

Income statements

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Read first: [Costs, scale of production and break-even analysis](#), [Cash-flow forecasting and working capital](#)

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What you need to know

By the end of this topic you should be able to:

1. **How a profit is made.** Explain that a business makes a profit when the money it gets from selling its goods or services is more than all its costs, and a loss when it is less.
2. **Why profit matters to private sector businesses.** Explain why profit is important: it rewards the owners for taking a risk and for their enterprise, it is a source of finance the business can reinvest, and it shows how successful the business is.
3. **Profit is not cash.** Explain the difference between profit and cash, and why a business needs both.
4. **The main features of an income statement.** Know what revenue, cost of sales, gross profit, expenses, profit and retained profit mean, and how each line follows from the one before.
5. **Use an income statement to make decisions.** Work out missing figures in a simple income statement, compare statements, and use profit calculations to judge a decision, such as which way to raise profit or whether a forecast profit is realistic.

You will **not** be asked to draw up a full income statement from a list of figures. You will be asked to read one, fill a gap in an extract, and use the figures.

Understand it

How a profit is made

A business sells goods or services and receives **revenue**: the income a business receives from selling its goods or services over a period ($\text{price} \times \text{quantity sold}$). To make and sell those goods it has costs: materials or goods bought for resale, wages, rent, electricity, advertising, interest on loans.

Profit is total revenue minus total costs (gross profit minus expenses). If total costs are bigger than revenue, the business makes a **loss**.

A business can raise its profit in only two ways: **increase revenue** (sell more, or sell at a higher price without losing too many customers) or **reduce costs** (cheaper materials, lower rent, fewer staff). Every way you can think of is one of these, and each has a catch, which is what exam questions ask you to weigh up.

Why profit is important to private sector businesses

Private sector businesses are owned by individuals or shareholders who put their own money in. Profit matters to them for several separate reasons:

- **Reward for risk-taking and enterprise.** The owners risked their savings and used their ideas and effort. Profit is their return; without it they have no reason to carry on, and could put their money somewhere safer instead.
- **A source of finance.** Profit kept in the business (retained profit) can pay for new equipment, a new shop or a new product. It does not have to be repaid and has no interest, unlike a bank loan.
- **Attracting investors and lenders.** Investors buy shares in businesses that make profits, hoping for dividends. Banks are more willing to lend to a business with a record of profit.
- **A measure of success.** Profit shows how well the business, and its managers, are doing, compared with last year, with its objectives or with rivals.
- **Deciding what to keep.** A product or branch that makes no profit may be closed, freeing money for one that does.
- **Long-term survival.** A business that makes losses year after year will eventually close.

Profit does **not** pay this month's wages and bills: cash does. Mark schemes do not accept "to pay day-to-day costs" as a reason why profit is important.

Profit is not cash

Profit is worked out in the income statement over a whole year. A sale counts as revenue when it is made, even if the customer will pay in two months. **Cash** is the money actually in the bank or till, counted only when it comes in or goes out.

So the two can move in opposite directions:

- a business selling on **credit** can show a profit while its bank balance falls, because customers have not paid yet;
- **repaying a loan** or **buying inventory** for next year takes cash out but is not a cost in this year's income statement;
- a **loan received** brings cash in but is not revenue, so it adds nothing to profit.

A business needs **cash in the short term** to pay its bills, or it can be forced to close even while profitable. It needs **profit in the long term** to reward its owners and to grow. The topic "Cash-flow forecasting and working capital" covers cash in detail.

The income statement

An **income statement** is a financial statement that shows a business's revenue and costs over a period, usually a year, and so how much profit (or loss) it made. Its lines always come in this order.

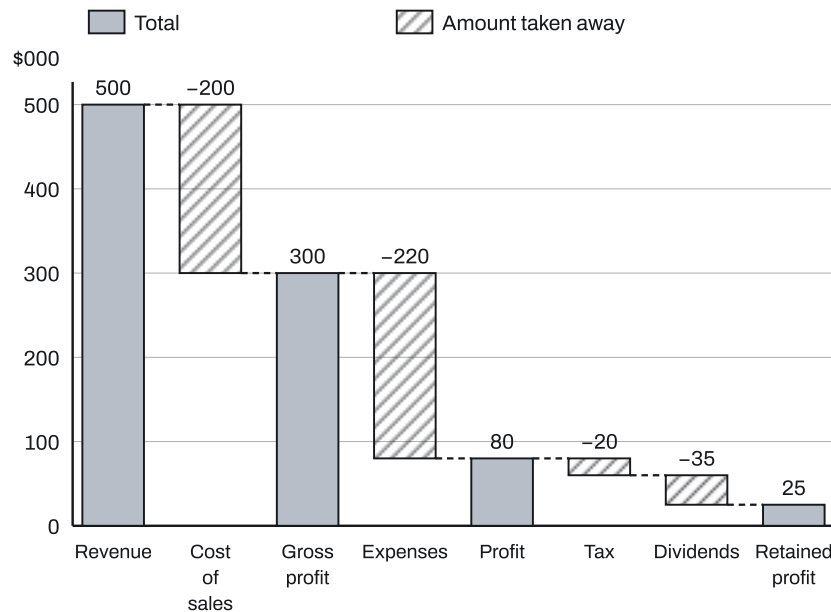
Line	What it is
Revenue	the income a business receives from selling its goods or services over a period (price × quantity sold)
– Cost of sales	the cost of buying or making the goods that were sold in the period
= Gross profit	revenue minus cost of sales
– Expenses	the other costs of running the business that are not part of cost of sales, such as rent, salaries, advertising and interest
= Profit (also called profit for the year)	total revenue minus total costs (gross profit minus expenses)
– Tax and dividends	tax paid on the profit; dividends paid to shareholders of a company
= Retained profit	the profit kept in the business after tax and dividends have been paid

The two kinds of cost are the key to the whole topic:

- **Cost of sales** goes up and down with how much is sold: the stock a shop buys to resell, or the materials a factory uses for the goods it sold. A shoe shop's cost of sales is what it paid for the shoes it sold. Only the goods **sold** count: shoes still on the shelves are not in this year's cost of sales.
- **Expenses** are everything else needed to run the business: rent, rates, electricity and other utilities, insurance, salaries of office and shop staff, advertising, phone and internet, repairs, interest on loans. They do not affect gross profit, only profit.

Worked through for a bookshop that is a private limited company:

Bookshop company, income statement for the year	\$
Revenue (25 000 books at \$20 each)	500 000
Cost of sales (what it paid publishers for those books)	200 000
Gross profit	300 000
Expenses: rent 90 000, salaries 100 000, other 30 000	220 000
Profit	80 000
Tax	20 000
Dividends to shareholders	35 000
Retained profit	25 000



After revenue, each total is the total before it minus what is taken away

Read the chart from left to right: after revenue, each solid grey bar is what is left once the striped bars before it are taken away. A **sole trader** or **partnership** pays no dividends: the owners simply take what they need from the profit, and what they leave in is retained.

Working backwards

Because each line is the one above it minus a cost, any one missing figure can be found from the others:

- $\text{cost of sales} = \text{revenue} - \text{gross profit}$; $\text{revenue} = \text{gross profit} + \text{cost of sales}$;
- $\text{expenses} = \text{gross profit} - \text{profit}$; $\text{gross profit} = \text{profit} + \text{expenses}$;
- $\text{retained profit} = \text{profit} - \text{tax} - \text{dividends}$.

Keep the units of the table. If it says "\$ million" or "\$000", your answer is in millions or thousands too, and you must say so.

Using income statements to make decisions

An income statement is a record of the past, but managers, owners, banks and investors use it to decide what to do next:

- **Did the business make a profit, and how big?** A loss may mean cutting costs, raising prices or closing a product line.
- **Compare with last year.** If revenue rose but profit fell, the costs grew faster: which ones? A falling gross profit points at sales or cost of sales; a rising gross profit with a falling profit points at expenses.
- **Compare with rivals or objectives.** Profit can be turned into ratios (gross profit margin, profit margin), which are covered in "Analysis of accounts".
- **Judge a plan.** A forecast income statement shows the profit a plan should make. Ask whether each line is realistic: will the extra goods all sell at that price? Will costs rise more than expected?

- **Support a loan application.** A bank wants evidence that the business makes enough profit to pay interest.



Gross profit up \$150 000, expenses up \$230 000, profit down \$80 000

The chart compares the hotel's two years from Example 2. Gross profit rose, so the fall in profit must come from expenses, which grew by more than gross profit did.

What changes gross profit, and what changes profit

Change	Gross profit	Profit
Fewer goods sold	falls	falls
Lower selling price (same quantity sold)	falls	falls
Supplier raises the price of goods or materials (higher cost of sales)	falls	falls
Rent, salaries or advertising rise (higher expenses)	no change	falls
More interest on a new loan	no change	falls
Higher tax or dividends	no change	no change (retained profit falls)

Key facts and formulas

This topic has no formula list in the exam. "Learn it" means you must remember it.

Fact or formula	Status
Revenue: the income a business receives from selling its goods or services over a period (price × quantity sold)	Learn it
Revenue = price × quantity sold	Learn it
Cost of sales: the cost of buying or making the goods that were sold in the period	Learn it
Gross profit = revenue – cost of sales	Learn it
Expenses: the other costs of running the business that are not part of cost of sales, such as rent, salaries, advertising and interest	Learn it
Profit: total revenue minus total costs (gross profit minus expenses)	Learn it
Profit = gross profit – expenses	Learn it
Retained profit: the profit kept in the business after tax and dividends have been paid	Learn it
Retained profit = profit – tax – dividends	Learn it
Expenses = gross profit – profit; cost of sales = revenue – gross profit	Learn it
Why profit matters: reward for risk-taking and enterprise, source of finance, attracts investors and lenders, measure of success, decide which products to keep, long-term survival	Learn it
Profit is counted when a sale is made; cash is counted when money comes in or goes out	Learn it

How to do it

We have tagged 16 questions on this topic (2021–2025), on Paper 1 and Paper 2. Four of them have parts of more than one type, so the counts add to 22.

Question type	Questions
Explain why profit is important to a business	6
Define an income-statement term	6
Ways to increase profit, or why gross profit changes	3
Calculate a missing income-statement figure	2

Question type	Questions
Use income-statement figures to make or judge a decision	2
Profit versus cash flow	2
Identify examples of expenses	1

The mark scheme codes are **k** (knowledge: a correct point), **app** (application: a detail from the case), **an** (analysis: a developed consequence) and **eval** (evaluation: a justified judgement).

Part	Marks	What earns them
Paper 1 "Define" (a)	2	a full definition; a partial one gets 1
Paper 1 "Identify" or "Calculate" (b)	2	1 per point or value, or 1 for the method and 1 for the answer; only the first ones asked for are marked
Paper 1 "Outline" (c)	4	each point: k + app
Paper 1 "Explain" (d)	6	each point: k + app + an
Paper 1 (e) "Do you think ...?" or "Explain two ... Which ...?"	6	2 k + 2 an + 2 eval; a general question, so no app
Paper 2 (a)	8	four points × (1 + 1 explanation), or two points developed further, as the question says
Paper 2 (b) "Consider ... Which ...? Justify"	12	levels: applied discussion of every option, then a conclusion that says why the others were rejected

1. Explain why profit is important to a business (6 questions)

- Pick different reasons** (k): reward for risk-taking or enterprise; source of finance (retained profit, no interest, no repayment); attracts investors or lenders; measure of success or of managers' performance; decide whether to keep a product; long-term survival.
- Tie each to the business** (app) when the question names one, using a different case detail for each reason: its product, its number of shops, its profit figure, its plan to grow.
- Develop each** (an) for "Explain": what the profit lets the owners or the business do, or what happens without it. "So it can expand" is too vague on its own; say profit **pays** for the expansion **without borrowing**.
- For "Which is most important?"**, compare the two: say why your choice matters more **and** why the other matters less, or when it would.

Example for a chain of car washes planning a new site: "Profit is a source of finance (k): the \$60 000 profit can pay for the new site's equipment (app) without a bank loan, so there is no interest to pay and nothing to repay (an)."

Variations you will meet:

- **Paper 1 (e), two reasons and the most important (0450/13/O/N/25 Q1, part (e)):** a general question, so there were no application marks, and evaluation needs two reasons discussed first. The mark scheme listed source of funds (no interest), reward for risk-taking, return on the owners' investment, attracting investors, measure of success and long-term survival.
- **Paper 2 (a), explain four reasons (0450/22/M/J/24 Q3, part (a)):** 1 per reason and at most 1 more for explaining it, with no application marks. Reasons credited included rewarding the owners, a source of finance for new assets or products, attracting investors when selling more shares, a measure of success, showing whether a product should be withdrawn, and measuring managers' performance.
- **Paper 2 (b), three given reasons for a house builder (0450/23/O/N/23 Q4, part (b)):** reward for risk-taking, source of finance and measuring success, each discussed in the case; the top band needs a conclusion that also says why the other reasons were rejected.
- **Outline two reasons for a travel business with 37 shops (0450/12/O/N/23 Q4, part (c)):** each reason k + app, such as its \$46 million profit as a measure of success.
- **Explain two reasons for a food retailer that is a private limited company (0450/13/M/J/22 Q2, part (d)):** the report says this was poorly answered. The best answers saw profit as a source of finance the company did not need to repay; a common mistake was jumping to "to expand" without saying how profit helps, and some thought profit pays day-to-day expenses.
- **Outline two reasons for a paint maker whose objective is to grow (0450/11/O/N/21 Q3, part (c)):** the report says "for growth" alone was too imprecise; it needed to say profit is a source of finance for growth. Some lost application marks by not referring to the business. The mark scheme did not credit paying day-to-day expenses.

2. Define an income-statement term (6 questions)

Paper 1 (a), 2 marks: a full definition gets 2, a partial one 1. Learn these word for word in meaning:

- **Profit:** total revenue minus total costs (gross profit minus expenses). The word **total** matters.
- **Revenue:** the income a business receives from selling its goods or services over a period (price × quantity sold).
- **Cost of sales:** the cost of buying or making the goods that were sold in the period.

Variations you will meet:

- **Define "profit" (0450/12/M/J/25 Q2, part (a); 0450/13/M/J/24 Q2, part (a); 0450/11/M/J/21 Q1, part (b)):** "revenue minus costs" was partial (1); 2 marks needed revenue and **total** (or all) costs, or gross profit minus expenses. In 2025, writing "money" instead of revenue or income capped the answer at 1, and in 2021 "money made by the business" was not credited. The 2025 report says some wrote costs rather than total costs, confused profit with revenue or gross profit, or subtracted only expenses from revenue; the 2021 report says some defined gross profit or confused costs with expenses.
- **Define "revenue" (0450/12/O/N/22 Q2, part (a); 0450/13/M/J/22 Q2, part (a)):** "income of the business" alone was partial (1); the full answer says the income comes **from selling** the goods or services (price × quantity sold is also full). Both reports say a common mistake was confusing revenue with profit; the 2022 November report adds that many wrote "sales" without saying it was the **value** of sales.

- **Define "cost of sales" (0450/11/O/N/21 Q4, part (a)):** the cost of producing or buying in the goods sold during the period. Any answer mentioning expenses was not credited. The report says the weakest answers just repeated "the cost of making sales"; some gave the method (opening inventory + purchases – closing inventory), which was credited that time, but the report advises learning the definition instead.

3. Ways to increase profit, or why gross profit changes (3 questions)

Paper 1 (e), 6 marks, "Is ... the best way to increase profit?", a general question with no app:

1. **Develop the way in the question** (k + an): what it does to revenue or costs, and its catch.
2. **Develop one alternative** (k + an), with its own catch.
3. **Decide** (eval × 2): which is better and **why**, saying when the other would win.

Way	How it raises profit	The catch
Raise the selling price	more revenue per item sold; a higher price can suggest better quality	customers may switch to rivals, so fewer sales and lost market share
Cut variable costs (cheaper materials, cheaper supplier)	lower cost of sales, so a higher gross profit on each item	quality may fall, harming reputation and future sales
Cut expenses (cheaper premises, lower rent)	lower expenses, so higher profit at the same gross profit	hard to change quickly; cheaper premises may have fewer customers
Sell more (promotion, new markets, new products)	more revenue	extra advertising or development costs; rivals may respond

Paper 1 (c), 4 marks, reasons gross profit has fallen: gross profit = revenue – cost of sales, so only these can move it: **fewer sales** (lower demand, fewer customers), **a change in selling price**, or **a higher cost of sales** (suppliers charging more). Each reason k + a different case detail (app). Expenses such as rent and salaries cannot change gross profit.

Variations you will meet:

- **Is increasing prices the best way to increase profit? (0450/11/O/N/24 Q3, part (e)):** credited points included more revenue if sales hold up, a quality image, customers switching to rivals, a higher profit margin; alternatives were cheaper raw materials (but lower quality), better products or packaging, new markets (but advertising costs) and lower rent or other expenses.
- **Is reducing variable costs the best way to improve profit? (0450/13/O/N/23 Q2, part (e)):** no need to raise prices, a higher (gross) profit margin and a lower break-even output, against cheaper materials lowering quality; alternatives were higher prices, selling more (with extra promotion costs) and cutting fixed costs such as rent.
- **Two reasons a furniture retailer's gross profit is falling (0450/12/M/J/25 Q2, part (c)):** fewer sales at its 460 shops, a price change, a higher cost of buying its inventory. The report says many used the same application for both reasons, and a common mistake was assuming expenses such as rent and salaries affect gross profit.

4. Calculate a missing income-statement figure (2 questions)

Paper 1 (b), 2 marks.

1. **Write the rule** you need: gross profit = revenue – cost of sales; profit = gross profit – expenses. Rearrange it for the missing line.
2. **Substitute the table's figures** and work it out.
3. **Give the units** of the table (\$ million, \$000) and write the answer on the final-answer line.

For a table in \$ million with gross profit 52 and profit 14: expenses = $52 - 14 = 38$, so **\$38 million**.

Variations you will meet:

- **Expenses from gross profit and profit (0450/13/O/N/25 Q1, part (b)):** gross profit – profit = \$390m – \$90m = \$300 million. Two marks needed the answer in millions; 300 on its own earned 1, and so did the right figure written in the working but not given as the final answer.
- **Revenue and expenses, X and Y (0450/11/O/N/21 Q4, part (b)):** X = gross profit + cost of sales = 720 + 180 = 900 (\$900 000), and Y = gross profit – profit = 720 – 400 = 320 (\$320 000), 1 mark each. The report says weaker answers gave a wide variety of wrong figures.

5. Use income-statement figures to make or judge a decision (2 questions)

Paper 1 (c), 4 marks, how a manager could use the figures: each way k + a case figure (app). Ways: see whether a profit was made and how much; work out the gross profit margin or profit margin; decide whether to continue or stop making a product; track performance over time or against objectives; compare with other businesses; support a loan application.

Paper 2 (b), 12 marks, is a forecast profit realistic? Take each line in turn:

1. **Revenue:** will all the extra output sell? At the same price? How long until the new capacity is used? Will a price cut be needed?
2. **Cost of sales:** should it rise in line with output, or less because of bulk-buying discounts (purchasing economies of scale)?
3. **Expenses:** are any missing or understated, such as interest on a new loan or training for new staff?
4. **Conclude:** will the forecast profit be reached, more or less, and why? Use the case's figures.

Variations you will meet:

- **Two ways the Finance Director of a computer maker could use its figures (0450/13/O/N/25 Q1, part (c)):** showing the \$90m profit, calculating the profit margin or gross profit margin, deciding whether to continue production, tracking performance, comparing with rivals, supporting a loan; "use ratio analysis" was credited only when no specific example was given.
- **Will a paint maker reach its forecast profit after building a second factory? (0450/22/F/M/23 Q4, part (b)):** revenue \$20 million, cost of sales \$6 million and expenses including interest \$12 million, giving a forecast profit of \$2 million. The report calls it the most challenging question on the paper: many assumed that if output doubled then everything else would double; some confused cost of sales with sales revenue,

and some treated expenses as the purchase of raw materials. Better answers asked why each figure might or might not be reached (time to sell the extra output, price elasticity, bulk-buying discounts, interest on the \$50m bank loan), then concluded on the profit.

6. Profit versus cash flow (2 questions)

Paper 1 (e), 6 marks, general: "Is making a profit more important than managing cash flow?"

1. **Profit side** (k + an): a source of finance for growth (say **finance**), a reward for risk-taking that keeps the owners investing, a measure of success, long-term survival.
2. **Cash side** (k + an): pays day-to-day costs and suppliers so production continues; credit sales mean the cash arrives later than the profit; less need for an overdraft and its interest; a business that runs out of cash can be forced to close even when profitable.
3. **Decide** (eval × 2): a usual line is that cash matters more in the short term, because a business can survive a while without profit but not without cash; profit matters more for the long term. Link it to the business the question describes (for example, a growing one).

Variations you will meet:

- **For a business in general** (0450/11/O/N/23 Q3, part (e)): "important for growth" was not credited unless linked to profit as a source of finance or for reinvestment.
- **For a growing business** (0450/13/M/J/21 Q2, part (e)): both evaluation marks needed a link to a growing business; saying profit pays day-to-day costs and giving definitions were not credited. The report calls it the most challenging question on the paper: many treated cash flow and profit as the same thing, said profit pays day-to-day expenses or that a cash-flow forecast records profit, and analysis and evaluation were rarely awarded.

7. Identify examples of expenses (1 question)

Paper 1 (b), 2 marks, first two answers only. Give two **different** running costs: rent, rates, utilities (electricity, water), insurance, interest, advertising, salaries, repairs, phone and internet.

- **Identify two expenses** (0450/12/M/J/25 Q2, part (b)): the report says salaries and rent were typical correct answers, and the most common mistake was giving cost of sales items, notably buying raw materials.

Worked examples

Example 1

Bloom Ltd is a florist. An extract from its income statement for 2025 is shown (\$000).

	\$000
Revenue	640
Cost of sales	X
Gross profit	256
Expenses	166
Profit	Y
Tax	18
Dividends	30
Retained profit	Z

(a) Define "gross profit". [2]

(b) Calculate X, Y and Z. [3]

(a) The profit made from selling goods before expenses are taken away (1): revenue minus cost of sales (1).

(b) $X = \text{revenue} - \text{gross profit} = 640 - 256 = 384$, that is \$384 000 (1). $Y = \text{gross profit} - \text{expenses} = 256 - 166 = 90$, that is \$90 000 (1). $Z = \text{profit} - \text{tax} - \text{dividends} = 90 - 18 - 30 = 42$, that is \$42 000 (1).

Part (a) earns 2 for the full definition; part (b) 1 per value. Total 5 marks. Z depends on Y, so check Y first: a wrong profit spoils the retained profit too.

Example 2

A hotel has 60 rooms. In 2025 it opened a spa, employed 12 more staff and paid for the spa with a bank loan. An extract from its income statements is shown (\$000).

	2024	2025
Revenue	1 200	1 400
Cost of sales	300	350
Gross profit	900	1 050
Expenses	700	930
Profit	200	120

(a) Calculate the change in gross profit and the change in profit from 2024 to 2025. [2]

(b) Explain two possible reasons why the hotel's profit fell even though its gross profit rose. [6]

(a) Gross profit rose by $1050 - 900 = 150$, that is \$150 000 (1). Profit fell by $200 - 120 = 80$, that is \$80 000 (1).

(b) Reason 1: higher salaries (k). The hotel employed 12 more staff for the spa (app). Salaries are an expense, not part of cost of sales, so they leave gross profit unchanged but come out before profit; expenses rose by $930 - 700 = 230$ thousand dollars, more than the \$150 000 rise in gross profit, so profit fell (an).

Reason 2: interest on the loan (k). The spa was paid for with a bank loan (app), so the hotel now pays interest every year. Interest is an expense, so more of the gross profit is used up before any profit is left, even though the spa brings in more revenue (an).

Part (a) earns 1 per change (2); part (b) earns k + app + an for each reason ($3 + 3 = 6$). Total 8 marks. Other creditable reasons would include advertising the new spa or the cost of running it (electricity, repairs), each with a case detail. The second diagram in "Understand it" shows these figures.

Example 3

Mei runs a café as a sole trader. Last year her income statement showed revenue of \$300 000, cost of sales of \$120 000, gross profit of \$180 000, expenses of \$150 000 (rent \$60 000, wages \$70 000, other \$20 000) and a profit of \$30 000. She is considering three ways to raise her profit next year:

- **A:** raise all prices by 10%; she expects to sell 5% fewer meals.
- **B:** change to a cheaper food supplier, cutting cost of sales by 15%; she expects sales to stay the same.
- **C:** move to smaller premises with rent of \$36 000; she expects 10% fewer customers because there are fewer seats.

Assume cost of sales changes in proportion to the number of meals sold, and that all other expenses stay the same.

(a) Calculate the forecast profit for each option. [6]

(b) Which option should Mei choose? Justify your answer. [6]

(a) Option A. Revenue = $300\,000 \times 1.10 \times 0.95 = 313\,500$. Cost of sales = $120\,000 \times 0.95 = 114\,000$, so gross profit = $313\,500 - 114\,000 = 199\,500$ dollars (1). Profit = $199\,500 - 150\,000 = 49\,500$ dollars (1).

Option B. Cost of sales = $120\,000 \times 0.85 = 102\,000$, so gross profit = $300\,000 - 102\,000 = 198\,000$ dollars (1). Profit = $198\,000 - 150\,000 = 48\,000$ dollars (1).

Option C. Revenue = $300\,000 \times 0.90 = 270\,000$ and cost of sales = $120\,000 \times 0.90 = 108\,000$, so gross profit = $162\,000$. Expenses = $150\,000 - 60\,000 + 36\,000 = 126\,000$ dollars (1). Profit = $162\,000 - 126\,000 = 36\,000$ dollars (1).

(b) Raising prices gives the highest forecast profit, \$49 500, because each meal earns more (k). But the forecast depends on losing only 5% of meals: if regular customers moved to rival cafés and she sold 15% fewer meals, revenue would be $300\,000 \times 1.10 \times 0.85 = 280\,500$, cost of sales 102 000, and profit only $280\,500 - 102\,000 - 150\,000 = 28\,500$ dollars, less than now (an).

A cheaper supplier gives almost as much, \$48 000, without asking customers to pay more (k). The risk is that cheaper ingredients lower the quality of her meals, which could cost her customers and her reputation over time (an).

Mei should choose B, because it gives nearly the same profit as A (only \$1500 less) while her prices stay the same, so the forecast does not depend on guessing how customers react to a price rise (eval). She can reduce B's quality risk by testing the new supplier's food before switching, whereas once customers have gone to rivals after a price rise, they may not come back; C should be rejected, as it adds only \$6000 to profit and loses a tenth of her customers (eval).

Part (a) earns 2 per option (6). Part (b) is marked like a Paper 1 (e): 2 k + 2 an + 2 eval = 6. Total 12 marks. Choosing A could also earn full marks if justified, for example by arguing her café has loyal customers and few rivals nearby.

Example 4

A sole trader made a loss last year. Explain two problems this could cause for the business. Which problem is likely to be the most serious? Justify your answer. [6]

There is no retained profit to reinvest (k). If the owner wants to replace equipment or open a second outlet, the money must come from a loan or from the owner's savings, so the business takes on interest payments, or the plan is put off (an).

The owner receives no reward for the risk taken (k). The owner put savings into the business and worked long hours for nothing in return, so may decide to close it and put the money and effort into something safer, such as a job or a savings account (an).

Losing the owner's reward is likely to be the most serious problem, because a sole trader makes every decision alone, and if the owner loses the will to carry on the business closes, whatever its plans (eval). The lack of retained profit only delays growth, and can be covered by borrowing for a while if the loss is a one-off, for example in the first year of trading (eval).

This is a general question, so there are no marks for application: 2 k + 2 an + 2 eval = 6.

Common mistakes

- **Leaving "total" out of the profit definition.** "Revenue minus costs" earns 1; "total revenue minus total costs" earns 2. Writing "money" instead of revenue caps the answer at 1, and "money made by the business" earns nothing. Don't subtract only expenses from revenue.
- **Defining the wrong term.** Reports in 2021, 2022 and 2025 say candidates confused profit with revenue or with gross profit. Revenue is income from selling, before any cost is taken away.
- **"Sales" for revenue.** Revenue is the **value** of sales (price × quantity), not the number sold.
- **Defining cost of sales as "the cost of making sales"**, or mentioning expenses in it. It is the cost of buying or making the goods that were sold.

- **Putting cost of sales items in expenses**, such as buying raw materials or stock. The 2025 report says this was the most common mistake when asked for expenses.
- **Saying rent or salaries change gross profit**. Expenses come after gross profit; they change profit only.
- **Leaving out the units**. \$300 is not \$300 million. Copy the table's units into the final answer.
- **"Profit is important for growth" or "to expand"** without saying profit is a **source of finance** for it. Reports in 2021 and 2022 name this.
- **Saying profit pays day-to-day costs**. That is the job of cash. Mark schemes refuse it as a reason profit is important.
- **Treating profit and cash as the same thing**, or saying a cash-flow forecast shows profit. A credit sale is profit now and cash later.
- **Defining terms the question did not ask for** in a 6-mark evaluation; it earns nothing.
- **Assuming everything doubles when output doubles**. The 2023 report says this was common in the forecast question: prices may fall, bulk buying may cut unit costs, new loans add interest.
- **Using the same case detail twice**. Each reason needs its own application; the 2025 report says many lost marks this way.
- **Not referring to the business** in an Outline or Explain part, which loses the application marks.

How to get the marks

- **Define** (2 marks): the full idea. Profit needs revenue **and total costs**; revenue needs income **from selling** goods or services; cost of sales needs the goods **sold** in the period.
- **Identify** (1 each): short, different answers. Only the first two (or four) are marked, so don't list extras and hope.
- **Calculate** (2 marks): write the rule, the figures, then the answer with units on the final-answer line. A correct answer with no working still gets 2, but working rescues 1 mark if the answer is wrong.
- **Outline** (k + app): a correct point and a detail from this case that makes sense with it, such as the product, the number of shops or a figure from the table. Analysis is not needed.
- **Explain** (k + app + an): add the consequence, using words like "so" or "which means".
- **Paper 1 (e)** (6 marks): general, so no case details are needed. Develop two points (often the option in the question and one alternative), then a decision that says **why** one is better and why the other is weaker or when it would win. Don't just repeat earlier points as your conclusion.
- **Paper 2 (a)** (8 marks): if the question asks for four reasons, give four different ones, each with one sentence of explanation.
- **Paper 2 (b)** (12 marks): discuss **every** option or forecast line in the case, using its figures; then a conclusion that chooses and says why the others were rejected.

Quick check

1. For a shoe shop, say whether each item is part of cost of sales, an expense, or neither: (a) shoes bought from the maker that were sold this year; (b) shop rent; (c) sales assistants' wages; (d) advertising; (e) interest on a bank loan; (f) dividends paid to shareholders.
2. A phone repair business has revenue of \$210 000, cost of sales (spare parts) of \$84 000 and expenses of \$95 000. (a) Calculate its gross profit and profit. (b) Its rent then rises by \$12 000 a year, with nothing else changing. Calculate the new gross profit and profit. (c) Instead, the price of its spare parts rises by 10%, with nothing else changing. Calculate the new gross profit and profit.
3. A student writes: "Profit is the money a business makes." Explain why this would earn no marks, and write a full definition.
4. A company makes a profit of \$900 000. It pays tax of \$180 000 and dividends of \$400 000. Calculate its retained profit and state one way it could use it.
5. A bakery's income statement shows a profit of \$40 000 for the year, but its bank balance fell over the same year. Give two possible reasons.

Answers

1. (a) Cost of sales. (b) Expense. (c) Expense. (d) Expense. (e) Expense. (f) Neither: dividends are paid out of profit, after it has been worked out.
2. (a) $\text{Gross profit} = 210\,000 - 84\,000 = 126\,000$ dollars; $\text{profit} = 126\,000 - 95\,000 = 31\,000$ dollars. (b) Rent is an expense, so gross profit stays \$126 000 and profit falls to $31\,000 - 12\,000 = 19\,000$ dollars. (c) $\text{Cost of sales} = 84\,000 \times 1.1 = 92\,400$, so $\text{gross profit} = 210\,000 - 92\,400 = 117\,600$ dollars and $\text{profit} = 117\,600 - 95\,000 = 22\,600$ dollars.
3. It says "money" instead of revenue and leaves out costs, so it does not say how profit is worked out. Full definition: total revenue minus total costs (gross profit minus expenses).
4. $\text{Retained profit} = 900\,000 - 180\,000 - 400\,000 = 320\,000$ dollars. It could pay for new machinery or a new branch without borrowing, so there is no interest to pay.
5. Any two: customers bought on credit and have not paid yet, so the sales count in profit but the cash has not arrived; it repaid part of a loan, which takes cash out but is not an expense; it bought a large stock of flour for next year, which is cash out but not yet cost of sales.

Past questions to try

- **0450/11/O/N/21 Q4:** parts (a) and (b), defining cost of sales and finding revenue and expenses in an extract.
- **0450/23/O/N/23 Q4:** part (b), weighing three reasons why profit matters to a house builder.
- **0450/22/F/M/23 Q4:** part (b), judging whether forecast revenue, cost of sales and expenses will give the forecast profit.
- **0450/11/O/N/23 Q3:** part (e), whether making a profit matters more than managing cash flow.