shareholders/owners to see how the business has performed and whether it has made an acceptable profit (return)
- Helps identify whether the profit earned by the business is sustainable ("profit quality")
- Enables comparison with other similar businesses (e.g. competitors) and the industry as a whole
- Allows providers of finance to see whether the business is able to generate sufficient profits to remain viable (in conjunction with the cash flow statement)
- Allows the directors of a company to satisfy their legal requirements to report on the financial record of the business

The structure and format of a typical income statement is illustrated below:

Boston Learning Systems plc		
Income Statement	**2011**	**2010**
Year Ended 31 December	£'000	£'000
Revenue	21,450	19,780
Cost of sales	13,465	12,680
Gross profit	**7,985**	**7,100**
Distribution costs	3,210	2,985
Administration expenses	2,180	1,905
Operating profit	**2,595**	**2,210**
Finance costs	156	120
Profit before tax	**2,439**	**2,090**
Tax expense	746	580
Profit attributable to shareholders	1,693	1,510

The lines in the income statement can be briefly described as follows:

Category	**Explanation**
Revenue	The revenues (sales) during the period are recorded here. Sometimes referred to as the "top line" – revenue shows the total value of sales made to customers
Cost of sales	The direct costs of generating the recorded revenues go into "cost of sales". This would include the cost of raw materials, components, goods bought for resale and the direct labour costs of production.
Gross profit	The difference between revenue and cost of sales. A simple but very useful measure of how much profit is generated from every £1 of revenue before overheads and other expenses are taken into account. Is used to calculate the

	gross profit margin (%)
Distribution & administration expenses	Operating costs and expenses that are not directly related to producing the goods or services are recorded here. These would include distribution costs (e.g. marketing, transport) and the wide range of administrative expenses or overheads that a business incurs.
Operating profit	A key measure of profit. Operating profit records how much profit has been made in total from the **trading activities of the business** before any account is taken of how the business is financed.
Finance expenses	Interest paid on bank and other borrowings, less interest income received on cash balances, is shown here. A useful figure for shareholders to assess how much profit is being used up by the funding structure of the business.
Profit before tax	Calculated as operating profit less finance expenses
Tax	An estimate of the amount of **corporation tax** that is likely to be payable on the recorded profit before tax
Profit attributable to shareholders	The amount of profit that is left after the tax has been accounted for. The shareholders then decide how much of this is paid out to them in dividends and how much is left in the business ("retained earnings" in the equity section of the balance sheet)