


**Chapter 2, Module 3 – Financial Statements**

**Slide 1**

*Chapter 2 Module 3*

**AMIS 211**  
**Introduction to Financial Accounting**

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COLLEGE OF BUSINESS

Hi everyone. Welcome back.

We have talked about the Balance Sheet and what the Balance Sheet is.

Let's go ahead in this module and talk about the next financial statement.

Go to the next slide with me.

Slide 2

*Chapter 2 Module 3: Income Statement*

**INCOME STATEMENT**

**The income statement is the financial statement that shows the profitability of the company for a period of time**

**2 Items Found on the Income Statement:**

- 1. Revenues**
- 2. Expenses**

The Income Statement:

Let's give it a definition.

The Income Statement is the financial statement that shows the profitability of the company for a period of time.

Now, note the difference in the wording there:

The Balance Sheet was a financial statement that showed the Assets, Liabilities, and Equity of the company at a point in time. It was a Point-in-Time Statement.

The Income Statement shows the company's profits for a period of time, typically from January through December. "For the year, here is how profitable we were." This is a Period-of-Time Financial Statement.

Now, on this Income Statement we will find two (2) specific items.

Remember on the Balance Sheet we saw Assets, Liabilities, and Equity.

Here, on the Income Statement, we will find 1) Revenues and 2) Expenses.

So, we will see Revenues and Expenses on this Statement of Earnings or Income Statement.

Go to the next slide with me.

**Slide 3**

***Chapter 2 Module 3: Revenues***

**Revenues:**

- represent amounts earned during the accounting period (year)
- may result from sale of merchandise, services, rental of property, or lending money

**Examples of Revenues:**

1. Sales Revenue (result from sales of inventory)
2. Service Revenue
3. Rental Revenue
4. Interest Revenue
5. Dividend Revenue

And, let's talk about these two (2) things a little bit in depth.

Let's start with our 1) Revenues.

Revenues represent amounts that have been earned during the accounting period—during the year that the Income Statement covers—from January through December—amounts that have been earned.

Now, these amounts that we earn may result from selling inventory, or performing a service, or renting equipment or a building to somebody; or lending money and being paid interest.

There are lots of different ways we can earn Revenues. But, that is what they represent: amounts that have been earned during the year.

Some common examples of Revenues:

The most important—the one we will really sort-of focus on a lot this quarter is: 1) Sales Revenue.

Sales Revenue represents the revenue that we earn when we sell our product—by selling our inventory.

Some other examples of Revenues include things like:

2) Service Revenue: performing a service.

3) Rental Revenue: renting equipment, or a building, to somebody else.

4) Interest Revenue: we have lent money to somebody or put money in the bank. We may earn some interest.

And, 5) Dividend Revenue: Dividend Revenue represents when we own the stock of say, another company—say, AT&T—and they pay a dividend to us.

All of those represent amounts earned (i.e. Revenues) for the company.

Let's go to the next slide...

Slide 4

***Chapter 2 Module 3: Expenses***

**Expenses:**

- **costs incurred in the process of earning revenues**

**Examples of Expenses:**

1. **Cost of Goods Sold (cost of inventory sold)**
2. **Salaries Expense**
3. **Rent Expense**
4. **Utilities Expense**
5. **Interest Expense**
6. **Advertising Expense**
7. **Income Tax Expense**

And, let's talk about the other item on the Income Statement: our 2) Expenses.

We can define our Expenses as the costs that have been incurred in the process of earning Revenues.

We are out there trying to earn Revenues. But, we cannot do that for free. We have a whole bunch of costs we incur in order to try to do that.

Examples of Expenses include:

One: and again, this is a big one, 1) the Cost of Goods Sold (CGS).

Cost of Goods Sold (CGS) represents the inventory that we have sold to customers—the cost of that inventory—hence: the **COST of GOODS SOLD**.

So, CGS represents the cost of inventory sold to customers.

A little bit later in this module, we will look more in depth at the Sales Revenue and Cost of Goods Sold ideas.

But, let's look at some other examples of Expenses first.

Other examples of Expenses include:

2) Salaries Expense: we have to pay the employees.

3) Rent Expense; 4) Utilities Expense; 5) Interest Expense; 6) Advertising Expense; 7) Income Tax Expense.

And, we could probably spend the next hour listing out different Expenses that the organization encounters.

So, once again, just like we saw with the Balance Sheet and those lists that we prepared—the list of Revenues and Expenses are not all-inclusive. They do not include every possible Revenue or Expense—just the most common ones.

Hey, by the way, just as a quick aside:

Take a look here at the bottom of this slide (Slide 4).

One of the things that you are going to have to be able to do is pick out different accounts, or different items, from a list.

So, let's say I gave you a list of a whole bunch of items and said: "Pick out all of those that are considered Expenses."

What is the easy way to pick most of them out?

Just look at the slide (Slide 4)! Most of them say: Expense. That is telling you that is an Expense.

That one notable exception is the first one: that Cost of Goods Sold (CGS). It is still an Expense even though it does not actually use the word "expense."

Please go to the next slide with me.

Slide 5

*Chapter 2 Module 3: Income Statement*

**IMPORTANT:**

**Income Statement Equations:**

$$\text{Revenues} - \text{Expenses} = \text{Net Income}$$

$$\text{Sales Revenue} - \text{Cost of Goods Sold} = \text{Gross Profit}$$

Remember the Balance Sheet? And, the most fundamental accounting equation—the most important equation that we talk about:

Assets equal (=) Liabilities plus (+) Equity ( $A = L + E$ ).

We have a couple of equations on the Income Statement that are also very important.

The basic Income Statement equation is: how to calculate your profit.

Remember what the Income Statement does? It shows the profitability of the company for a period of time.

To calculate that profit—referred to as Net Income—simply take: Revenues minus (-) Expenses.

So, one important equation on the Income Statement is:

Revenues minus (-) Expenses equals (=) the company's Net Income.

Another important one that you need to be comfortable with; this kind-of goes back to the Sales Revenue and Cost of Goods Sold idea that we talked about a little bit ago.

Sales Revenue minus (-) Cost of Goods Sold (CGS) is referred to as the company's Gross Profit.

Let's go to the next slide and expand on that a little bit.

**Slide 6**

*Chapter 2 Module 3: Gross Profit*

**The income statement begins as follows:**

**Sales Revenue**  
- **Cost of Goods Sold**  
**Gross Profit**

**Sales revenue** represents the selling price of inventory (5 pieces of inventory each sold to customers for \$10 would result in sales revenue of \$50)

However, the company had to pay something to acquire the inventory. Say each piece of inventory cost the company \$6 to purchase.

**Cost of goods sold** is the cost of the inventory sold (5 pieces of inventory sold to customers with each piece costing the seller \$6 to purchase would result in cost of goods sold of \$30)

You see there at the top (of Slide 6) how the Income Statement would begin.

An Income Statement always starts with your Sales Revenue. You then subtract (-) your Cost of Goods Sold (CGS)--that is an Expense—to calculate what we call: Gross Profit.

We just saw that a second ago.

The Sales Revenue that we have here. That represents the actual selling price of the inventory.

For example:

Let's say we are in the business of selling markers. And, we sell five (5) markers to our customers—five (5) pieces of inventory. Each marker is sold to customers for ten bucks (\$10.00). That would result in Sales Revenue of \$50.00 ( $5 \times \$10.00$ )—the total sales price of the inventory sold—the actual Sales Revenue.

However, we did not get the markers for free. Right? We just did not happen to be running outside one day and markers fell out of the sky and we grabbed them and said: “Hey, let's sell them for ten bucks (\$10.00) each.” We had to pay some money to go out and buy the markers so that we could then put them on our shelf and sell them to our customers.

Let's say, in the example that we have here on the slide (Slide 6): each of the markers—each piece of the inventory—cost us \$6.00 to go out and acquire. That is referred to as your Cost of Goods Sold (CGS).

Cost of Goods Sold (CGS) is the cost of the inventory sold to customers. We sold five (5) markers. Each marker cost us \$6.00 to go buy so we could turn around and sell it to somebody else. That would give us a Cost of Goods Sold (CGS) of \$30.00 ( $5 \times \$6.00$ ).

The Sales Revenue—the revenue part—what we actually sell it for; the Expense—the Cost of Goods Sold (CGS)—the cost of the markers—or inventory—sold to customers.

Please go to the next slide with me.

## Slide 7

***Chapter 2 Module 3: Gross Profit***

**The income statement begins as follows:**

**Sales Revenue**  
 - **Cost of Goods Sold**  
**Gross Profit**

**Gross Profit represents the profit earned from selling inventory**

As we said a minute ago, the Income Statement begins as follows:

Sales Revenue minus (-) Cost of Goods Sold is equal to (=) the Gross Profit.

And, we can think of Gross Profit as the profit earned from selling our product. And, that is it! That is all that Gross Profit represents. It represents the profit earned from selling inventory.

Now, that is our primary activity. That is why we are in business. We are in business to sell the product.

This is a very important number. It tells us what sort of profit we are earning from that primary activity.

If you remember back to the example on the previous slide (Slide 6): We would have had Gross Profit of \$20.00.

We had Sales Revenue of \$50.00—five markers sold for \$10.00 each (5 x \$10.00). But, the Cost of Goods Sold (CGS): it cost us \$6.00 to buy each

marker (5 x \$6.00). So, the Cost of Goods Sold (CGS) was 30 bucks (\$30.00).

Telling us: the profit earned from selling the product, or inventory, would have been \$20.00 (5 x \$4.00).

Let's go to the next slide.

**Slide 8**

*Chapter 2 Module 3: Income Statement*

**Income Statement Format**

**The basic format of the income statement is:**

- Sales Revenue**
- Cost of Goods Sold**
- Gross Profit**
- + Other Revenues**
- Other Expenses**
- Net Income**

**Note: If expenses > revenues, it is referred to as a net loss.**

Okay, so we have seen this idea an awful lot the last couple of slides.

The Income Statement starts like this:

Sales Revenue minus (-) Cost of Goods Sold (CGS) is Gross Profit.

But you know what? That is not the Net Income.

Why not?

How do we get from the Gross Profit down to the Net Income—the actual income that we earn for the year?

What am I missing?

I am missing all those other Revenues and Expenses that exist. Right?

The Gross Profit is just the profit earned from selling inventory.

You, then, have to add to that all of the other Revenues—maybe Interest Revenue, maybe Dividend Revenue, whatever—subtract (-) all of the other Expenses—Advertising Expense, Salary Expense, Utilities Expense, etc.—and that gets you to the Net Income.

You start at the top with just your primary activity:

Sales Revenue minus (-) Cost of Goods Sold (CGS) is (=) Gross Profit.

From that; add (+) to that all of the other Revenues, subtract (-) all of the other Expenses; and that allows us to calculate the company's Net Income.

Note: there is just one thing to note. It unfortunately happens, hopefully, not to any of us if we ever have a business. But: should the Expenses exceed the Revenues: that would be referred to as a Net Loss rather than Net Income.

That—what you see right there (on Slide 8)—is the basic Income Statement format.