

3.4 Final accounts

Final accounts: Statement of profit or loss

The statement of profit or loss, also known as an income statement, shows the profit or loss that is generated by a business from its trading activities. The statement of profit or loss is constructed differently depending on whether the business is a for-profit enterprise or a non-profit enterprise. Both are outlined below.



Figure 1. Statement of profit or loss.

Credit: maybefalse, Getty Images

Statement of profit or loss for a for-profit enterprise

In this and the following sections, a fictitious business is used as an example. The business is called Pap-Pie Ltd and it sells pap pies (or pap terts) – South African pies made from corn flour. The financial figures used for Pap-Pie Ltd are from the year ending 31 December 2021. The full statement of profit or loss is shown in **Table 1**, and it is divided by colour into three sections that relate to the three steps needed to construct the statement.

- **Step 1:** Calculate gross profit (green section).

- **Step 2:** Calculate the profit or loss (yellow section).
- **Step 3:** List how the profits are distributed (orange section).

Table 1. Statement of profit or loss for Pap-Pie Ltd for the year ending 31 December 2021.

	\$	\$
Sales revenue		1000000
Cost of sales		(450000)
Gross profit		550000
Administrative staff salaries	20000	
Lighting	30000	
Advertising	60000	
Transport	90000	
Rent	40000	
Expenses		(240000)
Profit before interest and tax		310000
Interest		(10000)
Profit before tax		300000
Tax (15%)		(45000)

	\$	\$
Profit for the period		255 000
Dividends		150 000
Retained profit		105 000

Step 1: Calculate the gross profit

The first section of the statement of profit or loss is used to calculate the gross profit of the business. The gross profit is the sales revenue minus the cost of sales.

Gross profit = sales revenue – cost of sales

The cost of sales includes the direct costs associated with producing the product that has been sold. In the Pap-Pie Ltd example, this could include the corn flour and other raw materials used to make the pies or the labour expenses that can be directly connected to making the pies. This figure of 450 000 is shown in parentheses in **Table 2** to indicate that it should be subtracted from the sales revenue; in effect it is a negative value. The information on the cost of sales and the gross profit is represented in the statement of profit or loss shown in **Table 2**.

Table 2. Statement of profit or loss for Pap-Pie Ltd for the year ending 31 December 2021 (first section).

	\$	\$
Sales revenue		1 000 000
Cost of sales		(450 000)
Gross profit		550 000

Step 2: Calculate the profit or loss

The second section of the statement of profit or loss takes the gross profit amount and subtracts the indirect costs, or expenses. These include rent, administration costs and other expenses that are not directly attributable to the production of the product. Profit can be calculated as follows:

$$\text{Profit before interest and tax} = \text{gross profit} - \text{expenses}$$

The expenses for Pap-Pie Ltd include:

- Administrative staff salaries: \$20 000
- Lighting: \$30 000
- Advertising: \$60 000
- Transport: \$90 000
- Rent: \$40 000

This section of the statement of profit or loss includes interest payments on loans that the business has taken. It also includes taxes paid to the government, which are calculated after interest has been deducted. It is important to know that these are two elements of the statement that the business does not control. Interest and taxes are separated out so that the business can see more clearly the impact of the elements of the business over which it has more control.

All this information and the profit for the period is now included in the statement of profit and loss, as shown in **Table 3**. Note that whenever there is a set of interim calculations that need to be made, in this case, all the listed expenses, these figures can be written in a middle column. The final value of expenses is then written in the right-hand column.

Table 3. Statement of profit or loss for Pap-Pie Ltd for the year ending 31 December 2021 (first and second sections).

	\$	\$
Sales revenue		1 000 000

	\$	\$
Cost of sales		(450 000)
Gross profit		550 000
Administrative staff salaries	20 000	
Lighting	30 000	
Advertising	60 000	
Transport	90 000	
Rent	40 000	
Expenses		(240 000)
Profit before interest and tax		310 000
Interest		(10 000)
Profit before tax		300 000
Tax (15%)		(45 000)
Profit for the period		255 000

Step 3: List how the profits are distributed

The third section of the statement of profit or loss shows how the profits are distributed. There are two items in this section:

- **Dividends.** This is the money paid to shareholders from the profit after interest and tax. Dividends are allocated based on the decision of the Board of Directors and must be approved at the Annual General Meeting.
- **Retained profit.** This is the portion of the profit that the business keeps for its use after paying dividends. This money could be used in a number of ways. For example, the business could use the retained profits for investments, or it could decide to buy back its stock to boost the stock price for shareholders, which is another way of distributing value to shareholders.

Assume the board of directors for Pap-Pie Ltd decides to distribute the net profit after interest and taxes as follows:

- Dividends: \$150 000
- Retained profit: \$105 000

All this information has been added to the statement of profit or loss as shown in **Table 4**.

Table 4. Statement of profit or loss for Pap-Pie Ltd for the year ending 31 December 2021 (all three sections).

	\$	\$
Sales revenue		1000000
Cost of sales		(450000)
Gross profit		550000
Administrative staff salaries	20000	
Lighting	30000	

	\$	\$
Advertising	60 000	
Transport	90 000	
Rent	40 000	
Expenses		(240 000)
Profit before interest and tax		310 000
Interest		(10 000)
Profit before tax		300 000
Tax (15%)		(45 000)
Profit for the period		255 000
Dividends		150 000
Retained profit		105 000

Making connections

Retained profit can be used as an internal source of finance as it was studied in [Subtopic 3.2 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/internal-sources-of-finance-id-39255\)](/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/internal-sources-of-finance-id-39255).

Activity

Learner profile: Knowledgeable

Approaches to learning: Thinking skills (transfer)

Table 5 shows the statement of profit and loss for a company called Shine PLC, however the values for cost of sales, profit before interest and tax, taxes and retained profit (denoted by the letters W, X, Y and Z) are missing. Find the values of W, X, Y and Z.

Table 5. Statement of profit or loss for Shine PLC for the year ending 31 December 2021.

	\$
Sales revenue	120000
Cost of sales	W
Gross profit	40000
Expenses	7000
Profit before interest and tax	X
Interest	1000
Profit before tax	32000
Taxes	Y
Profit for the period	30000
Dividend	1000
Retained profit	Z

Statement of profit or loss for a non-profit enterprise

As explained in [section 1.2.4 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/nonprofit-social-enterprises-id-36511\)](#), a [non-profit social enterprise](#) works to improve social or environmental outcomes. To qualify for non-profit status, organisations typically need to prove their social or environmental purpose to the government. They are required by law to reinvest any surplus that is generated into the business, in order to increase its impact.

Non-profit social enterprises need to keep records of their transactions and record their surplus or losses. It is important to highlight some features of the statement of profit or loss that are specific to non-profit social enterprises.

- Non-profit social enterprises pay no taxes to the government.
- Non-profit social enterprises pay no dividends to shareholders, as these organisations have no shareholders
- Non-profit social enterprises record their profits as surpluses.

Table 6 shows an example of the statement of profit or loss for the Lowood University – a non-profit social enterprise – for the year ending 31 December 2021. It uses the following information:

- Number of students: 9000
- Average fees per student: \$900
- Cost of sales: \$5 000 000
- Expenses: \$2 750 000
- Interest: \$100 000

Table 6. Statement of profit or loss for Lowood University for the year ending 31 December 2021.

	\$
Sales revenue	8 100 000
Cost of sales	(5 000 000)

	\$
Gross surplus	3 100 000
Expenses	(2 750 000)
Surplus before interest and tax	350 000
Interest	(100 000)
Surplus before tax	250 000
Tax	0
Surplus for period	250 000
Retained surplus	250 000

Exam tip

In the example you have just looked at, there is no information on opening stock, purchases or closing stock. There is also no detailed listing of individual expenses. When this is the case, there is no need for a middle column to record and calculate these interim figures. The exam may or may not list the details of the cost of sales, or expenses, so you can adjust your statement of profit or loss accordingly.

Activity

Learner profile: Knowledgeable

Approaches to learning: Thinking skills (transfer)

Using the information below, create a statement of profit or loss for the non-profit social enterprise Sustainable Shoes for the year ending 31 December 2021.

- Sales: 6000 units
- Sales price: \$40
- Cost of sales: \$15 per unit
- Expenses: \$20 per unit

- Interest: \$20000