Jihočeská univerzita
v Českých Budějovicích
University of South Bohemia
in České Budějovice

FINANCIAL STATEMENTS
- Study Text

FINANCIAL STATEMENTS: PROFIT/LOSS (INCOME) STATEMENT

Jihočeská univerzita v Českých Budějovicích
Branišovská 1645/31a
370 05 České Budějovice
IČ: 60076658

EVROPSKÁ UNIE
Evropské strukturální a investiční fondy
Operační program Výzkum, vývoj a vzdělávání

MINISTERSTVO ŠKOLSTVÍ, MLÁDEŽE A TĚLOVÝCHOVY

1 DEFINITIONS AND CLASSIFICATIONS

The Profit/loss statement (Income statement) summarizes the revenues earned and costs (expenses) incurred by a business over a period of time. Many people consider it the most important financial report because if shows whether or not a business achieved its profitability goal of earning an acceptable income.

Profit/Loss Statement, is a financial statement for companies that indicates how revenue (money received from the sale of products and services before costs (expenses) are taken out) is transformed into net income (the result after all revenues and costs (expenses) have been accounted for.

The purpose of the income statement is to show managers and investors whether the company made or lost money during the period being reported.

Costs (expenses) and revenues affect profit entity. Costs are to be distinguished from expenditure (the transaction with cash). It can be characterized as a monetary expression of power, as opposed to spending the loss of funds without ties to specific output. Similarly, it is necessary to distinguish revenues from income (the transaction with cash). Revenues are outputs of entity, while revenue increases represent funds.

Examples of definitions

(http://www.businessdictionary.com/definition)

Cost

An amount that has to be paid or given up in order to get something. In business, cost is usually a monetary valuation of (1) effort, (2) material, (3) resources, (4) time and utilities consumed, (5) risks incurred, and (6) opportunity forgone in production and delivery of a good or service. All expenses are costs, but not all costs (such as those incurred in acquisition of an income-generating asset) are expenses.

Expense

Money spent or cost incurred in an organization's efforts to generate revenue, representing the cost of doing business. Expenses may be in the form of actual cash payments (such as wages and salaries), a computed expired portion (depreciation) of an asset, or an amount taken out of earnings (such as bad debts). Expenses are summarized and charged in the income statement as deductions from the income before assessing income tax. Whereas all expenses are costs, not all costs (such as those incurred in acquisition of income generating assets) are expenses.

Expenditure

Payment of cash or cash-equivalent for goods or services, or a charge against available funds in settlement of an obligation as evidenced by an invoice, receipt, voucher, or other such document. See also revenue expenditure, capital expenditure.

Revenue

The income generated from sale of goods or services, or any other use of capital or assets, associated with the main operations of an organization before any costs or expenses are deducted. Revenue is shown usually as the top item in an income (profit and loss) statement from which all charges, costs, and expenses are subtracted to arrive at net income. Also called sales, or (in the UK) turnover.

Income

1. The flow of cash or cash-equivalents received from work (wage or salary), capital (interest or profit), or land (rent).

2. Accounting: (1) An excess of revenue over expenses for an accounting period. Also called earnings or gross profit. (2) An amount by which total assets increase in an accounting period.

3. Economics: Consumption that, at the end of a period, will leave an individual with the same amount of goods (and the expectations of future goods) as at the beginning of that period. Therefore, income means the maximum amount an individual can spend during a period without being any worse off. Income (and not the GDP) is the engine that drives an economy because only it can create demand.

4. Law: Money or other forms of payment (received periodically or regularly) from commerce, employment, endowment, investment, royalties, etc.

By IFRS/IAS:

Income is:

- an increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases in liabilities
- transactions that result in increases in equity, other than those relating to contributions from equity participants.

This definition follows a statement of financial position approach rather that the more traditional profit or loss approach to recognising income.

Expenses (costs) are:

- decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities
- transactions that result in decreases in equity, other than those relating to distributions to equity participants.

Usefulness and limitations of income statement

Income statements should help investors and creditors determine the past performance of the enterprise; predict future performance; and assess the risk of achieving future cash flows.

However, information in an income statement has several limitations:

- items that might be relevant but cannot be reliably measured are not reported (e.g. brand recognition and loyalty)
- some numbers depend on accounting methods used (e.g. using FIFO or LIFO accounting to measure inventory level)
- some numbers depend on judgments and estimates (e.g. depreciation expense depends on estimated useful life and salvage value).

In the single-step statement, just two groups exist: revenues and expenses. Expenses are deducted from revenues to get net income (single step). Its main advantage is simplicity, but more and more companies choose multiple-step statements.

Costs and revenues are divided for the purpose of finding profit into 2 groups:

a) operational,
b) financial.

(Extraordinary cots and revenues were from 2016 cancelled.)

COSTS (EXPENSE)

- **definition and usage**
  - an indicator characterizing all inputs to the economic activity of the enterprise (individual)

- provide information on what kinds of assets, purchased services, personnel and other costs for the relevant accounting period incurred
- represent an outflow of resources in terms of money for a specific purpose
- beginning to be observed as:
  - decrease of assets (cash outflow or loss previously purchased property, which is now fully consumed or gradually worn out)
  - increase of liabilities (when the cost in terms of time occurs before there is a cash payment - eg. payroll employees)

Accounting cost is the recorded cost of an activity. An accounting cost is recorded in the ledgers of a business, so the cost appears in an entity's financial statements.

If an accounting cost has not yet been consumed and is equal to or greater than the capitalization limit of a business, the cost is recorded in the balance sheet. If an accounting cost has been consumed, the cost is recorded in the income statement. If cash has been expended in association with an accounting cost, the related cash outflow appears in the statement of cash flows. A dividend has no accounting cost, since it is a distribution of earnings to investors.

An accounting cost is most typically recorded via the accounts payable system. It can also be recorded through a journal entry for individual transactions, or through the payroll system for compensation-related costs.

The scope of an accounting cost can change, depending on the situation. For example, a manager wants to know the accounting cost of a product. If this information is needed for a short-term pricing decision, only the variable costs associated with the product need to be included in the accounting cost. However, if the information is needed to set a long-term price that will cover the company's overhead costs, the scope of the accounting cost will be broadened to include an allocation of fixed costs.

- **classification**

Cost classification involves the separation of a group of expenses into different categories. A classification system is used to bring to management's attention certain costs that are considered more crucial than others, or to engage in financial modelling.

Evidence cost is recognized in the accounts. Accounting is suitable for those needs to classify to:

- ***Financial Accounting*** - focused on the enterprise as a whole
- ***Managerial (internal) accounting***, it includes:
  - <u>Cost (operating) accounting</u>, which focuses on:
    a) monitoring of actual costs in terms of internal departments and performance.
    b) management of internal departments - must know how costs and revenues, all of which can be quantified the economic result
  - it provides the necessary information for operational management and is basically still accounting. To financial accounting supplies information:
    1. the change in inventories produced internally, by activation of the performance, the valuation of inventories and other outputs generated by their activities,
    2. costs, revenues of internal departments,
    3. incurred costs for the corporate and internal performance,
    4. ensures control of formation costs (interim and subsequent),
    5. will provide an overview of economic activities for managers in terms of performance and components of enterprise
  - closely connected and <u>calculations</u> and <u>budgeting</u>.

Generally, the cost therefore can be found in the following areas:

a) the costs shown in Financial Accounting

- see Classification of accounts: class 5 – Costs, groups:

50 - Consumed purchases
51 - Consumed services
52 - Personal costs
53 - Taxes and fees
54 - Other operating costs
55 - Depreciation, reserves, reserves and prepaid expenses period and adjustments relating to operating activities
56 - Financial costs
57 - Reserves and adjustments relating to financial activity
58 - Change in inventory and activation
59 - Income tax, transfer accounts

b) the expenses for Tax purposes

- related to national economic regulation and the intent is to divide the costs into two groups:
    1. expenses not included in the tax base
    2. expenses which is deducted from the tax base

c) the costs shown in Managerial (Internal) accounting

- *costs (expenses)* = monetised cost effective use of resources for economic growth of property business purpose related to the implementation of the objects of the company
- characteristics: monetary terms (cost – cash; consumption – natural), efficiency (spending of economic resources is rational and reasonable outcome of)
- cost reduction is a major source of profit growth and business efficiency. Efficiency understand the firm's ability to assess the resources embedded in the business. Its quantitative indication is based on comparing incurred inputs and outputs achieved - see financial analysis tasks.
- here are several types of cost classifications:
    - **Fixed and variable costs**. Expenses are separated into variable and fixed cost classifications, and then variable costs are subtracted from revenues to arrive at a company's contribution margin. This information is used for break-even analysis.
    - **Departmental costs**. Expenses are assigned to the departments responsible for them. This information is used on a trend line to examine the ability of each department manager to control his or her assigned costs.
    - **Distribution channel costs**. Expenses are separated into each of the distribution channels used, such as retail, wholesale, and Internet store. The aggregate amount of each of these classifications is then subtracted from the related channel revenues to determine channel profit.
    - **Customer costs**. Expenses are classified by individual customer, such as the costs of warranties, returns, and customer service. This information is used to determine individual customer profitability.
    - **Discretionary costs**. Those expenses that can be temporarily reduced or eliminated are classified as discretionary. This approach is used to reduce costs on a temporary basis, particularly when a business anticipates having a brief decline in revenues.

The preceding examples of cost classifications should make it clear that costs can be subdivided in many ways. Only a few of these classifications are provided for within the formal accounting system (mostly to classify costs by department). Other types of classifications must be performed manually, usually with an electronic spreadsheet.

REVENUES

- **definition and usage**
    - in accordance with the Conceptual Framework for IAS/IFRS revenues are characterized as increases in economic benefits

- an indicator of economic activity of the enterprise (individual)
- constitute a payment (whether received or yet unrealized) results from the sale of the undertaking, respectively payment for the consumed components of business assets
- beginning to be observed as:
    - increase of assets (ie. Increase in cash, an increase in receivables, etc.).
    - decrease of liabilities

➢ **classification**

a) the revenues for Tax purposes:

- tax deductible
- non-tax deductible

b) the revenues shown in Financial Accounting:

- see Classification of accounts: class 6 – Revenues, groups:

60 - Revenues for own products and merchandise
64 - Other operating revenues
66 - Financial revenues
69 - Transfer accounts

Operating revenue

Operating revenue is the sales associated with the normal daily operations of a business. For example, the meals sold by a restaurant would generate operating revenue, while the sale of its delivery van would instead generate a profit or loss. The concept of operating revenue is important, because it reveals the core sales productivity of a business. Operating revenue information is especially valuable when tracked on a trend line, since it can reveal spikes or declines in sales activity that could indicate a long-term trend.

What constitutes operating revenue can be difficult to resolve, especially when a business is transitioning out of one product line or industry and into another. In this situation, it is possible that the revenues associated with both areas are operating revenue, but that the one related to the new area is more important, since this is the direction in which the company is headed.

Sales revenue

Sales revenue is the amount realized by a business from the sale of goods or services. This figure is used to define the size of a business. The concept can be broken down into two variations, which are:

Gross sales revenue. Includes all receipts and billings from the sale of goods or services; does not include any subtractions for sales returns and allowances.

Net sales revenue. Subtracts sales returns and allowances from the gross sales revenue figure.

This variation better represents the amount of cash that a business receives from its customers.

Sales revenue is typically reported for a standard period of time, such as a month, quarter, or year, though other non-standard intervals can be used. The key figure against which sales revenue is compared is net profits, so that the analyst can see the percentage of sales revenue that is being converted into profits. This net profit percentage is usually tracked on a trend line, to see if there are any material changes in performance. Investors also like to track sales revenue on a trend line, and especially the percentage rate of growth, to see if there is any evidence of changes in the growth rate. A declining growth rate may trigger a sell-off among shareholders.

Financial revenue

Financial revenues form revenues from interest, rent, and other such income earned in owning or renting an asset or property.

Principles for accounting of costs and revenues:

- items increasing costs are recognized usually on the side of the credit of cost's accounts,
- items increasing revenues are recognized usually on the side of the debit revenue's accounts,
- costs and revenues are accounted for by species (economically homogeneous costs and revenues)
- costs and revenues are recognized in each of the accounting period to which they relate,
- at the cost and revenue accounts are charged an incremental basis from the beginning of the financial year,
- the final states of cost and expense accounts are translated at the period end on account 710 - Profit and loss account, which permits an entity to determine profit for the entire accounting period.

2 FINDINGS OF ECONOMIC RESULT – PROFIT/LOSS

Comparing the revenues and costs of the entity to establish the result (profit or loss). In accounting terms, this comparison is made at the end of the reporting period on account 710 - Profit and loss account.

PROFIT/LOSS

- an important goal of an enterprise (until recently the main; today - maximizing the company's market value) - to make a profit
- it can be defined as the difference between revenues and costs (expenses), and generally it can be called the result (profit/loss)
- profit/loss is an indicator that reflects the performance of the business
- costs and revenues are divided for the purpose of finding profit into 2 groups:

  a) operational (Acc. group: 50-55, 58 and 60-64),

  b) financial (Acc. group: 56-57 and 66),

- in light of the above breakdown of the profit in the income statement also consists of 2 components:

  1) Operating profit/loss

  2) Financial profit/loss

  = Profit/loss of current accounting period

(note: Extraordinary profit/loss was from 2016 cancelled.)

A Profit/loss Statement can be prepared according to the purpose or type classification:

- **Type structure**
  - used by the most companies. We can characterize it as specific type of costs that were spent for specific purpose.
  - for example: consumption of material, goods, energy, payroll, etc.
- **Purpose structure (by function)**
  - this classification specifies the relation of costs to their origin
  - they are divided according to the relation to the following processes:
    - technological costs (incur only during technological production of a given product),
    - direct and indirect costs.

Type of profit/loss (earning, income)

There are several important profit measures in common use. Note that the words earnings, profit and income are used as substitutes in some of these terms.

Gross profit equals sales revenue minus cost of goods sold, thus removing only the part of expenses that can be traced directly to the production or purchase of the goods. Gross profit still includes general (overhead) expenses like R&D, S&M, G&A, also interest expense, taxes and extraordinary items.

Earnings before interest, taxes, depreciation, and amortization (EBITDA) equals sales revenue minus cost of goods sold and all expenses except for interest, amortization, depreciation and taxes. It measures the cash earnings that can be used to pay interest and repay the principal. Since the interest is paid before income tax is calculated, the debt holder can ignore taxes.

Earnings before interest and taxes (EBIT) or operating profit equals sales revenue minus cost of goods sold and all expenses except for interest and taxes. This is the surplus generated by operations. It is also known as Operating Profit Before Interest and Taxes (OPBIT) or simply Profit Before Interest and Taxes (PBIT).

Earnings before taxes (EBT) or net profit before tax equals sales revenue minus cost of goods sold and all expenses except for taxes. It is also known as pre-tax book income (PTBI), net operating income before taxes or simply pre-tax income.

Net income or earnings after tax or net profit after tax equals sales revenue after deducting all expenses, including taxes (unless some distinction about the treatment of extraordinary expenses is made). In the US, the term net income is commonly used. Income before extraordinary expenses represents the same but before adjusting for extraordinary items.

Retained earnings equals earnings after tax minus payable dividends.

To accountants, **economic profit**, or EP, is a single-period metric to determine the value created by a company in one period—usually a year. It is earnings after tax less the equity charge, a risk-weighted cost of capital. This is almost identical to the economists' definition of economic profit.

Minimum compulsory information under Regulation 500/2002 Coll.

PROFIT/LOSS ACCOUNT

as at December 31st, 2017

(in thousands of Czech Crowns)

TYPE CLASSIFICATION

IC

Comercial name or other name of an accounting unit

Registered office or adress of an accounting unit

	Profit/Loss Account	Row	Current period	Previous period
a	b	c	1	2
I.	**Revenues from the sale of own products and services**	01	**0**	**0**
II.	**Revenues from sold goods**	02	**0**	**0**
A.	**Production consumption (r. 04 + 05 + 06)**	03	**0**	**0**
1.	Expenses on sold goods	04	0	0
2.	Consumption of material and energy	05	0	0
3.	Services	06	0	0
B.	**Change in inventory of own products (+/-)**	07	**0**	**0**
C.	**Capitalisation (-)**	08	**0**	**0**
D.	**Personal expenses (r. 10 + 11)**	09	**0**	**0**
1.	Wages and salaries	10	0	0
2.	Social security, healt insurance and other expenses (r. 12 + 13)	11	0	0
2. 1	Social security and healt insurance expenses	12	0	0
2. 2	Other expenses	13	0	0
E.	**Value adjustments in the operational area (r. 15 + 18 + 19)**	14	**0**	**0**
1.	Value adjustments of intagible and tangible fixed assets (r. 16 + 17)	15	0	0
1. 1	Value adjustments of intagible and tangible fixed assets - permanent	16	0	0
1. 2	Value adjustments of intagible and tangible fixed assets - temporary	17	0	0
2.	Stock value adjustments	18	0	0
3.	Receivable value adjustments	19	0	0
III.	**Other operating revenues (r. 21 + 22 + 23)**	20	**0**	**0**
III. 1	Revenues from disposals of fixed assets	21	0	0
2	Revenues from disposals of materials	22	0	0
3	Other operating revenues	23	0	0
F.	**Other operating expenses (r. 25 to 29)**	24	**0**	**0**
1.	Net book value of sold fixed assets	25	0	0
2.	Net book value of sold material	26	0	0
3.	Taxes and fees	27	0	0
4.	Reserves and complex deferred costs	28	0	0
5.	Other operating expenses	29	0	0
*	**Operating profit/loss (+/-)** **(r. 01 + 02 - 03 - 07 - 08 - 09 - 14 + 20 - 24)**	30	**0**	**0**

a	Profit/Loss Account b	Row c	Current period 1	Previous period 2
IV.	**Revenues from long-term financial assets - shares (r. 32 + 33)**	31	**0**	**0**
IV. 1	Revenues from shares - controlled and controlling organizations	32	0	0
2	Other revenues from shares	33	0	0
G.	**Costs spent for sold shares**	34	**0**	**0**
V.	**Revenues from other long-term financial assets (r. 36 + 37)**	35	**0**	**0**
V. 1	Revenues from other long-term financial assets - controlled and controlling organizations	36	0	0
2	Revenues from other long-term financial assets	37	0	0
H.	**Costs related to other fixed financial assets**	38	**0**	**0**
VI.	**Interest revenues (r. 40 + 41)**	39	**0**	**0**
VI. 1	Interest revenues - controlled and controlling organizations	40	0	0
2	Other interest revenues	41	0	0
I.	**Value adjustments and reserves in the financial area**	42	**0**	**0**
J.	**Interest expenses (r. 44 + 45)**	43	**0**	**0**
1.	Interest expenses - controlled and controlling organizations	44	0	0
2.	Other interest expenses	45	0	0
VII.	**Other financial reveneus**	46	**0**	**0**
K.	**Other financial expenses**	47	**0**	**0**
*	**Profit/Loss from financial operatioons (+/-) (r. 31 - 34 + 35 - 38 + 39 - 42 - 43 +46 - 47)**	48	**0**	**0**
**	**Profit/Loss before tax (+/-) (r. 30 + 48)**	49	**0**	**0**
L.	**Income tax (r. 51 + 52)**	50	**0**	**0**
1.	Income tax - due tax	51	0	0
2.	Income tax - tax deferred	52	0	0
**	**Profit/Loss after tax (+/-) (r. 49 - 50)**	53	**0**	**0**
M.	Transfer profit (loss) to partners (+/-)	54	0	0
***	**Profit/Loss of current accounting period (+/-) (r. 53 - 54)**	55	**0**	**0**
*	**Net turnover for the accounting period = I. + II. + III. + IV. + V. + VI. + VII**	56	**0**	**0**