

# How's This Business *Really* Doing?

## - Part Two -

**Objective:** To introduce students to the components of the income statement and allow them to complete an income statement for Pastrami's Pizza Joint.

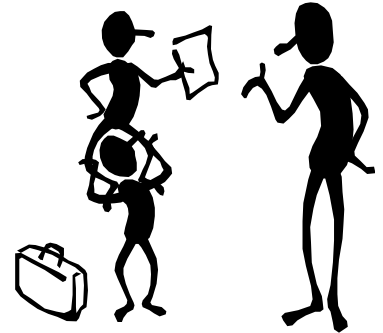
### Materials

- Vocabulary list (included)
- Pen or pencil
- Calculator

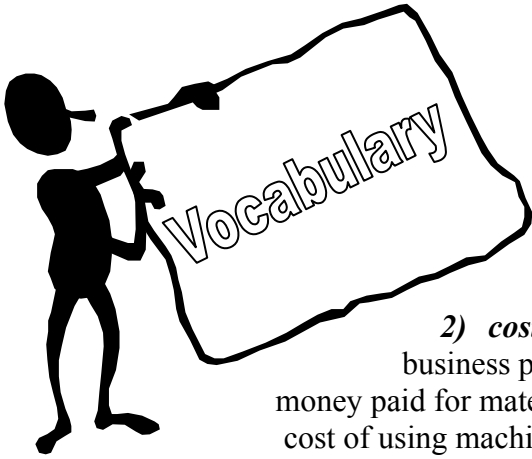
### Overview

*Introduce this scenario to your students:*

Tony needs a loan to open a new restaurant. As Pastrami's accountant, Tony needs your help. Now that you have categorized the various items within Tony's business correctly, you are ready to prepare an income statement. Recall that an income statement is the financial statement that documents the business' total revenue, expenses and income or loss for a given period of time. You need to submit an income statement to the bank to prove Tony's belief that Pastrami's is indeed making money. Before you can help, you need to understand a few new vocabulary words.



Use the attached sheet to complete the student lesson. First, the students will be given various totals and will be asked to connect them with the correct item on the income statement. After placing each total amount correctly on the income statement, the students will need to determine whether or not Pastrami's earned a profit for the previous period. Review the answers together with your students.



- 1) **Revenue (sales):** Revenue is the money that a business receives when a customer buys its product or service. Different forms of revenue include cash, checks and credit card payments from customers.
- 2) **cost of goods sold (COGS):** COGS are the expenses that a business pays to make its products. Examples of COGS include money paid for materials, wages paid to employees who make products and the cost of using machines needed for production.
- 3) **gross margin:** Gross margin is the total amount of money that a business has before paying taxes and other expenses. Gross margin is also the difference between revenue and COGS. \*\*\*Note: a business can have a negative gross margin if it has less revenue than COGS.
- 4) **selling, general and administrative expenses (SG&A):** SG&A includes all expenses that a business pays aside from making its products. Some examples include money paid for advertising, the owner's salary and money paid to the CPA who files the business' tax returns.
- 5) **operating income:** Operating income is the total amount of money a business has after paying its COGS and its SG&A expenses. Operating income can be negative if a business' COGS and SG&A exceed its revenue. Operating income is the difference between gross margin and SG&A.
- 6) **income taxes:** Income taxes are money that a business pays to the state and federal governments from its operating income. Governments determine income tax rates to be a percentage of operating income. If a business has negative operating income, it does not pay income taxes.
- 7) **net income:** Net income is the amount of money that a business has remaining after paying income taxes. Net income is the difference between operating income and income taxes. A business can have a negative net income.