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The big picture

Unilever, a multinational consumer products company, reported a profit of approximately six billion euros in 2021. This was an increase of 8.4% compared with the company's profit in 2020. However, in its 2021 financial report, Unilever warned of the significant impact on its business from inflation in 2022. The company's costs will also likely increase due to needed investment and research and development.

In this context, Unilever decided to sell its tea business unit Ekaterra, a portfolio of 34 tea brands including Lipton, PG Tips, TAZO and Pukka Herbs. These brands generated around two billion euros in revenue for Unilever in 2020.

Why would Unilever sell a part of its business that generates so much revenue? The answer is likely related to tools and theories that you have already encountered, such as the internal and external factors affecting businesses. But quantitative data can also provide clues. These can be found in Unilever's final accounts. The focus of this subtopic is final accounts.

Figure 1. Tea: A business unit of Unilever.

Source: "Lipton-mug-tea (https://commons.wikimedia.org/wiki/File:Lipton-mug-tea.jpg)", by Evan-Amos is licensed under Public Domain, via Wikimedia Commons

Learning objectives from the IBDP Business Management guide with assessment objective level:

- **Explain** the purpose of accounts to different stakeholders (AO2)

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- **Analyse** the elements of statement of profit or loss (profit and loss account) and statement of financial position (balance sheet) (AO2)
- **Construct** a statement of profit or loss (profit and loss account) (AO4)
- **Construct** a statement of financial position (balance sheet) (AO4)
- **Distinguish** between different types of intangible assets (AO2)
- **Calculate** depreciation using the straight-line method (AO4)
- **Calculate** depreciation using the units of production method (AO4)
- **Discuss** the appropriateness of each depreciation method (AO3)

3. Finance and accounts / 3.4 Final accounts

The purpose of accounts for different stakeholders

The purpose of accounts The purpose of accounts

The financial health of a business is central to its success. Businesses need to be transparent about their financial condition because this impacts many stakeholders. As you learned in Subtopic 1.4 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-36525/), stakeholders have varied interests in a business. This means that stakeholders also have varied interests in the final accounts.

As you also know, stakeholders can be divided into internal and external groupings (see **Figure 1**). In this section, stakeholders' interests in the final accounts will be approached using the same classifications.

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-39045/print/) Assign

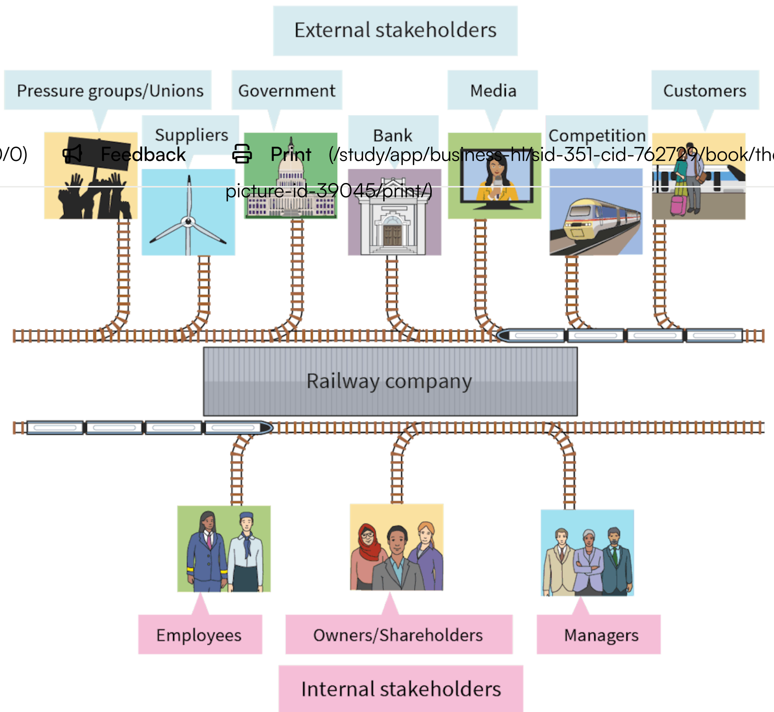

Figure 1. Business stakeholders.

More information for figure 1

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The diagram represents the external and internal stakeholders of a railway company. At the center is the "Railway company," depicted with a train track running through it.

Above the railway company, the external stakeholders are labeled as follows:

- "Pressure groups/Unions" with an image of raised hands holding signs.
- "Suppliers" with an image of a wind turbine.
- "Government" with an image of government buildings.
- "Bank" with an image of a bank facade.
- "Media" with an image of a person on a television screen.
- "Competition" with an image of a train on a track.
- "Customers" with an image of people with luggage at a station.

These stakeholders are connected to the railway company through tracks.

Below the railway company, the internal stakeholders are:

- "Employees" represented by two figures in uniforms.
- "Owners/Shareholders" represented by a group of diverse business people.
- "Managers" represented by a group of people in suits.

Each group is associated with the railway company through tracks, and labeled accordingly. External stakeholders are highlighted in blue, while internal stakeholders are highlighted in pink.

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Internal Stakeholders

Internal stakeholders are groups within the business that are interested in the final accounts. They include management, owners and shareholders, and employees.

Management

Management refers to people in the organisation that plan, organise, coordinate and control the activities in the business. Managers, such as the chief executive officer (CEO), could be working at the top of the hierarchy, or they could be working at lower levels of management. Managers use final accounts to see changes in the business and develop new strategies. They might use them to identify the following:

- how easily a business can cover its immediate, short-term and medium-term debts to ensure that the company does not become insolvent
- the profit earned during the year
- the value of assets owned by the company
- the amount of money invested by shareholders

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Owners and shareholders

Owners and shareholders are the individuals and organisations that own shares in the company. These stakeholders might use the final accounts to identify the following:

- how effectively their money has been invested
- how much they will receive in dividends

Employees

Employees are the people who work in the business. They could be interested in the final accounts for the following reasons:

- to know the overall financial stability of the business and how secure their jobs are
- to be able to negotiate for better wages based on the profits of the business

Figure 2. Employees may be interested in final accounts to know whether there is room to negotiate higher salaries.

Credit: jayk7, Getty Images

Exam tip

Each stakeholder has a specific interest in the final accounts. You need to be precise in explaining how each group could use the accounts.

External stakeholders

External stakeholders are groups outside the business that are interested in the final accounts of a business. They include the government, competitors, banks, the business's suppliers and the local community.

Government

The government authorities of the country, region, or city where the business is located will be interested in the final accounts for several reasons.

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- The government may wish to assess taxes on the business, based on the business's profits. These taxes are used to fund essential public services like education and infrastructure that businesses depend on to be able to function.
- The government may also want to assess the health of businesses, because businesses provide jobs and contribute in other ways to the community. Businesses may need support in difficult times and financial reporting can reveal when this is necessary.

Competitors

Competitors are the rival businesses in the market. They would be interested in the company's final accounts for the following reasons:

- to assess the overall financial strength of the company
- to compare profits for the year of businesses in the same industry as themselves

Banks

Banks would be interested in final accounts to check the ability of a business to repay loans.

Suppliers

Suppliers are businesses that supply goods and services to the company. They would be interested in the final accounts of the company to assess how effectively the company would be able to pay for the goods supplied to it on credit.

Local community

The local community refers to the people and authorities of the town or city where the business is located. They are interested in the wellbeing of the community. So they want to know whether the business is financially stable and will remain in the community to provide jobs and the goods and services that the community needs.

Figure 3. The local community is interested in final accounts because businesses provide goods and services and have a relationship with the people they serve.

Credit: Jetta Productions Inc, Getty Images

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Concept

Ethics

Ethics is the moral conduct of businesses to do the right thing. Some ethical behaviour is coded in laws and regulations. But much ethical behaviour is grounded by the mutual responsibilities that develop between networks of stakeholders — such as employees, customers, shareholders and suppliers — when organisations are established.

Accountants have a responsibility to keep business accounts in order and prepare the final accounts. These accounts must be accurate and transparent because many stakeholders rely on them for information that is important for their relationship with the business.

Activity

Learner profile: Inquirers
Approaches to learning: Research skills (information literacy)

Using newspapers, the internet and your own knowledge, identify one business that had a positive financial performance in the most recent year, and one whose performance was not so good.

1. Identify some internal and/or external factors that impacted the business (see SWOT analysis in Section 1.1.5 (/study/app/business-hl/sid-351-cid-762729/book/tool-swotsteeple-analysis-id-36504/)).
2. Identify how some stakeholders were affected by the positive or negative financial performance of the business.

2 section questions

Question 1

Why would competitors be interested in the final accounts of another company?

1 To be able to compare their own performance ✓

2 To assess employment prospects

3 To know if they will be paid for the goods they supplied to the company

4 To bargain for higher wages

Explanation

Competitors would like to know the profits that another company makes to know what price-cutting strategies they could use themselves to compete with it. If the company has high profits (and therefore a good financial base), it would be difficult to outcompete it.

The other options — bargaining for higher wages, assessing employment prospects and suppliers being paid — are incorrect because a competitor is unlikely to have a direct interest in them. Profitability is of prime concern as explained above.

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Question 2

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Which one of these stakeholders would be interested in the dividends they would receive from a company?

1 Shareholders ✓

2 Suppliers

3 The community

4 The government

Explanation

Shareholders invest their money into a company because they can receive dividends on their investments. The other options are incorrect because the government, the community and suppliers do not invest in the company, so they are not eligible to receive dividends.

3. Finance and accounts / 3.4 Final accounts

Final accounts: Statement of profit or loss

Final accounts Final accounts

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

More information for figure 1

The image shows a profit and loss statement document on which a hand is writing with a pen. The document includes headings such as "Profit and Loss Statement," "Company Name," and placeholders for dates and values. It lists items like Sales Revenue, Cost of Sales, along with brackets "[1]", "[2]", suggesting spaces for specific data entries. There is a section labelled "Stated in 000s," and it appears to have columns for prior period, budget, current period, % change period, and % change from budget, though specific numerical values are not visible. Glasses are placed on the upper left corner of the document.

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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		**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**
Dividends		(150 000)
Retained profit		105 000

Student view

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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.

$$\text{Gross profit} = \text{ sales revenue} - \text{cost of sales}$$

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		**1000 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.

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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.

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

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

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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		**1000 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**
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/business-hl/sid-351-cid-762729/book/internal-sources-of-finance-id-39255/).

Activity

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (transfer)

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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	120 000
Cost of sales	W
Gross profit	40 000
Expenses	7000
Profit before interest and tax	X
Interest	1000
Profit before tax	32 000
Taxes	Y
Profit for the period	30 000
Dividend	(1000)
Retained profit	Z

W = cost of sales
= sales revenue — gross profit
= $120 000 — $40 000
= $80 000

X = profit before interest and tax
= gross profit — expenses
= $40 000 — $7000
= $33 000

Y = taxes
= profit before tax — profit for the period
= $32 000 — $30 000
= $2000

Z = retained profit
= profit for the period — dividend
= $30 000 — $1000
= $29 000

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Statement of profit or loss for a non-profit enterprise

As explained in section 1.2.4 (/study/app/business-hl/sid-351-cid-762729/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

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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: $20 000

Statement of profit or loss for Sustainable Shoes for the year ending 31 December 2021.

	$
Sales revenue	240 000
Cost of sales	(90 000)
Gross surplus	150 000
Expenses	(120 000)
Surplus before interest and tax	30 000
Interest	(20 000)
Surplus before tax	10 000
Tax	0
Surplus for period	10 000
Retained surplus	10 000

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3 section questions

Question 1

The gross profit is calculated by:

1 Subtracting cost of sales from sales revenue ✓

2 Subtracting expenses from sales revenue

3 Subtracting dividends from profit

4 Subtracting retained profit from profit

Explanation

The gross profit is calculated by subtracting the cost of sales from the sales revenue. Cost of sales are the direct costs associated with producing the product.

Question 2

What is the result of subtracting expenses from the gross profit?

1 Profit before interest and tax ✓

2 Profit before tax

3 Profit after interest and tax

4 Dividends

Explanation

Profit before interest and tax is calculated by subtracting expenses from the gross profit figure. This represents the profits that the business earns after subtracting all direct and indirect costs from the sales revenue. However, it does not yet account for interest or taxes.

Question 3

One difference in the profit and loss account between for-profit enterprises and non-profit social enterprises is:

1 The for-profit enterprise records a profit, while the non-profit social enterprise records a surplus. ✓

2 The for-profit enterprise records sales revenue, while the non-profit business does not.

3 The for-profit enterprise does not have cost of sales, while the non-profit social enterprise does.

4 The for-profit enterprise has expenses, while the non-profit social enterprise does not.

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Explanation

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Non-profit social enterprises reinvest all money left over from sales revenue after cost of sales, expenses and interest are subtracted. This is in order to increase the positive impact on a wide range of stakeholders. So the concept of profit for non-profit social enterprises is replaced by surplus.

3. Finance and accounts / 3.4 Final accounts

Final accounts: Statement of financial position

Final accounts Final accounts

Figure 1. The statement of financial position shows the value of assets — such as these weaving looms — as well as the liabilities of a business.

Credit: Trevor Williams, Getty Images

The statement of financial position (also known as the balance sheet) is a ‘snapshot’ of a company’s financial position at a specific point in time, such as the end of the financial year. It states the company’s assets and liabilities and shareholders’ investment or equity in the business.

This is shown in the simple accounting equation below:

$$\text{Assets} = \text{liabilities} + \text{equity}$$

For the statement of financial position to be valid, both sides of the equation must ‘balance’.

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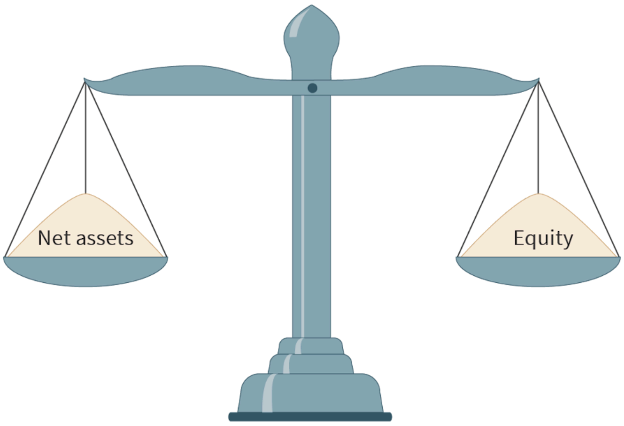

Figure 1. The statement of financial position shows that assets and equity are equal.

Statement of financial position for a for-profit enterprise

As in Section 3.4.2 (/study/app/business-hl/sid-351-cid-762729/book/final-accounts-st-of-profit-or-loss-id-39284/), this section uses financial data for the fictitious company Pap-Pie Ltd for the year ending 31 December 2021. The full statement of financial position (balance sheet) for the company is shown in **Table 1**. The table is divided by colour to indicate the different sections of the statement of financial position, which will be explained in this section in different steps moving from top to bottom in the statement as follows:

- **Step 1:** Assets: current and non-current (green section)
- **Step 2:** Liabilities: current and non-current (yellow section)
- **Step 3:** Net assets and equity (orange section)

Table 1. Statement of financial position for Pap-Pie Ltd for the year ending 31 December 2021.

	Thousands of $	Thousands of $
Non-current assets		
Buildings	250	
Machinery and equipment	300	
Motor vehicles	150	
Accumulated depreciation	(40)	
Non-current assets		**660**
Current assets		
Cash	40	
Debtors	10	
Stock	20	

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	Thousands of $	Thousands of $
Current assets		**70**
Total assets		**730**
Current liabilities		
Overdrafts	8	
Trade creditors	7	
Short-term loans	5	
Current liabilities		**20**
Non-current liabilities		
Borrowing (long term)	100	
Mortgage	80	
Non-current liabilities		**180**
Total liabilities		**200**
Net assets		**530**
Equity		
Share capital	400	
Retained earnings	130	
Total equity		**530**

Step 1: Assets (current and non-current)

Exam tip

In this section, you will learn about current assets first, so that the terminology 'non-current' makes sense.

However, in the statement of financial position, you will list non-current assets first, as shown in **Table 1.**

Listing current assets and then current liabilities directly below the assets also makes it easier to see the working capital of the business. Working capital is calculated by subtracting current liabilities from current assets. You will learn more about working capital in Subtopic 3.5 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-39042/).

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The first section of information presented in the statement of financial position relates to assets. Assets are all items of value that are owned by the business; they can be broken down into current assets and non-current assets. Non-current assets have been referred to as 'fixed assets' until now. Current assets are items of value owned by the business that can be converted into cash in the short term; that is within 12 months. Typical types of current assets are:

- **Cash:** This includes cash in hand and cash in the business's bank account.
- **Debtors:** This relates to money owed to a business by individuals or other organisations. For example, if a person or business buys goods on credit from another business, but has not yet paid for the goods, the person or business owing the money would be considered a debtor.
- **Stock (inventory):** This refers to unsold goods, raw materials or work-in-progress that the company has in hand at the end of the trading period.

Figure 3. Stock (inventory) is considered a current asset.

Credit: alvarez, Getty Images

The ease with which assets can be converted into cash is called liquidity. Cash is the most liquid current asset. Debtors are the next most liquid current asset, followed by stock. Stock is considered the least liquid current asset, since the business does not know whether it can sell the stock within the trading period. When listing current assets in the statement of financial position, you should place them in order – either from most liquid to least liquid or the other way around.

Non-current assets, also known as fixed assets, are long-term tangible items of value owned by the business. These are items that are necessary for the operations of the business and have a lifespan of over 12 months, or are not sold within a year. These assets are less liquid than current assets. Examples of non-current assets include factory buildings, land, equipment, and other physical capital. When listing these assets in the statement of financial position, you would also list them in a pattern from most to least liquid, or the other way around.

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Figure 4. A coffee roasting machine is a non-current asset.

Credit: Edwin Tan, Getty Images

Over time, some non-current assets lose their value. For example, a coffee machine in a café that was bought new for $2000 may only be worth $1000 after a few years. This is because the machine will not work as well after making thousands of coffees, and because newer better coffee machines will be available. This loss in value is called depreciation and is included in the statement of financial position. This keeps value of non-current assets up to date by subtracting accumulated (over time) depreciation from the value of non-current assets (see **Table 2**). HL students will learn more about depreciation in Section 3.4.5 (/study/app/business-hl/sid-351-cid-762729/book/depreciation-hl-id-39287/).

Table 2. Assets for Pap-Pie Ltd recorded in the statement of financial position (first section).

	Thousands of $	**Thousands of $**
Non-current assets		
Buildings	250	
Machinery and equipment	300	
Motor vehicles	150	
Accumulated depreciation	(40)	
Non-current assets		**660**
Current assets		
Cash	40	
Debtors	10	
Stock	20	
Current assets		**70**

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view

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	Thousands of $	Thousands of $
Total assets		730

Activity

Learner profile: Inquirer
Approaches to learning: Thinking skills (transfer)

Consider a business that you visit regularly. List the current and non-current assets that you notice in the business.

Step 2: Liabilities (current and non-current)

The next set of information in the statement of financial position is liabilities. Liabilities are all funds owed by the company to financial and other institutions, such as banks and suppliers respectively. Liabilities can be classified into current liabilities and non-current liabilities.

Current liabilities are funds that a business owes to individuals or institutions that should be paid within 12 months. Examples include:

- **Bank overdrafts**: These relate to situations whereby a business takes out more money from its bank account than it had in deposit. You learned about overdrafts in Section 3.2.3 (/study/app/business-hl/sid-351-cid-762729/book/ext-sources-of-finance-debt-id-39292/).
- **Short-term loans**: These refer to money that the business has borrowed from a bank, which will be paid back over a relatively short period of time. You learned about short-term finance in Section 3.2.2 (/study/app/business-hl/sid-351-cid-762729/book/ext-sources-of-finance-equity-id-39291/).
- **Trade creditors**: These relate to money that a business owes another business or individual when it has bought goods or services on credit. For example, Pap-Pie Ltd may buy corn flour from a miller on credit and be given 30 days to pay. You learned about trade credit in Section 3.2.3 (/study/app/business-hl/sid-351-cid-762729/book/ext-sources-of-finance-debt-id-39292/).

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/final-accounts-st-of-profit-or-loss-id-39284/print/) Assign

Non-current liabilities are funds that a business owes individuals and/or institutions that are paid back over a longer period, typically more than 12 months. Examples are long-term loans and mortgages. A mortgage is a loan for immovable property such as land and buildings, and where the property itself is taken as collateral. The liabilities of Pap-Pie Ltd are listed in **Table 3**.

Table 3. Liabilities of Pap-pie Ltd recorded in the statement of financial position (second section).

	Thousands of $	Thousands of $
Current liabilities		
Overdrafts	8	
Trade creditors	7	

Student view

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	Thousands of $	Thousands of $
Short-term loans	5	
Current liabilities		**20**
Non-current liabilities		
Borrowing — long term	100	
Mortgage	80	
Non-current liabilities		**180**
Total liabilities		**200**

Exam tip

Students often confuse the terms 'debtors' and 'trade creditors'.

Debtors are considered a current asset, referring to the amount of money owed to the business by customers who have been sold goods on credit.

Trade creditors are considered a current liability, referring to the amount of money the business owes to its suppliers for goods bought on credit.

Step 3: Net assets and equity

The next section of the statement of financial position will show why the statement is often called a balance sheet. As you will see, the net assets 'balance' with the equity in the business.

The net assets are the total assets minus the total liabilities. In the case of Pap-Pie Ltd this would be:

$730 000 – $200 000 = $530 000

The value of the net assets should be equal to the value of equity in the business. Equity refers to the money that the shareholders have invested in the business plus retained profits (retained earnings) of the business. There are two elements to the equity section of the statement of financial position (see **Table 4**):

- **Share capital:** This is the money raised through the sale of shares.
- **Retained earnings (retained profit):** This is the amount of profit after interest, tax and dividends have been paid. It is the last line of the statement of profit or loss that you learned about in Section 3.4.2 (/study/app/business-hl/sid-351-cid-762729/book/final-accounts-st-of-profit-or-loss-id-39284/).

Table 4. Net assets and equity of Pap-Pie Ltd recorded in the statement of financial position (third section).

Student
view

Overview (/study/app/hl/sid-351-cid-762729/c

Net assets		**530**
Equity		
Share capital	400	
Retained earnings	130	
Total equity		**530**

Now that you have been introduced to the three sections of the statement of financial position (balance sheet), you may want to revisit **Table 1** to see how assets, liabilities and equity all fit together.

Activity

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (transfer)

Classify the following items from a statement of financial position (balance sheet) into assets (current and non-current), liabilities (current or non-current) or equity by copying the table and writing an 'x' in the relevant cells.

Statement of financial position (balance sheet) item	Non-current assets	Current assets	Current liabilities	Non-current liabilities	Owner's equity
Overdraft					
Stock					
Share capital					
Cash					
Mortgage					
Building					
Trade creditors					
Retained profit					

Statement of financial position (balance sheet) item	Non-current assets	Current assets	Current liabilities	Non-current liabilities	Owner's equity
Overdraft			x		

Student view

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Statement of financial position (balance sheet) item	Non-current assets	Current assets	Current liabilities	Non-current liabilities	Owner's equity
Stock		x			
Share capital					x
Cash		x			
Mortgage				x	
Building	x				
Trade creditors			x		
Retained profit					x

Activity

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (transfer)

Use the following financial information about Ahaan Hotels — a fictional multinational company — to complete the tasks below.

- Current assets: $2006 million
- Current liabilities: $1836 million
- Share capital: $1040 million
- Retained profit: $2590 million
- Non-current liabilities: $162 million
- Equity: $3630 million
- Non-current assets: $3622 million

1. Construct a statement of financial position (balance sheet) for Ahaan Hotels for the year ending 31 December 2021 (in millions of dollars). Note that because the list of items given does not include subcategories of assets or liabilities, the statement of financial position only needs to include one column of figures.
2. Create a second version of your statement of financial position, and add in hypothetical subcategories of non-current assets, current assets, current liabilities and non-current liabilities. Make sure to place these in the right grouping and use numbers that would make sense given the totals for assets and liabilities.

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1. The statement of financial position for Ahaan Hotels Ltd for year ending 31 December 2021 should be constructed as follows:

	Millions of $
Non-current assets	3622
Current assets	2006
Total assets	5628
Current liabilities	1836
Non-current liabilities	162
Total liabilities	1998
Net assets	**3630**
Equity	
Share capital	1040
Retained profit	2590
Equity	**3630**

2. Answers will vary. Swap your results with another student to check the work, or you could look at the statement of financial position in Table 1 of this section to check that you have constructed your statement correctly.

Statement of financial position for non-profit social enterprises

As was the case with the statement of profit or loss, non-profit social enterprises have a slightly different structure for the statement of financial position (balance sheet). Non-profit social enterprises have no shareholders, so there is no share capital listed in the equity section of the statement of financial position.

Table 5. Statement of financial position for Lowood University for the year ending 31 December 2021.

	Thousands of $	**Thousands of $**
Non-current assets		
Property, plant, equipment	250 000	
Accumulated depreciation	(25 000)	

Student
view

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(/study/app/business-hl/sid-351-cid-762729/c

	Thousands of $	Thousands of $
Non-current assets		**225 000**
Current assets		
Cash	510	
Debtors	120	
Stock	90	
Current assets		**720**
Total assets		**225 720**
Current liabilities		
Trade creditors	250	
Short-term loans	5000	
Current liabilities		**5250**
Non-current liabilities		
Borrowing (long term)	70 000	
Non-current liabilities		**70 000**
Total liabilities		**75 250**
Net assets		**150 470**
Equity		
Retained earnings	150 470	
Total equity		**150 470**

Activity

Learner profile: Thinkers; Inquirers
Approaches to learning: Thinking skills (creative thinking, critical thinking, transfer); Research skills (information literacy)

The following activities will deepen, extend and connect your understanding of final accounts. Choose one or more activity to complete, depending on your learning needs.

1. **Deepen:** Make up your own practice question with hypothetical financial data and write out the relevant statement. Challenge another student to complete the statement. Then ask them to do the same for you. This will give you more practice and, by having to think up data that makes sense in the statements, you will be thinking in a different way and deepening your understanding.

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2. **Extend:** Select a large publicly listed company that you know and access that company's annual report from the most recent year. You should be able to see the statement of profit or loss (income statement) and the statement of financial position (balance sheet). These statements will not look exactly like the statements required by the IB, but you should be able to make some sense of them using your new knowledge. These statements could be a good source of information for your internal assessment or extended essay.
3. **Connect with descriptive data:** You can practise graphing and interpreting data (Section 4.4.6 (/study/app/business-hl/sid-351-cid-762729/book/tool-descriptive-statistics-id-39001/)) by looking at company final account information over time. There are several places you can look to find company financial data. One example is the Wall Street Journal Markets (https://www.wsj.com/market-data/quotes/company-list/?mod=nav_top_subsection) page, where you can search for companies by sector or country. There is a tab for financial accounts data, which usually covers the past five years.

Find a company that you know and use the data in the financial accounts to graph sales revenue, gross profit, profit before income and tax (EBIT), profit (net profit), or some other indicator from the statement of financial position in which you are interested.

International Mindedness

Different countries will have different reporting requirements for the statement of profit or loss and the statement of financial position. If you research this information for a company in your own country, the reporting format may look different from what has been explained here. Nonetheless, you should be able to pick out the key elements of the final accounts.

3 section questions

Question 1

The statement of financial position (balance sheet) shows:

1 The assets, liabilities and equity in a business at a specific point in time ✓

2 The break-even point of a business

3 The gross profit generated by the business in a year

4 The total expenses of the business in a year

Explanation

The statement of financial position (balance sheet) shows the assets, liabilities and owner's equity of the business. The break-even point shows the output necessary for total revenues to cover total costs. The gross profit is part of the statement of profit or loss. Expenses are also included in the statement of profit or loss.

Question 2

Student view

Which of the following is **not** an example of a liability?

1 A new computer system ✓

2 A bank overdraft

3 Money owed to suppliers

4 A mortgage

Explanation

A new computer system is an asset to the company as it is an item of value owned by the company. The other options are incorrect because they are examples of liabilities.

Question 3

What is the term from the statement of financial position that refers to the long-term tangible items of value owned by the business, also known as fixed assets?

1 Non-current assets ✓

2 Current assets

3 Current liabilities

4 Non-current liabilities

Explanation

Non-current assets, also known as fixed assets, are the tangible items of value owned by the business that are used to create a business's product or service. Examples include factories, machinery and equipment.

Intangible assets

In the previous section, assets were classified into non-current assets and current assets. This section examines another form of asset, called intangible assets. These are non-physical items of value owned by a company that have a lifespan of more than a year.

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Figure 1. A patent is an example of an intangible asset.

Credit: maybefalse, Getty Images

Theory of Knowledge

One of the arguments for granting ownership rights over innovations and artistic content is that it provides an incentive for scientists, engineers, artists and others to develop new ideas. If these innovators know that they can get exclusive rights to produce and profit from their ideas for a period of time, they may be more willing to spend time and money to innovate.

However, a compelling argument against ownership of intellectual property is that it slows innovation by preventing innovators from building on the work of others. Many new ideas are not completely original but develop ideas that already exist. Intellectual property protections often block those kinds of innovations.

- Does ownership of knowledge help or hinder innovation?

Patents

Patents are legal protection given to an inventor of a product to safeguard it from being copied for a specified number of years. The time period is on average about 20 years in most countries. Anyone wanting to produce the product must first get permission from the patent holder, otherwise they could be prosecuted under the law. Because patents grant a temporary monopoly for production, businesses can earn very large revenues for a period. Patents are meant to give businesses an incentive to develop new, innovative products even when significant investment costs are involved. Selling patents to other businesses can also be very profitable.

The value of a patent can be derived in several ways. One method is to calculate the value of a patent's projected net cash flows. You will learn more about these in Subtopic 3.7 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-39317/) and Subtopic 3.8 (/study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-39324/).

Activity

Learner profile: Inquirers
Approaches to learning: Thinking skills (critical thinking)

Student
view

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Research the dispute between governments, activists and pharmaceutical companies about whether these companies should waive their patent rights to COVID-19 vaccines. You could organise a discussion or a debate about this question in your class using the information you have found.

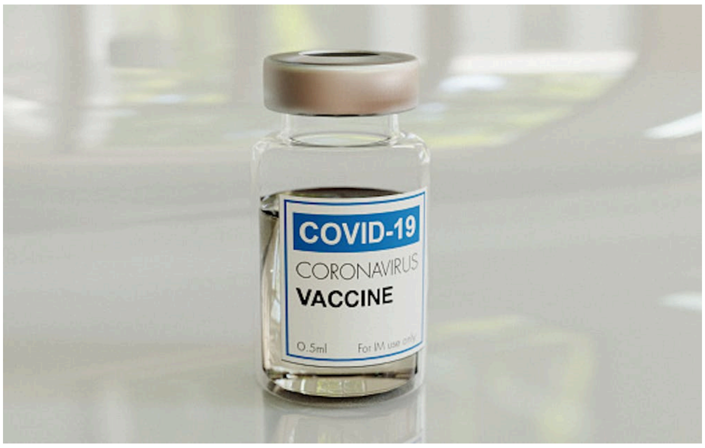
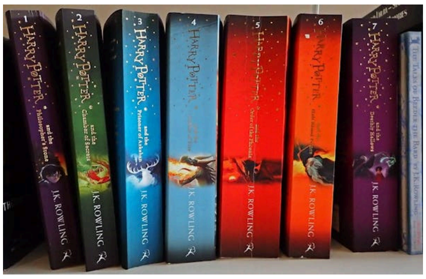


Figure 2. Covid vaccines have been the focus of a number of patent disputes.

Credit: Joao Paulo Burini, Getty Images

Copyright ©

Copyright is a form of legal protection given to the producers of literary or artistic works such as music, books, movies, photographs, images, computer software, web pages, audio and art. Copyright protects authors' and artists' exclusive right to publish, reproduce, perform, distribute and sell the artistic works.



The Harry Potter series of books and films.

Source: "Harry Potter Series (https://www.flickr.com/photos/45909111@N00/33987957441/in/photolist-TMpaCe-c8x2xw-canucC-canoFU-cantHN-canmnf-c9N4r3-c8EN7W-c8EFqw-c8wu7J-c9N5pu-cantu9-canrDh-canqFA-canq7Y-cankFL-c9N2qf-c8EV1u-c8EUrW-c8EAXA-c8wvMU-canrZU-cannaW-c8EMny-c8EHgd-c8wqVU-c8EKhY-canvME-cansES-canoC7-canrp7-c8ELJj-QhStpy-3kDtR-Ccudgi-5MkAHP-opzRe-canpSh-c8EDcm-canuSU-canuhm-cansQN-c8EDjj-2q3vJS-canrko-nAZUU5-7h4o5Q-s4wid9-canr3b-c8wrLf)" by Gwydion M. Williams is licensed under CC BY 2.0 (https://creativecommons.org/licenses/by/2.0/)

Student view

Overview (/study/app/business-hl/sid-351-cid-762729/c

The Lion King musical and animated movies.

Figure 3. Examples of work protected by copyright.

Copyright usually lasts for 50 years after the death of the author, according to the copyright laws signed at the **Berne Convention for the Protection of Literary and Artistic Works of 1886**. In some countries, a copyright can last up to 70 years after the death of the author. After the term expires, the artworks enter the public domain, which means they are no longer copyright protected.

Registered trademark ®

A trademark is a distinctive mark, sign or symbol that a company or individual uses to identify or brand itself to distinguish itself from competitors, after registration with the relevant government entity. Examples include the Coca-Cola logo, the McDonald’s golden arches, Microsoft Windows, Dangote and Alibaba.com. Any individual or organisation that uses a registered trademark that they do not own can be legally prosecuted.

Case study

The technology firm Apple is very protective of its trademark — the well-known apple symbol that it uses to identify its products. According to the Tech Transparency Project (https://www.techtransparencyproject.org/articles/apples-trademark-bullying-targets-small-businesses-nonprofits), Apple has filed hundreds of trademark infringement claims against companies with trademarks or names associated with the fruit. The claim is that using a symbol or name similar to Apple’s may cause confusion in the minds of consumers. Many of these are filed against companies that have no link to technology or the products that Apple sells, such as jewellery, plumbing and medical services. These companies seem to represent no commercial threat to Apple’s business and are unlikely to cause confusion among consumers.

These trademark infringement claims can be harmful for the businesses that are targeted. The targeted businesses must either change their own trademarks and names, or they must hire legal representation that can be very costly. Many of these small businesses cannot afford to fight a large, well-funded company like Apple in court.

Ironically, Apple itself was taken to court in 1978 for trademark infringement. Apple Corp. is the holding company and owner of the Beatles’ record label, Apple Records. The two companies fought legal battles over the Apple trademark until 2006, when they finally settled the dispute in court. Apple (the technology company) had to pay Apple Corp. (the music company) millions in their multiple settlement agreements. But eventually the two companies reconciled, with Beatles’ music now featured in the Apple iTunes store.

Questions

1. Define trademark. [2 marks]
2. Explain why Apple would want to protect its trademark from use by other businesses. [2 marks]

Question 1

Student view

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A trademark is a distinctive mark, sign or symbol that a company or individual uses to identify or brand itself to distinguish itself from competitors. Trademarks are registered with a relevant government authority.

Define is an AO1 level command term, requiring a precise meaning of a word.

- One mark is given for a vague definition.
- Two marks are given for a complete definition.
- Definitions do not require application to the stimulus material.

Question 2

A trademark is valuable to a company because it helps distinguish a business from its competitors. It is a key part of a business's brand image. Apple, a large and successful technology company, uses its distinctive apple logo and name to identify its products and services. If other companies, particularly those in technology fields, used a similar logo or name, it could 'cause confusion in the minds of consumers'. Consumers could be led to believe that the company using the similar logo or name is connected with Apple. This could be a commercial threat to the business.

Explain is an AO2 level command term, requiring a detailed account including reasons or causes. Explain *why*, explain *how*.

- Only one point needs to be made. Other responses are possible and would be rewarded if appropriate.
- To achieve full marks, you must always include theory and application to the case study in your responses.

Goodwill

Goodwill is the intangible value of a company derived from its 'good nature' in business. This could be attributed to brand loyalty, patents, talent management, good relationships with customers (and therefore wide customer base), and many other such attributes that give a business a competitive edge over its rivals. The monetary value of goodwill is derived when the selling price of a business is higher than the value of its net assets when the company is acquired or sold.

3 section questions

Question 1

What is a patent?

1 Legal protection that gives the inventor of a product the exclusive right to produce and sell a product ✓

2 The name of a product

3 Something that depends on a company's profits

4 Legal protection for literary works

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Explanation

A patent is used to protect an inventor from others using their invention to produce goods for sale.

Question 2

Which of the following is **not** an example of a trademark?

1 The vision statement of a company ✓

2 The IB logo

3 The Apple computer sign

4 The shape and design of the Coca-Cola bottle

Explanation

The vision statement of a company is not registered, is internal to the business and is not necessarily used to distinguish a company from its rivals. The other three options are incorrect because they are examples of trademarks.

Question 3

The goodwill of a company is reflected:

1 When the selling price of the company is higher than the value of its net assets ✓

2 By the company's current profit

3 In the value of the company's liabilities

4 By the number of shareholders the company has

Explanation

When a company is sold, the 'premium', or price charged above the value of its net assets, reflects the good reputation that the company has built up over the years. This is influenced by branding, wide customer base, etc. The other three options are incorrect because they do not directly influence the reputation of the company.

3. Finance and accounts / 3.4 Final accounts

Depreciation (HL)

Depreciation methods (HL) Appropriateness of depreciation methods (HL)

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/depreciation-hl-id-39287/print/) Assign

Student view

Over time, as a business produces its output, the non-current assets (fixed assets) of the business will lose value or depreciate. For example, the value of a peanut packaging machine, or the value of computers used in an office, will be different five years after the equipment was purchased. This depreciation is often due to use and damage that

Overview
(/study/app/business-hl/sid-351-cid-762729/c

occurs over time, which is called 'wear and tear'. Depreciation can also occur because the equipment is not up to the latest standards.

Figure 1. Depreciation refers to assets that lose their value.

Credit: cogal, Getty Images

Businesses account for the depreciation of these assets in their final accounts. This depreciation figure is recorded on the statement of profit or loss as an expense. This same figure is also used to depreciate or reduce the value of non-current assets in the statement of financial position (balance sheet). This section looks at two methods for calculating depreciation, and the appropriateness of each method in certain circumstances.

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/intangible-assets-id-39286/print/) Assign

Causes of depreciation of non-current (fixed) assets

There are a number of reasons why a non-current asset (fixed asset) can decrease in value over time.

Wear and tear

Factories and equipment are used in production, and working parts will deteriorate or be damaged over time. This damage and deterioration is called wear and tear. This is perhaps the most common cause of depreciation.

Figure 2. Depreciation is the loss in the value of a fixed asset over time.

Credit: sorendls, Getty Images

Student view

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Obsolescence

Obsolescence occurs when the technology used in the asset has been surpassed by more recent innovations. Over time, machinery will be replaced by new and more efficient machines. For example, the widespread use of computer technology in production has meant that equipment purchased even a few years ago rapidly becomes obsolete.

Calculating depreciation

Straight-line method of depreciation

The straight-line method of depreciation is used to calculate the fall in value of an asset evenly over its useful life. This method uses the formula:

$$\textbf{Annual depreciation} = \frac{\textbf{purchase price} - \textbf{residual value}}{\textbf{estimated useful life}}$$

For example, Chinon Africa Investments Ltd buys a delivery truck for transporting fresh fruit and vegetables to all its supermarket franchise outlets at a cost of $100 000. The truck has an estimated residual or scrap resale value (at the end of its life) of $25 000 and an estimated useful life of five years. Calculate the annual provision for depreciation.

$$\text{Annual provision for depreciation} = \frac{\$100\ 000 - \$25\ 000}{5\ \text{years}} = \$15\ 000$$

The fall in value of the truck over the years can be illustrated by a straight line on the graph when the depreciation figure is graphed against the number of years. This gives the method its name: straight-line depreciation. This is illustrated in **Table 1** and **Figure 3**.

Table 1. Straight-line depreciation for delivery truck.

Year	Depreciation ($)	Value of the asset ($)
0	--	100 000
1	15 000	85 000
2	15 000	70 000
3	15 000	55 000
4	15 000	40 000
5	15 000	25 000

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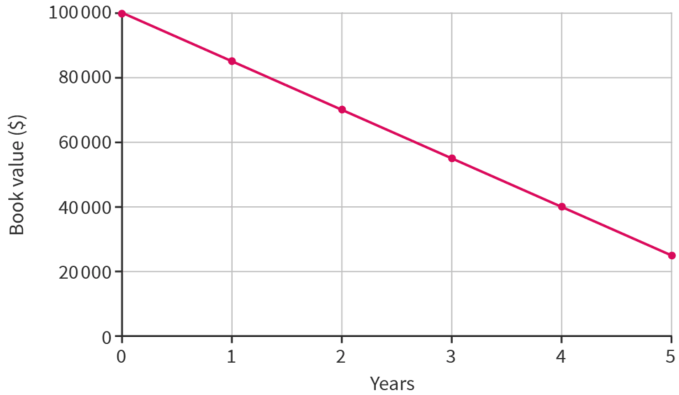


Figure 3. Straight-line depreciation for the delivery truck.

More information for figure 3

The line graph illustrates the straight-line depreciation of a delivery truck over a period of five years. The X-axis represents the number of years, labeled from 0 to 5. The Y-axis indicates the book value in dollars, ranging from $0 to $100,000 at intervals of $20,000. The graph shows a red line starting at $100,000 at year 0 and declining linearly to $0 by year 5. The points along the line indicate consistent depreciation each year, highlighting the straight-line depreciation method.

[Generated by AI]

Activity

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/final-accounts-st-of-financial-position-id-39285/print/) Assign

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (transfer)

A university decides to purchase studio and video equipment to produce educational videos for its online courses. The cost of the equipment is $2 500 000. The studio and video equipment are expected to serve for five years. After five years, the university plans to sell the equipment, and to replace it with more modern equipment. The scrap value of the equipment is approximately $500 000.

1. Determine the annual depreciation of the equipment using the straight-line method.
2. Construct the depreciation table and graph the depreciating value of the equipment over time.

1. $\text{Annual depreciation} = \frac{\text{purchase price} - \text{residual value}}{\text{estimated useful life}}$

$= \frac{\$2\ 500\ 000 - \$500\ 000}{5} = \$400\ 000$

2. The table of depreciated value of equipment over five years should be created as follows:

Depreciation of equipment over five years.

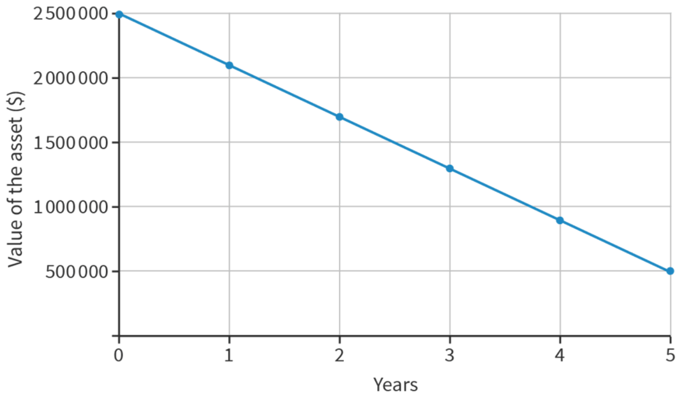
Year	Depreciation ($)	Value of the asset ($)
0	---	2 500 000
1	400 000	2 100 000
2	400 000	1 700 000

Student view

Overview
(/study/app/business-hl/sid-351-cid-762729/c

Year	Depreciation ($)	Value of the asset ($)
3	400 000	1300 000
4	400 000	900 000
5	400 000	500 000

The graph of depreciated value of equipment over five years should be drawn as follows:



Graph of depreciated value of equipment over five years.

Check your graph to make sure that the x-axis and y-axis are appropriately labelled and that the graph has a title. This is good practice for use of graphs in the internal assessment and extended essay.

Units of production method

The units of production method of depreciation is a method of calculating the loss in value of an asset by estimating the units produced annually.

To determine the annual depreciation, the business must create a production plan. This plan will outline the estimated production output per year during the time period that the asset will be used.

$$\text{Annual depreciation} = \frac{\text{yearly units of production}}{\text{total estimated lifetime production}} \times (\text{original value of asset} - \text{residual value})$$

For example, Company A acquires machinery on 1 January 2022 for $20 000. Company A creates a production plan for four years that shows total lifetime production of 8000 units, and at that point the residual value will be $0. Company A's production plan is shown in **Table 3** and the annual depreciation of the value of the asset is shown in **Table 4**.

Table 3. Company A's production plan.

Student view

Overview
(/study/app/business-hl/sid-351-cid-762729/c

Year	Number of units
1	1000
2	2000
3	2000
4	3000
Total	**8000**

Table 4. Annual depreciation and value of the asset.

Year	Calculation	Depreciation ($) (Recorded as expense in statement of profit or loss)	Value of asset ($) (Recorded in non-current assets in statement of financial position)
0			20 000
1	(1000 ÷ 8000) x ($20 000 — $0)	2500	17 500
2	(2000 ÷ 8000) x ($20 000 — $0)	5000	12 500
3	(2000 ÷ 8000) x ($20 000 — $0)	5000	7500
4	(3000 ÷ 8000) x ($20 000 — $0)	7500	0

Activity

Learner profile: Knowledgeable
Approaches to learning: Thinking skills (transfer)

A hospital purchases tomographic equipment at $850 000. The equipment has an estimated useful life of 140 000 pictures. The machine is predicted to operate in the following way:

- Year 1: 35 000 pictures
- Year 2: 30 000 pictures
- Year 3: 25 000 pictures
- Year 4: 20 000 pictures
- Year 5: 15 000 pictures
- Year 6: 10 000 pictures
- Year 7: 5000 pictures

After seven years the equipment can be sold at 5% of the purchase price.

- Create a table to record the annual depreciation from year 1 to year 7 considering the residual value.

Student view

The value of the asset that is going to depreciate: $850 000
The residual value of the asset: $850 000 x 0.05 = $42 500

$$\text{Annual depreciation} = \frac{\text{yearly units of production}}{\text{total estimated lifetime production}} \times (\text{original value of asset} - \text{residual value})$$

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Annual depreciation and value of the asset.

Year	Depreciation	Annual depreciation ($)	Value of asset ($)
0			850 000
1	Annual depreciation = (35 000 ÷ 140 000) x ($850 000 — $42 500) = 0.25 x $807 500 Value of asset = $850 000 — $201 875	201 875	648 125
2	Annual depreciation = (30 000 ÷ 140 000) x ($850 000 — $42 500) = 0.21 x $807 500 Value of asset = $648 125 — $169 575	169 575	478 550
3	Annual depreciation = (25 000 ÷ 140 000) x ($850 000 — $42 500) = 0.18 x $807 500 Value of asset = $478 550 — $145 350	145 350	333 200
4	Annual depreciation = (20 000 ÷ 140 000) x ($850 000 — $42 500) 0.14 x $807 500 Value of asset = $333 200 — $113 050	113 050	220 150
5	Annual depreciation = (15 000 ÷ 140 000) x ($850 000 — $42 500) = 0.11 x $807 500 Value of asset = $220 150 — $88 825	88 825	131 325
6	Annual depreciation = (10 000 ÷ 140 000) x ($850 000 — $42 500) 0.07 x $807 500 Value of asset = $131 325 — $56 525	56 525	74 800
7	Annual depreciation = (5000 ÷ 140 000) x ($850 000 — $42 500) 0.04 x $807 500 Value of asset = $74 800 — $32 300	32 300	42 500

Student view

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Appropriateness of each depreciation method

Table 5 shows the main advantages and disadvantages of each of the two methods.

Table 5. Advantages and disadvantages of each depreciation method.

Depreciation method	Advantages	Disadvantages
Straight-line method	Easy to calculate and apply; comparisons over time are possible. The complete value of the asset is accounted for in the scrap value, so the full value is accounted for.	Assumes that the asset is used evenly throughout its life, which is not the case for most assets. The useful life of some assets cannot be predicted and the scrap value is an estimate, so the depreciation figures are not completely accurate.
Units of production method	More realistic for many types of assets; provides a more accurate picture of the loss of value due to wear and tear.	More complex to calculate.

The straight-line depreciation method is best used for assets that operate in a consistent way throughout the life of the asset and have a predictable life span. It is also suitable for less expensive items, such as furniture, and for small businesses that value accounting simplicity. Finally, it can be used for assets that may not become obsolete over their lifespan.

The units of production method is best used for assets that may see varied levels of use over time. Also, more appropriate for more expensive assets, where having an accurate value for depreciation is very important for accounting purposes and product pricing decisions.

3 section questions

Question 1

What is meant by depreciation of a non-current (fixed) asset?

1 The non-current (fixed) asset loses value over time. ✓

2 The value of the non-current (fixed) asset stays constant over time.

3 The value of the non-current (fixed) asset increases over time.

4 The non-current (fixed) asset is worth more money.

Student view

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Explanation

Over time, through the wear and tear of being used to produce goods and services, non-current (fixed) assets such as machinery lose value. Two of the answers are incorrect because they refer to an increase in value, while the other incorrect answer refers to a constant value.

Question 2

Which of the following is **not** an example of depreciation of non-current (fixed) assets?

1 The fall in the value of the euro to the US dollar ✓

2 Large cracks in the walls of a factory

3 The conveyor belt in a car manufacturing plant becoming inefficient

4 A new machine to knead, form and bake bread, replacing an older oven that just bakes bread.

Explanation

Currency is not an example of a non-current (fixed) asset, so the fall in its value is not depreciation of a non-current (fixed) asset. The other options are incorrect because they are all examples of how non-current (fixed) assets can lose value over time.

Question 3

The 1 straight-line ✓ depreciation method assumes that the non-current asset is used evenly throughout its life.

Accepted answers and explanation

#1 straight-line

3. Finance and accounts / 3.4 Final accounts

Terminology exercise

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/terminology-exercise-id-39288/print/) Assign

Student view

Check that you understand the terminology used in this subtopic by dragging the correct word into each space.

The final accounts of a business are shown in two important statements. The first of these is the statement of ______ or loss, also known as the income statement. This statement records the sales revenues and costs of the business in order to determine profits. The ______ is the difference between sales revenues and cost of sales. The profit before ______ is gross profit less expenses. Non-profit enterprises record a ______ instead of a profit.

The second important final account statement is called the statement of ______ position, also known as the balance sheet. This statement records the values of a business's ______, which are all the items that are owned by the business. It also records the ______, which are all the debts of the business. Non-physical items of value owned by the business, known as ______ assets, are also recorded.

Trucks, machinery and buildings are examples of ______ assets – or fixed assets. These experience ______, which is the fall in the value of these types of assets over the time.

assets | surplus | gross profit | intangible | non-current | liabilities | depreciation | interest and tax | financial | profit

Check

Interactive 1. Understanding Key Financial Term.

3. Finance and accounts / 3.4 Final accounts

Checklist

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/checklist-id-39289/print/) Assign

What you should know

By the end of this subtopic, you should be able to:

- define the following terms: (AO1)
  - final accounts
  - statement of profit and loss (profit and loss account)
  - statement of financial position (balance sheet)
  - intangible asset
  - depreciation
- explain the purpose of accounts to different stakeholders (AO2)
- analyse the elements of a statement of profit or loss (profit and loss account) and a statement of financial position (balance sheet) (AO2)

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- construct a statement of profit or loss (profit and loss account) (AO4)
- construct a statement of financial position (balance sheet) (AO4)
- distinguish between different types of intangible assets (AO2)
- calculate depreciation using the straight-line method (AO4)
- calculate depreciation using the units of production method (AO4)
- discuss the appropriateness of each depreciation method (AO3)

3. Finance and accounts / 3.4 Final accounts

Reflection

Section Student... (0/0) Feedback Print (/study/app/business-hl/sid-351-cid-762729/book/reflection-id-48322/print/) Assign

Teacher instructions

The goal of this section is to encourage students to pause at the end of the subtopic and to reflect on their learning. Students can use the questions provided below to guide their reflection. The questions encourage students to look at the bigger picture and to consider how the subtopic's contents might have impacted the way they view the subject.

The following table shows you how each prompt aligns to the DP *Business management guide*:

Prompt #	Syllabus alignment
1	**Learner profile:** Reflective
2	**Learner profile:** Thinkers
3	**Learner profile:** Open-minded **(HL only)**
4	**Concept:** Sustainability

Students can submit their reflections to you by clicking on 'Submit'. You will then see their answers in the 'Insights' part of the Kognity platform.

Reflection

In this subtopic you learned about profit and loss accounts, balance sheets and types of assets.

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Take a moment to reflect on your learning so far. You can use the following questions to guide your reflection. If you click 'Submit', your answers will be shared with your teacher.

1. Initially many students struggle with understanding the purpose of final accounts, especially the balance sheet. What helped you understand how the balance sheet is set up? If you still don't understand it fully, which elements do you struggle with?
2. Think of the businesses you know and buy from often. Do you think it is ever possible to measure a business's goodwill?
3. Consider the methods of depreciation introduced in Section 3.4.5 (/study/app/business-hl/sid-351-cid-762729/book/depreciation-hl-id-39287/). To what extent are these methods a realistic way to find the value of an asset? (HL)
4. Now that you know about accounts, to what extent do you consider profit and loss statements and balance sheets good indicators of the economic sustainability of a business?

Once you submit your response, you won't be able to edit it.

0/2000

Submit

Rate subtopic 3.4 Final accounts

Help us improve the content and user experience.

Student
view