

# DP IB Business Management: SL



Your notes

## 3.4 Final Accounts

### Contents

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



Your notes

## Statement of Profit or Loss

# 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 Tips and Tricks

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**.

## 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**

### Diagram: the statement of profit or loss



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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)	
<b>GROSS PROFIT</b>	105.73	
EXPENSES	(39.87)	THE PROFIT AND LOSS ACCOUNT
<b>PROFIT BEFORE INTEREST &amp; TAX</b>	65.86	
INTEREST	(2.01)	
<b>PROFIT BEFORE TAX</b>	63.85	
TAX	(5.47)	THE APPROPRIATIONS ACCOUNT
<b>PROFIT FOR PERIOD</b>	58.38	
DIVIDENDS	(13.75)	
<b>RETAINED PROFIT</b>	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

$$\$105.73\text{m} - \$39.87\text{m} = \$65.86\text{m}$$



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- 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 Tips and Tricks

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

## 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"> <li>▪ Shareholders are interested in revenues, costs and profits earned, business growth and <b>dividend</b> payments</li> <li>▪ Shareholders may use <b>ratio analysis</b> tools to identify profit margins and returns on investment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Employees are interested in profits earned and the <b>potential for wage increases</b> and job stability</li> <li>▪ Employees may look at <b>notes to the accounts</b> that detail levels of executive pay</li> </ul>



Your notes

Managers & Directors	Suppliers
<ul style="list-style-type: none"> <li>▪ Managers are interested in key performance data <b>such as an improvement in sales revenue and net profit</b> <ul style="list-style-type: none"> <li>▪ This data can aid business decision making</li> <li>▪ Financial data can provide evidence to support the payment of bonuses</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Suppliers are interested in the <b>continued success of the company</b> they are supplying and this information is also used by suppliers to determine the level of <b>trade credit</b> offered to businesses</li> </ul>
Government	Local Community
<ul style="list-style-type: none"> <li>▪ Governments need to determine how much <b>tax</b> is payable</li> <li>▪ The Statement of Profit or Loss can provide an insight into whether the business will <b>continue to provide employment</b>, place orders with other businesses and supply goods and services to the public sector</li> </ul>	<ul style="list-style-type: none"> <li>▪ The local community is interested in the <b>stability</b> of the business and what this may mean for jobs in the community</li> <li>▪ Another interest is to see if the firm is generating enough profit to perhaps approach them for local sponsorship</li> </ul>



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## 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 **net assets should equal the total equity**

### Diagram: the statement of financial position

STATEMENT OF FINANCIAL POSITION: PACKER SPORTS LIMITED AS AT 31st DECEMBER 2022		
	\$	\$
<b>NON-CURRENT ASSETS</b>		
PROPERTY, PLANT & EQUIPMENT	22.700	
ACCUMULATED DEPRECIATION	1.550	
NON-CURRENT ASSETS		<u>24.250</u>
<b>CURRENT ASSETS</b>		
CASH	4.665	
DEBTORS	2.630	
STOCK	8.250	
CURRENT ASSETS		<u>15.545</u>
<b>TOTAL ASSETS</b>		<u>39.795</u>
<b>CURRENT LIABILITIES</b>		
BANK OVERDRAFT	540	
TRADE CREDITORS	3.960	
OTHER SHORT-TERM LOANS	560	
CURRENT LIABILITIES		<u>5.060</u>
<b>TOTAL LIABILITIES</b>		<u>20.000</u>
LONG-TERM BORROWING	20.000	
NON-CURRENT LIABILITIES		<u>20.000</u>
<b>TOTAL LIABILITIES</b>		<u>25.060</u>
<b>NET ASSETS</b>		14.735
<b>EQUITY</b>		
SHARE CAPITAL	1.500	
RETAINED EARNINGS	13.235	
TOTAL EQUITY		14.735

**NON-CURRENT ASSETS ARE ITEMS THAT ARE OWNED BY THE BUSINESS IN THE LONG-TERM. EXAMPLES INCLUDE MACHINERY, BUILDINGS & VEHICLES**

**CURRENT ASSETS ARE ITEMS THAT ARE CONVERTED INTO CASH QUICKLY – USUALLY WITHIN 12 MONTHS. THE MAIN TYPES OF CURRENT ASSETS ARE CASH, DEBTORS & STOCK**

**TOTAL ASSETS = NON-CURRENT ASSETS + CURRENT ASSETS**

**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**

**NON-CURRENT LIABILITIES ARE MONIES OWED THAT DO NOT NEED TO BE PAID BACK FOR AT LEAST 12 MONTHS. EXAMPLES INCLUDE BANK LOANS & MORTGAGES**

**TOTAL LIABILITIES = CURRENT LIABILITIES + NON-CURRENT LIABILITIES**

**NET ASSETS = TOTAL ASSETS – TOTAL LIABILITIES**

**EQUITY SHOWS HOW THE NET ASSETS OF A BUSINESS ARE FUNDED. TOTAL EQUITY IS ALSO KNOWN AS CAPITAL EMPLOYED**

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



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## 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 Tips and Tricks

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



Your notes

- 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

## 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
<b>Shareholders</b>	<ul style="list-style-type: none"> <li>▪ Used to identify the <b>asset structure</b> of the business and how their investment has been put to use</li> <li>▪ Used to calculate the <b>working capital</b> of the business and determine its solvency</li> <li>▪ Used to determine the rough <b>value of a business</b> which helps a judgement on <b>whether their investment is growing</b></li> </ul>
<b>Managers &amp; Directors</b>	<ul style="list-style-type: none"> <li>▪ Used to identify the <b>financial position</b> of the business at a given point in time</li> <li>▪ Useful to assess the <b>working capital</b> position of the business and determine if there are <b>enough liquid current assets to pay its bills</b></li> <li>▪ Provides information on the <b>capital structure</b> of the business which helps guide decisions on whether to raise further funds through <b>borrowing or via other means</b> (e.g. share issue)</li> </ul>
<b>Suppliers and Creditors</b>	<ul style="list-style-type: none"> <li>▪ Used to judge the <b>solvency</b> of the business to <b>determine the risk</b> when offering firms <b>trade credit</b></li> </ul>





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	<ul style="list-style-type: none"><li>▪ Businesses with <b>low levels of working capital</b> may find it difficult to pay short-term debts and so suppliers <b>may offer trade credit, but with stricter terms</b></li></ul>
<b>Employees</b>	<ul style="list-style-type: none"><li>▪ Used to answer questions such as:<ul style="list-style-type: none"><li>▪ Is the business financially stable or are jobs at risk?</li><li>▪ Has the businesses performance improved or worsened?</li><li>▪ What is the business spending its money on?</li><li>▪ How much are senior executives paid?</li><li>▪ How much tax is the business paying?</li></ul></li></ul>



### Examiner Tips and Tricks

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.

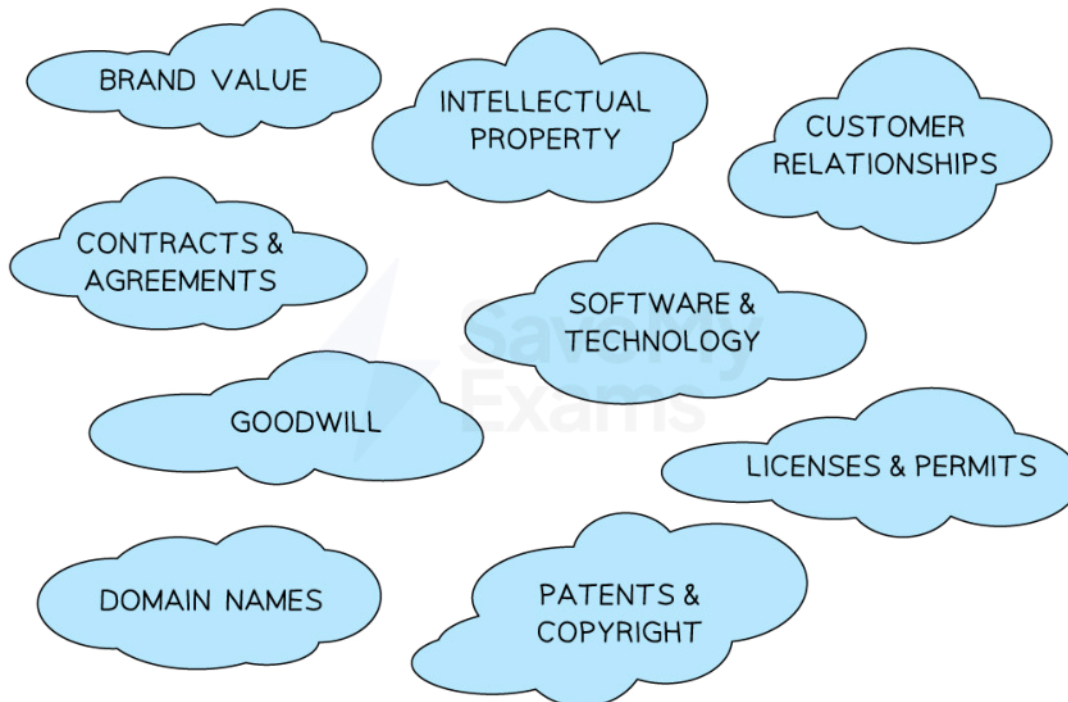
## Different types of Intangible Assets

- 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

### Diagram: intangible assets



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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



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