

Income Statement

Chapter 10

Unit 3

Performance Objectives:

You will analyze and calculate parts of an income statement using a sample company income statement. You will define major financial terms. You will work with another person to solve three practice income statement problems. You will examine the finances for your business and then calculate and write income statements in Microsoft® Excel.

Evaluation Criteria:

Successful completion of this chapter requires you to:

- ⑤ Analyze a sample income statement.
- ⑤ Work with a partner to write three practice income statements.
- ⑤ List supplies needed for your business.
- ⑤ Find costs of supplies.
- ⑤ Determine cost of goods sold for your products.
- ⑤ Estimate salaries.
- ⑤ List all operating expenses.
- ⑤ Write an income statement in Microsoft® Excel.
- ⑤ Use formulas in Microsoft® Excel.

Task 1: Examining Income Statements

Read the section below.

The income statement for RVC Fine Furniture is on the next page. It summarizes sales revenue and operating expenses for a given time period and indicates whether the RVC Fine Furniture is in profit or loss. It is one of two critical business financial statements that you will learn about.

Income Statements:

- Summarize sales revenue and operating expenses
- Indicate whether the company is in profit or loss
- Track patterns and trends in sales and expenses if you project your income statement over several months/years
- Provide investors and other interested parties with an easy-to-understand report on the company's financial position

Read through the sample income statement for RVC Fine Furniture on the next page and answer the following questions:

1. What is the time period covered by this income statement? (year, month, quarter)
2. Explain how gross margin is calculated:
3. From the sample income statement give an example of the following:
 - Sales:
 - Operating Expense:
 - Other Expense:
4. Which operating expense is costing the company the most this month?
5. How is (pretax) net profit calculated?
6. What is COGS?
7. After reading this sample, what do you think is the purpose of an income statement?

**RVC Fine Furniture
Income Statement
For Month Ended June 30, 2010**

Sales		
	Buffets	\$3,500
	Single Door Pie Cabinets	395
	Double Door Pie Cabinet	1,500
	Kitchen Cabinets	0
Total Sales		\$5,395
Cost of Goods Sold		<u>\$3,845</u>
Gross Margin		\$1,550
Operating Expenses		
	Owner's Draw	\$500
	Insurance	25
	Water Bill	150
	Electric Bill	150
	Internet	20
	Phone bill	50
	Cell Phone	30
	Yellow Pages ad	25
	PO Box	2
	Mailing/shipping costs	<u>35</u>
Total Operating Expenses		\$987
Other Expenses		
	Interest (Mortgage)	<u>400</u>
Total Other Expenses		<u>\$400</u>
Total Expenses		<u>\$1,387</u>
Net Profit Pretax		<u>\$163</u>

COGS is figured by totaling the cost of producing your product. In this example, RVC Fine Furniture spent \$3,845 on supplies to make its products. Also called **Variable Expenses**.

Operating expenses are costs that occur regularly and are related to the running of the business in general. Also called **Fixed Expenses**.

Expenses other than regular operating costs are listed here.

Task 2: Practice Problems

Find a partner and then read and work through the following examples.

Problem 1: Dairy Valley

Dairy Valley Restaurant has been making and selling a special meatless hot dog sauce at their restaurant since 1948. Local residents rave about the sauce, which is made from a secret family recipe. The owners of the restaurant decided to produce the sauce on a larger scale and sell 12-ounce jars from their restaurant and in the two local food stores. They were able to produce their sauce at a local kitchen incubator.

They hope to take their sauce to a national market within the next several years. The results of their sales for the month of June 2010 are below. Use the information below to complete an income statement for Dairy Valley.

- They sold 320 quarts of the special sauce in June.
- They charge \$3.00 per quart. (They did some quick market research and figured that the retailer can sell their sauce for \$4.00 per quart.)
- They have a cell phone so they can be reached for emergencies, which costs \$40 per month.
- They spent \$120 in ingredients to produce the 320 quarts they made in June.
- Each label costs 10¢.
- They deliver their orders to the local grocery stores so they do not have shipping costs.

From the kitchen incubator they:

- Rent production space for \$20 per hour (for four hours).
- Rent the wet room for processing at \$28 per hour (for four hours).
- Rent two 4 x 4 x 6 storage spaces at the kitchen incubator for \$13 each per month.
- Rent eight cubic feet of refrigerator/freezer space at \$13 total per month.
- Can produce 150 cases (of twelve jars) in four hours (processed and labeled).
- Got free nutritional analysis (saved \$5,000-\$7,000) to help in labeling.
- Got FDA approval (saved \$500).
- Got assistance with label design.

The counselor at the kitchen incubator introduced the owners of Dairy Valley to the owners of two other small businesses that were just starting up. They realized that they are all using similar ingredients and jars. Ordering supplies in bulk will reduce the cost of supplies. Furthermore, some food service supply companies will only sell in large quantities (e.g. a jar company may only sell a minimum of 4,000 jars on which the shipping and handling could cost \$400 to \$500).

Together with the owners of a pasta sauce company and a salsa company, the owners of Dairy Valley spent \$360 in ingredients (tomatoes, hot peppers, spices) of which Dairy Valley's share was \$120. They ordered the following items to produce the 320 quarts they sold in June:

- Jars (12 ounce) at 33¢ each
- Colored lids at 8¢ each

Write the definitions for, or explain how to calculate, each of the following terms. List the items in each category from the Dairy Valley problem. Calculate the totals in each category using the formulas below.

$$\text{Gross Margin} = \text{Total Sales} - \text{COGS}$$

$$\text{Net Profit} = \text{Gross Margin} - \text{Total Expenses}$$

Sales:

Cost of Goods Sold:

Gross Margin:

Operating Expenses:

Net Profit:

Use the information from the previous pages to complete this income statement for Dairy Valley.

Dairy Valley Hot Dog Sauce Income Statement For Month Ended June 30, 2010	
Sales	
Total Sales	
Cost of Goods Sold	
Gross Margin	
Operating Expenses	
Total Expenses	
Net Profit Pretax	

Gross Margin = Total Sales - COGS
Net Profit = Gross Margin - Total Expenses

Problem 2: JR's U\$ed CDs

JR's U\$ed CDs is a small music store located in a storefront on a main street in downtown Athens, Ohio. The store will buy and sell used music CDs and resell them for \$5-\$10 each. The target market is men between the ages of 15 and 64.

JR had just recently opened his used CDs business. Unfortunately, his financial records for the month of April 2010 were destroyed by a computer virus. He needs to recreate his income statement for the accountant to look over. He was able to find some paper receipts from that month. Below is *all* the information he has. Can you put it all together into an income statement?

Rent	500
Bill from Athens local daily paper for ad	75
Loan payment to Neon Sign Company	50
Bill from Office Max for wrapping and custom bags	50
Cash register total for week of April 1-7	783
Depreciation on equipment	129
Insurance payment to MyState Insurance	75
Bill from WPLQ Radio Station for five-minute radio spot	75
Jill's and Mike's salaries (part-time employees)	560
Cash register total for week of April 15-22	713
Payment to Bell Phone Company	35
Cash register total for week of April 8-15	697
Payment to Athens National Bank for loan	150
Cash register total for week of April 22-30	782
Payment to L. Smith for purchase of CDs	25
Payment to J. Anderson for purchase of CDs	7
Payment to M. Homes for purchase of CDs	12
Payment to T. Thompson for purchase of CDs	25
Payment to R. Morrison for purchase of CDs	80
Payment to A. Nunez for purchase of CDs	32
Payment to D. O'Malley for purchase of CD collection	224
Payment to M. Miller for purchase of CDs	212
Payment to T. Smith for purchase of CDs	32
Payment to R. Borden for purchase of CDs	21
Payment to A. Howard for purchase of CDs	10
Payment to Beatles Are Us for Complete Works	400

List the items in each category from JR's U\$ed CDs. Calculate the totals in each category.

Sales:

Total =

Cost of Goods Sold:

(Remember, these are the costs that the owners incur while creating their product)

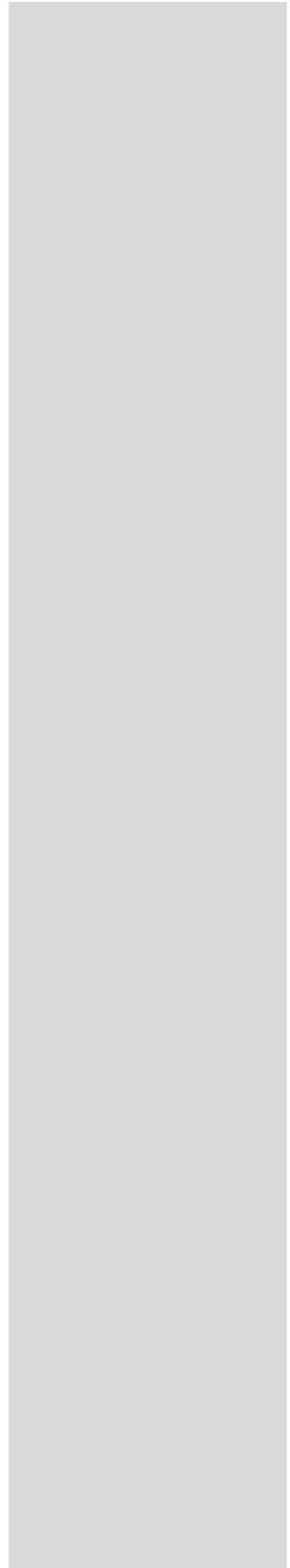
Total =

Operating Expenses:

Total =

Use the data above to create an income statement using formulas in **Microsoft® Excel** (use RVC's income statement on Page 75 as a guide to format). Be sure to include sales, cost of goods sold, operating expenses, gross margin, and net profit.

Problem 2: Answer Sheet



Problem 3: Jack N' Jill's Lawn Care

Jack and Jill started their part-time lawn care business last year. Their business has been extremely successful primarily because they do very careful work.

They now have one employee. They pay themselves and the employee a summer salary of \$340 per week. They work fifteen hours per week throughout the year but during the summer they work forty or more hours per week.

Expenses for the month of July 2010

Salary per week = \$340 per employee	
3 employees = \$340 per week x 3 = \$1,020 per week	
Total salaries for 4 weeks = \$1,020 x 4 weeks	\$4,080.00
Equipment loan	\$ 150.00
Insurance	\$ 100.00
Phone	\$ 35.00
Equipment maintenance	\$ 50.00
Oil and gas	\$ 250.00
Fertilizer – 1800 gallons (\$12.50 per 100 gallon) paid cash	\$ 225.00
Mulch – 400 cubic yards (\$1 per cubic yard) paid cash	\$ 400.00
Landscaping Materials (paid on credit)	\$ 650.00

On Page 100 you'll find their financial information for the month of July. **You will need to calculate labor, materials, and total customer charges in the spreadsheet. Write your answers in the gray cells.** Without this information you will not be able to prepare your income statement. (*HINT: Remember to use the information from the flyer in your calculations.*)



Summer Lawn Care Specials



Jack N' Jill's Lawn Care

We provide quality lawn care services to the residents of Flowerville, Ohio. We are offering these special prices during this summer season. Our trained lawn care and landscaping specialists will help you turn your yard into a place of beauty.

Call us for an estimate on your lawn care and landscaping needs.



All \$35 per hour

- **Mowing**
- **Edging**
- **Tree trimming**

All \$30 per hour plus materials

- **Landscaping**
- **Mulching**
- **Fertilizer application**

Mulch \$10 per 5 cubic yards

Fertilizer \$25 per 100 gallons

Landscape materials by arrangement

Jack N' Jill's Lawn Care
123-456-7890

Problem 3: Jack N' Jill's Lawn Care (continued)

List the items in each category from Jack N' Jill's Lawn Care.
Calculate the totals in each category for the month of June.

Sales:

1. Lawn mowing = \$1645 total charge to customer
- 2.
- 3.
- 4.
- 5.
- 6.

Total =

Cost of goods sold: (remember, these are the costs that the owners pay for creating or doing their product or service)

Total =



Service businesses do not normally list Cost of Goods Sold in their income statements. List supplies in the Expense section of the income statement instead.

Expenses:

Total =

Take the data from previous pages, including the flyer, and create an income statement using formulas in Excel. Be sure to include sales, gross margin, expenses, and profit.

Income Statement Blank for Jack N' Jill's Lawn Care

Recreate this income statement blank in Excel and insert the values you calculated in the appropriate boxes. Remember to use Excel formulas for calculating totals.

Jack N' Jill's Lawn Care Income Statement For Month Ended July 31, 2010

Sales	Lawn Mowing	\$1,645		
	Edging	210		
	Mulching	1,040		
	Fertilizer Application	720		
	Tree Trimming	350		
	Landscaping	2,420		
Total Sales			<u>\$6,385</u>	
Operating Expenses				
	Salaries	\$4,080		
	Insurance Expense	100		
	Equipment Maintenance	50		
	Phone	35		
	Supplies	1,525		
	Depreciation Expense - Equipment	(81)		
Total Operating Expenses			<u>\$5,709</u>	
Other Expenses			<u>\$0</u>	
Total Other Expenses			<u>\$0</u>	
Total Expenses			<u>\$5,709</u>	
Profit (Loss) Pretax				<u>\$676</u>

Task 3: Creating Your Own Income Statement

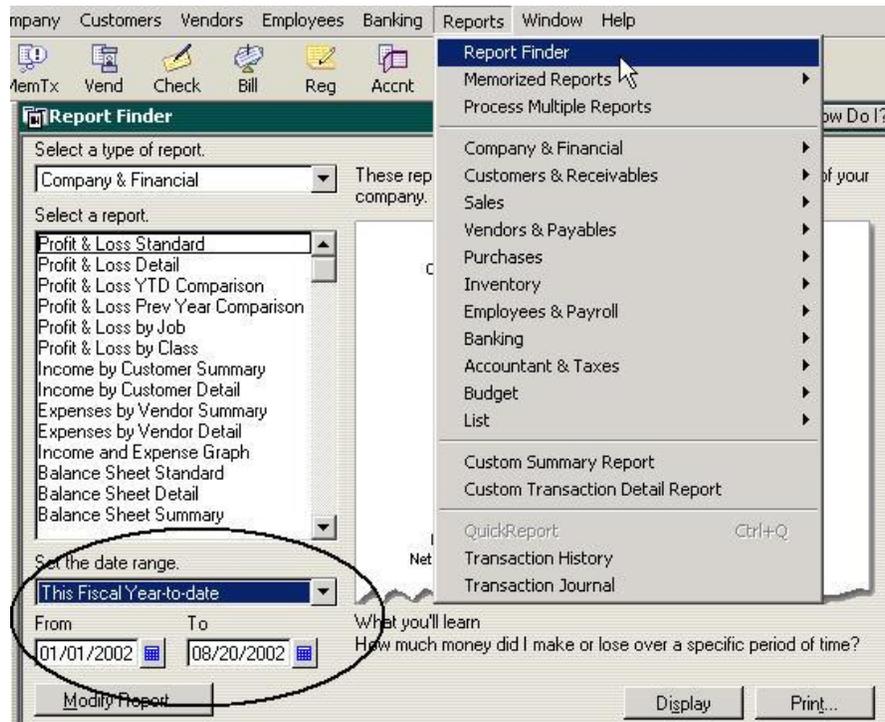
Follow the directions below to create your own income statement in Microsoft® Excel.

1. Open Microsoft® Excel and make a list of the supplies you will need to run your business.
2. Use the Internet or catalogs to determine the costs of any additional supplies for your product or service.
3. Any costs associated with the production of a product are considered part of Cost of Goods Sold. If your business is a service business, you do not have COGS in your income statement. These expenses are listed as supplies under operating expenses.
4. Determine salary costs (i.e., what you are going to pay yourself and your employees). List these costs as operating expenses
5. Record actual sales or project what your sales for one month might be. Be realistic. You will record this number as “Sales” on your income statement.
6. In a new worksheet in Microsoft® Excel, set up an income statement of your business, following the format of the income statements you have looked at previously in this chapter. Make sure you write formulas to perform the calculations.

Task 4: Creating Your Income Statement in QuickBooks® Basic 2002

Follow the directions below to create your income statement in QuickBooks® Basic 2002.

1. Go to **Reports** → **Report Finder** and then select **Profit & Loss Standard**.
2. Select the date range (circled area in image). You can choose month, quarter or a variety of other ranges.



3. Click Display. Your income statement will appear.