

SL IB Business Management


Your notes

3.4 Final Accounts

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- * Statement of Financial Position (Balance Sheet)
- * Statement of Profit or Loss



Your notes

Statement of Financial Position (Balance Sheet)

The Statement of Financial Position

- The Statement of Financial Position shows the **financial structure** of a business at a specific point in time
- It identifies a businesses assets and liabilities and specifies the **capital** (equity) used to fund the business
- The Statement of Financial Position is also known as the **Balance Sheet**
 - It is called the balance sheet as the **net assets should equal the total equity**

Diagram: Statement of Financial Position

STATEMENT OF FINANCIAL POSITION: PACKER SPORTS LIMITED AS AT 31st DECEMBER 2022

| | \$ | \$ | |
|--------------------------------|---------------|---------------|--|
| NON-CURRENT ASSETS | | | NON-CURRENT ASSETS ARE ITEMS THAT ARE OWNED BY THE BUSINESS IN THE LONG-TERM. EXAMPLES INCLUDE MACHINERY, BUILDINGS & VEHICLES |
| PROPERTY, PLANT & EQUIPMENT | 22.700 | | |
| ACCUMULATED DEPRECIATION | 1.550 | | |
| NON-CURRENT ASSETS | <u>24.250</u> | | |
| CURRENT ASSETS | | | CURRENT ASSETS ARE ITEMS THAT ARE CONVERTED INTO CASH QUICKLY – USUALLY WITHIN 12 MONTHS. THE MAIN TYPES OF CURRENT ASSETS ARE CASH, DEBTORS & STOCK |
| CASH | 4.665 | | |
| DEBTORS | 2.630 | | |
| STOCK | 8.250 | | |
| CURRENT ASSETS | <u>15.545</u> | | |
| TOTAL ASSETS | | <u>39.795</u> | TOTAL ASSETS = NON-CURRENT ASSETS + CURRENT ASSETS |
| CURRENT LIABILITIES | | | CURRENT LIABILITIES ARE MONIES OWED BY A BUSINESS THAT WILL FALL DUE WITHIN 12 MONTHS. THE MAIN TYPES OF CURRENT LIABILITIES ARE BANK OVEDRAFTS & CREDITORS |
| BANK OVERDRAFT | 540 | | |
| TRADE CREDITORS | 3.960 | | |
| OTHER SHORT-TERM LOANS | 560 | | |
| CURRENT LIABILITIES | <u>5.060</u> | | |
| NON-CURRENT LIABILITIES | | | NON-CURRENT LIABILITIES ARE MONIES OWED THAT DO NOT NEED TO BE PAID BACK FOR AT LEAST 12 MONTHS. EXAMPLES INCLUDE BANK LOANS & MORTGAGES |
| LONG-TERM BORROWING | 20.000 | | |
| NON-CURRENT LIABILITIES | <u>20.000</u> | | |
| TOTAL LIABILITIES | | <u>25.060</u> | TOTAL LIABILITIES = CURRENT LIABILITIES + NON-CURRENT LIABILITIES |
| NET ASSETS | | 14.735 | NET ASSETS = TOTAL ASSETS – TOTAL LIABILITIES |
| EQUITY | | | EQUITY SHOWS HOW THE NET ASSETS OF A BUSINESS ARE FUNDED. TOTAL EQUITY IS ALSO KNOWN AS CAPITAL EMPLOYED |
| SHARE CAPITAL | 1.500 | | |
| RETAINED EARNINGS | 13.235 | | |
| TOTAL EQUITY | <u>14.735</u> | | |

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An example of a Statement of Financial Position for Packer Sports Ltd



Your notes

Calculating the total assets

- On the stated date *Packer Sports Ltd* owned non-current assets worth \$24,250
 - It owns property, plant and machinery that is valued at \$22,700
 - These assets have been depreciated by \$1,550
- The value of its current assets was \$15,545, comprised of cash, debtors and stock
- Total assets were therefore
$$\$ 24,250 + \$ 15,545 = \$ 39,795$$

Calculating total liabilities

- On the stated date *Packer Sports Ltd* had current liabilities worth \$5,060, comprised of a bank overdraft, trade creditors and other short-term loans
- The value of its long-term liabilities were \$20,000
- Total liabilities were therefore
$$\$ 5,060 + \$ 20,000 = \$ 25,060$$

Calculating the net assets

- *Packer Sports Limited's* net assets were therefore
$$\$ 39,795 - \$ 25,060 = \$ 14,735$$

Calculating total equity

- Net assets of \$14,735 were funded through share capital of \$1,500 and retained earnings of \$13,235

Examiner Tip

In Paper 2 you may be asked to construct a balance sheet from given data.

To achieve full marks you must **follow the format illustrated above** and you should check that you have

1. Included all of the relevant **headings** in the correct order

- Non-current assets
- Current assets
- Total assets
- Current liabilities
- Non-current liabilities
- Total liabilities
- Net assets
- Equity

2. **Correctly classified** items under each heading

- For example, you need to ensure that you have correctly allocated cash, stock and debtors as current assets, and creditors and bank overdrafts as current liabilities

3. **Omitted irrelevant figures** that belong to the profit and loss account

- For example, costs and revenues are not included in the balance sheet



Your notes



Your notes

How Stakeholders use the Statement of Financial Position

- Stakeholders will use the Statement of Financial Position **alongside the Statement of Profit or Loss** to perform **ratio analysis** and **compare performance over time or with other businesses**

How Stakeholders use the Statement of Financial Position

| Stakeholder | Interest in the Balance Sheet |
|-----------------------|--|
| Shareholders | <ul style="list-style-type: none"> Used to identify the asset structure of the business and how their investment has been put to use Used to calculate the working capital of the business and determine its solvency Used to determine the rough value of a business which helps a judgement on whether their investment is growing |
| Managers & Directors | <ul style="list-style-type: none"> Used to identify the financial position of the business at a given point in time Useful to assess the working capital position of the business and determine if there are enough liquid current assets to pay its bills Provides information on the capital structure of the business which helps guide decisions on whether to raise further funds through borrowing or via other means (e.g. share issue) |
| Suppliers & Creditors | <ul style="list-style-type: none"> Used to judge the solvency of the business to determine the risk when offering firms trade credit Businesses with low levels of working capital may find it difficult to pay short-term debts and so suppliers may offer trade credit, but with stricter terms |
| Employees | <ul style="list-style-type: none"> Used to answer questions such as: <ul style="list-style-type: none"> Is the business financially stable or are jobs at risk? Has the businesses performance improved or worsened? What is the business spending its money on? How much are senior executives paid? How much tax is the business paying? |

 **Examiner Tip**

Information found in the Statement of Profit or Loss and Statement of Financial Position can be used in a range of answers.

For example, if you are answering a question about sources of finance you might be able to use the capital structure of the business to recommend whether a business should borrow or look at an alternative source.

If a business already relies heavily on borrowing, it may be more sensible to recommend seeking to raise more share capital.



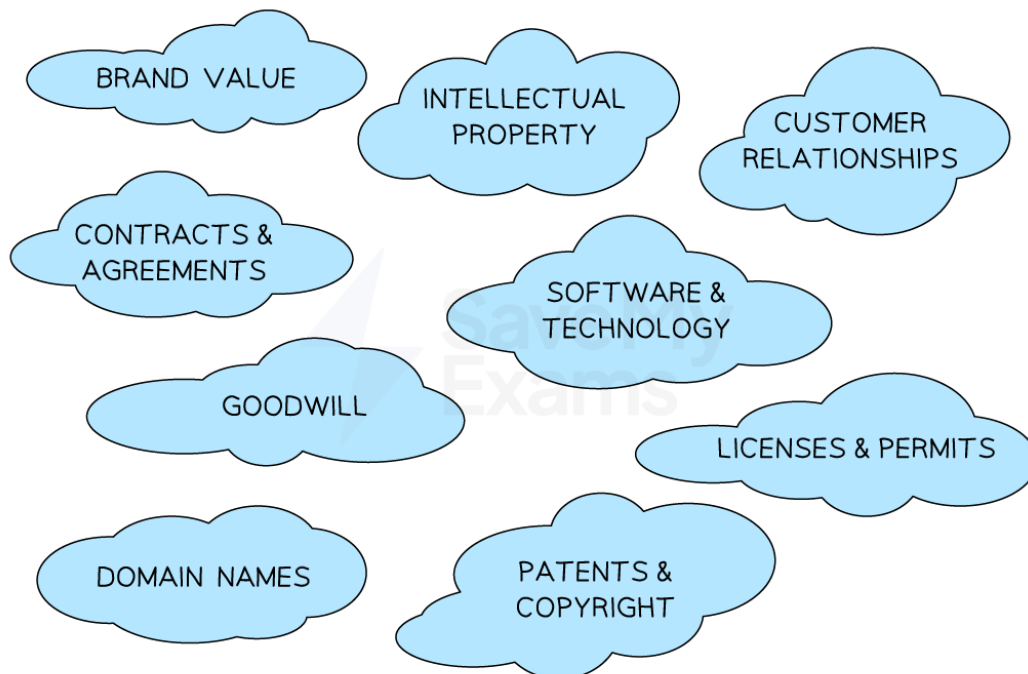
Your notes



Your notes

Different types of Intangible Assets

- Intangible assets are **non-physical assets** that cannot physically be held but **hold value for a business**
- Businesses need to **account for intangible assets** in their annual reports as it adds to the value of the business



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Examples of intangible assets

- Intellectual property**
 - This includes patents, trademarks, patents and copyrights which protect unique ideas, inventions, artistic works, and brand names
- Brand value**
 - The reputation and recognition associated with a brand has a value
 - It includes the **brand name, logo, slogans, and customer loyalty to the brand**
- Customer relationships**
 - Long-term relationships with customers including customer lists, contracts, and customer loyalty programs
 - These relationships can provide **recurring revenue and a competitive advantage**
- Software and technology**

- **Proprietary software**, computer programs and technology systems that are crucial to a business's operations or provide a competitive advantage
- **Contracts and agreements**
 - Long-term contracts, lease agreements, licensing agreements and franchise agreements that have value and **contribute to future cash flows**
 - **Agreements with employees or business partners** that restrict them from competing with the company for a specific period which protect the company's interests and market position (non compete contract)
- **Goodwill**
 - The value of a **company's reputation**, customer base and brand
 - Goodwill often represents the premium paid when one business takes over or merges with another business
- **Domain names and other online assets**
 - Valuable domain names, websites, social media accounts and online platforms **that drive customer engagement**, traffic, and online presence
- **Licenses and permits**
 - Licenses, permits, and regulatory approvals that **grant exclusive rights or access to certain markets** or resources, often issued by governments



Your notes

Statement of Profit or Loss



Your notes

An Introduction to Financial Accounts

- Financial accounts detail the **financial performance** of a business over a trading period
- The two main financial accounts are
 - The **Statement of Profit or Loss**
 - The **Statement of Financial Position**
- Public Limited Companies (PLCs) have to produce financial reports annually
 - Annual reports must comply with International Financial Reporting Standards (IFRS) allowing straightforward comparisons of performance **over time** and **between companies**

Examiner Tip

The two main financial accounts sometimes go by different titles, though the **titles given above are those that will be given in your examination.**

- The **Statement of Profit or Loss** is also widely known as the **Profit and Loss Account** or an **Income Statement**
- The **Statement of Financial Position** is often referred to as the **Balance Sheet.**



Your notes

The Statement of Profit or Loss

- The **Statement of Profit or Loss** shows the **income** and **expenditure** of a business over a period of time - usually a year - and calculates the amount of **profit** made
- It is divided into three parts
 - The **trading account**
 - The **profit and loss account**
 - The **appropriation account**

STATEMENT OF PROFIT OR LOSS: HEAD TO TOE WELLBEING LIMITED FOR THE YEAR ENDED 31st DECEMBER 2022

| | \$m | |
|---|---------|-----------------------------|
| SALES REVENUE | 124.65 | THE TRADING ACCOUNT |
| COST OF SALES | (18.92) | |
| GROSS PROFIT | 105.73 | |
| EXPENSES | (39.87) | THE PROFIT AND LOSS ACCOUNT |
| PROFIT BEFORE INTEREST & TAX | 65.86 | |
| INTEREST | (2.01) | |
| PROFIT BEFORE TAX | 63.85 | |
| TAX | (5.47) | |
| PROFIT FOR PERIOD | 58.38 | THE APPROPRIATIONS ACCOUNT |
| DIVIDENDS | (13.75) | |
| RETAINED PROFIT | 44.63 | |

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An example of a Statement of Profit or Loss for Head to Toe Wellbeing Ltd

The Trading Account

- The **trading account** is where the cost of sales is deducted from sales revenue to calculate the **gross profit**
 - In 2022 Head to Toe Wellbeing Limited's sales revenue was \$124.65m and its cost of sales were \$18.92m
 - The **gross profit** for the period was therefore

$$\$124.65\text{m} - \$18.92\text{m} = \$105.73\text{m}$$

The Profit & Loss Account

- The **profit and loss account** deducts a series of expenses to determine the **profit for the period**
 - In 2022 gross profit was \$105.73m and expenses were \$39.87m
 - The **profit before interest and tax** was therefore
$$\$105.73\text{m} - \$39.87\text{m} = \$65.86\text{m}$$
 - The business also paid \$2.01m interest
 - The **profit before tax** was therefore
$$\$65.86\text{m} - \$2.01\text{m} = \$63.85\text{m}$$
 - The business also paid \$5.47m tax
 - The **profit for the period** was therefore
$$\$63.85\text{m} - \$5.47\text{m} = \$58.38\text{m}$$

The Appropriations Account

- The **appropriations account** shows how profits are distributed for the period
 - In 2022 Head to Toe Wellbeing Limited distributed \$13.75m to shareholders as dividends
 - \$44.63m was therefore **retained as profit**

Examiner Tip

For **non-profit organisations** some amendments are made to the standard layout of the Statement of Profit or Loss

1. The word 'profit' is replaced by '**surplus**'
2. Non-profit organisations are usually **exempted from the payment of corporation tax** so this is not normally recorded or is recorded as a 0 value



Your notes



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How Stakeholders use the Profit & Loss Account

- The Statement of Profit or Loss is a very useful source of information for stakeholders to **evaluate the performance of a business**

How Stakeholders use The Statement of Profit or Loss

| Shareholders | Employees |
|---|--|
| <ul style="list-style-type: none"> ▪ Interested in revenues, costs and profits earned, business growth and dividend payments ▪ Shareholders may use ratio analysis tools to identify profit margins and returns on investment | <ul style="list-style-type: none"> ▪ Interested in profits earned and the potential for wage increases and job stability ▪ Employees may look at notes to the accounts that detail levels of executive pay |
| Managers & Directors | Suppliers |
| <ul style="list-style-type: none"> ▪ Interested in key performance data such as an improvement in sales revenue and net profit <ul style="list-style-type: none"> ▪ This data can aid business decision making ▪ Financial data can provide evidence to support the payment of bonuses | <ul style="list-style-type: none"> ▪ Interested in the continued success of the company they are supplying and this information is also used by suppliers to determine the level of trade credit offered to businesses |
| Government | Local Community |
| <ul style="list-style-type: none"> ▪ Used to determine how much tax is payable ▪ The Statement of Profit or Loss can provide an insight into whether the business will continue to provide employment, place orders with other businesses and supply goods and services to the public sector | <ul style="list-style-type: none"> ▪ Interested in the stability of the business and what this may mean for jobs in the community ▪ Another interest is to see if the firm is generating enough profit to perhaps approach them for local sponsorship |