

CHAPTER 19

PROFIT

Objectives

At the end of this chapter, the students should be able to explain the meaning of profit, state types of profit, calculate gross profit and net profit, and also calculate the percentage of gross profit or net profit to turnover.

19.1 Introduction

It is common practice in all types of business units to give periodical reports of their performances. Business organizations make use of such periodical reports to assess their performance among other things. For business units like public limited liability companies, such reports must be submitted by law to the registrar of companies.

19.2 Meaning of Profit

Profit may be defined as the excess of income over the expenses incurred in the general running a business. Profit is equally defined as the rewards for anyone who goes into business. Without profit no one would wish to go into business.

Profit motivates businessmen to take risks. The opposite of profit is loss which is the excess of expenses over income.

19.3 Types of Profit

- (i) **Gross Profit:** This is also known as a gross margin. It is the excess of sales over the cost incurred for generating that same volume of sales. Gross profit is not a reliable test of business performance which the net profit is.
- (ii) **Net Profit:** The measure of good performance here is net profit. This is the excess of gross profit over all the other expenses. Hence, it is determined by two factors, but in two different directions:
 - (i) The size of the gross profit (as mentioned earlier on)
 - (ii) The size of the expenses.

The two different directions could be put thus:

Increase the size of gross profit to increase the size of net profit. Decrease the size of expenses to increase the size of net profit. One can view it either way.

19.4 Calculation of Gross Profit and Net Profit

Mosayo Publishers (Nig.) Limited Trading Account for the Year Ended December 31, 2003 (in ₦ 000)

This is to ascertain the Gross Profit for the year

| | DR | | CR | |
|--------------------------------------|-----------------|---|---------------|------------------|
| | ₦ | k | ₦ | |
| Opening Stock | 1,000.00 | | Sales | 50,000.00 |
| Plus purchases | <u>4,000.00</u> | | - | |
| Total stock of materials for period | 5,000.00 | | Less | |
| | | | Cost of sales | <u>4,500.00</u> |
| Less closing stock | <u>500.00</u> | | Gross profit | <u>45,500.00</u> |
| Stock of sales (costs of goods sold) | <u>4,500.00</u> | | | |

Profit and Loss Account for the Year Ended December 31, 2003 (in ₦ 000)

This is to ascertain the Net Profit

| DR | | CR | |
|-----------------|------------------|--------------------|------------------|
| | ₦ | | k |
| Expenses | | Gross Profit (B/F) | 45,500.00 |
| Salaries | 15,000.00 | | |
| Fees | 5,000.00 | | |
| Rents | 2,000.00 | | |
| Depreciation | 5,000.00 | | |
| Advertising | 5,500.00 | | |
| Travelling | 3,000.00 | | |
| Net Profit | <u>10,000.00</u> | | |
| | <u>45,500.00</u> | | <u>45,500.00</u> |

N.B

Opening stock: This is the amount of stock left over from the previous period. It is the closing stock of the last accounting period.

Closing stock: This is the amount of unsold stock at the close of one current accounting period.

Cost of sales: The cost of what was offered for sales. It follows that the smaller the costs of sales, the larger the gross profit; if opening stock and purchases remain constant.

Sales: These are otherwise known as *turnover*: that is how much raw cash the stock has been turned into. In other words, given a volume of opening stock purchases and closing stock, the only way to increase gross profit is to increase sales.

Summary

The profit and loss: Takes into account all consumable expenses and gross profit plus any other receipts for the current period. It gives rise to net profit (gains on the enterprise) and it is passed into the appropriation section of final accounts.

Revision Questions

A. Essay Questions

1. Explain each of the following terminologies:
 - (a) Trading Account
 - (b) Cost of sales
 - (c) Net Profit
2. From the following data, you are expected to prepare trading, profit and loss account of Moyo and Sons Limited.

| | |
|----------------------------------|--------|
| Cost of sales | N8,000 |
| Gross profit on cost of sales | 50% |
| General and sundry expenses | |
| amounted to 25% of Gross profit. | |

It was later discovered that the cost of sales has been understated by 25% initially. You are required to show (a) the correct gross profit and (b) the net Profit.

3. A large-scale retail concern had the following balances in its book as at 31st December 1998.

| | |
|---------------------------|---------|
| | N |
| Stock 1st January 1998 | 8,000 |
| Purchases during the year | 85,000 |
| Sales for the year | 120,000 |
| Stock 31st December 1998 | 7,000 |
| Selling expenses | 10,000 |

- (a) You are required to calculate

- (i) Cost of goods sold
- (ii) Net Profit

4. Stock Jan 1, 2001 800

| | |
|----------------------|--------|
| Stock 31st Dec. 2001 | 2,400 |
| Purchases | 9,600 |
| Sales | 12,300 |
| Expenses | 1,500 |

From the above extract, calculate:

- (a) Cost of goods sold.
- (b) Gross profit
- (c) Net profit

B. Objective Questions

- Malam Saliu started a business with a capital of ~~N~~40,000.00 and spent ~~N~~30,000.00 of it to buy machines and equipment. The remaining ~~N~~10,000.00 is his
 - A. Capital Owned
 - B. Nominal Capital
 - C. Working Capital
 - D. Fixed Capital

WASSCE 1999

- Which of the following is likely to have the highest rate of stock turnover?
 - A. Bread
 - B. Jewellery
 - C. Machinery
 - D. Furniture

WASSCE 1999

Use the figures below which shows the Trading Account of Amura Ajita for the year ending 31st December 1990 to answer questions 3 - 7 below.

| | | | | |
|---------------------------------|------------|-------------|--------------|-------------|
| | N | N | | N |
| 1st Stock | | 922 | Sales | 5,489 |
| Purchases | 5050 | | Less returns | <u>293</u> |
| Less returns | <u>174</u> | | Net sales | 5196 |
| | 4876 | | | |
| Less 31st stock | <u>998</u> | | | |
| | | 4078 | | |
| Cost of goods sold (922 + 4078) | 5000 | | | |
| Gross profit | | <u>196</u> | | |
| | | <u>5196</u> | | <u>5196</u> |

- What is the average stock?
 - A. ~~N~~922.00
 - B. ~~N~~860.00
 - C. ~~N~~998.00

D. ~~N~~1280.00

E. ~~N~~1920.00

NECO 2001

4. What is the cost of goods sold?

A. ~~N~~4800.00

B. ~~N~~4876.00

C. ~~N~~5196.00

D. ~~N~~5000.00

E. ~~N~~5798.00

NECO 2001

5. What is the net cost of goods purchased for the period?

A. ~~N~~4800.00

B. ~~N~~4876.00

C. ~~N~~5196.00

D. ~~N~~5489.00

E. ~~N~~5798.00

NECO 2001

6. What is the rate of turnover of Amura Ajita's business?

A. 5.8

B. 5.3

C. 5.4

D. 5.7

E. 6

NECO 2001

7. What is the percentage of gross profit to turnover of the business?

A. 6.8%

B. 7.2%

C. 7.6%

D. 3.79% (3.8% app.)

E. 8.3%

NECO 2001

Use the following information to answer questions 8-10 Ndu enterprises had the following state of affairs: Opening stock was ~~N~~3,500 and at 31 December was ~~N~~3,000, his purchases was ~~N~~30,000 and sales was ~~N~~38,000 while a total of rent and electricity bills of ~~N~~4,500 was paid.

8. What is the gross profit?

A. ~~N~~8,000

B. ~~N~~7,500

C. ~~N~~6,500

D. ₦3,000

WASSCE 2002

9. The rate of stock turnover is

- A. 1.2 times
- B. 1.3 times
- C. 4.6 times
- D. 9.4 times

WASSCE 2002

10. The turnover for the period is

- A. ₦38,000
- B. ₦33,500
- C. ₦30,000
- D. ₦4,500

WASSCE 2002

Project

Using your own stated figures, construct a trading, profit and loss account of an imaginary company.