P&L and Balance Sheet v 1.0

A Primer

To be used in conjunction with Corporate ProfitAbility

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Corporate PROFITABILITY
CUSTOMERS 60 DAYS
CUSTOMERS 30 DAYS
RECEIVE
BANK 60 DAYS
BANK 30 DAYS
REPAY
PROFITABILITY
INTEREST
TAX
DIVIDENDS
RECRUIT STAFF
PRODUCTIVITY
PROMOTION
SERVICE
RENT
WAGES
ADMIN
WAGES 4
WAGES 5
WAGES 6
PROFITABILITY
Corporate ProfitAbility

Introduction

The P&L Statement

In the Corporate ProfitAbility Simulation, teams record monthly *Revenues* (*Sales*), the corresponding costs (*Cost-of-Sales* or *COS*) as well as *Expenses* in the *Profit & Loss (P&L) Statement*. (Figure 1)

Teams also compute and reflect profits for the month in the *P&L Statement*. The final profit value in the *P&L Statement*, after provisions for *Depreciation*, deductions for *Interest* and *Tax* is called *Profit After Tax (PAT) or Net Profit (NP).*

<u>Various forms of profit</u>

Gross Profit = Revenue - COS

EBITDA = Gross Profit – Expenses

EBIT = EBITDA – Depreciation (& Amortization)

Profit Before Tax (PBT) = EBIT – Interest

Profit After Tax (PAT) or Net Profit = PBT - Tax

Note : The P&L Statement captures all sales, COS and Expenses as well as Profits within a particular period – which is usually monthly, quarterly or yearly.

Figure 1 : The P&L Statement

The Balance Sheet The *Balance Sheet* keeps track of what the company owns *(Assets)* and what it owes *(Liabilities)* at a particular point of time. (Figure 2) The difference between *Assets* and *Liabilities* is called *Shareholder's Equity* represented by the equation below: Shareholders' Equity = Assets – Liabilities ……………(1) From the simulation, we also know that *Shareholder's Equity* comprises of *Share Capital* and *Retained Earnings*. As its name suggests, the *Balance Sheet* must always balance. Thus moving the elements in (1) around, the following equation must always hold true in the *Balance Sheet* **Assets = Liabilities + Shareholders' Equity ……………(2)**	*Note : Unlike the P&L Statement which is reported over a particular period, the Balance Sheet is reported as at a particular point of time usually coinciding with the last day of the month, quarter or year.* *The Balance Sheet changes at every transaction recorded.*

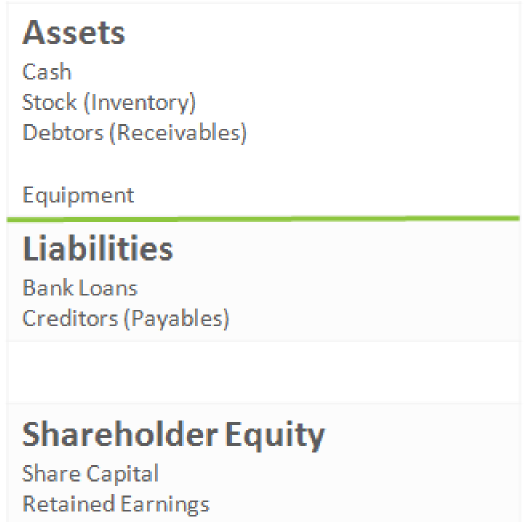

Figure 2 : The Balance Sheet

Assets include *Cash (in the bank)*, money that Customers owe the company (*Debtors* or *Receivables*), *Stock* or *Inventory*. These assets are classified as *Current Assets* as it can be converted into cash fast.

Equipment is classified as *Non-Current Assets* or *Fixed Assets* as it takes some time to convert them into cash. In the real world, non-current assets will also include buildings or vehicles that the company has purchased.

Liabilities include cash that the company owes its Suppliers (*Creditors* or *Payables*). These liabilities are classified as *Current Liabilities* while long term Bank Loans are classified as *Non-Current Liabilities*.

From the simulation, we also know that whenever an investor invests in a company, the *Cash* portion of the *Balance Sheet* increases while a corresponding value is recorded as *Share Capital*.

The P&L and the Balance Sheet Connection

A. PAT & Retained Profits (Figure 3)

When you make a Profit (ie *PAT* that is recorded in the *P&L Statement*) in any given month, the *Retained Profits* portion of *Shareholder Equity* in the *Balance Sheet* will show a corresponding increase. Over time, *Retained Profits* will show an accumulation of profits or losses left in the business.

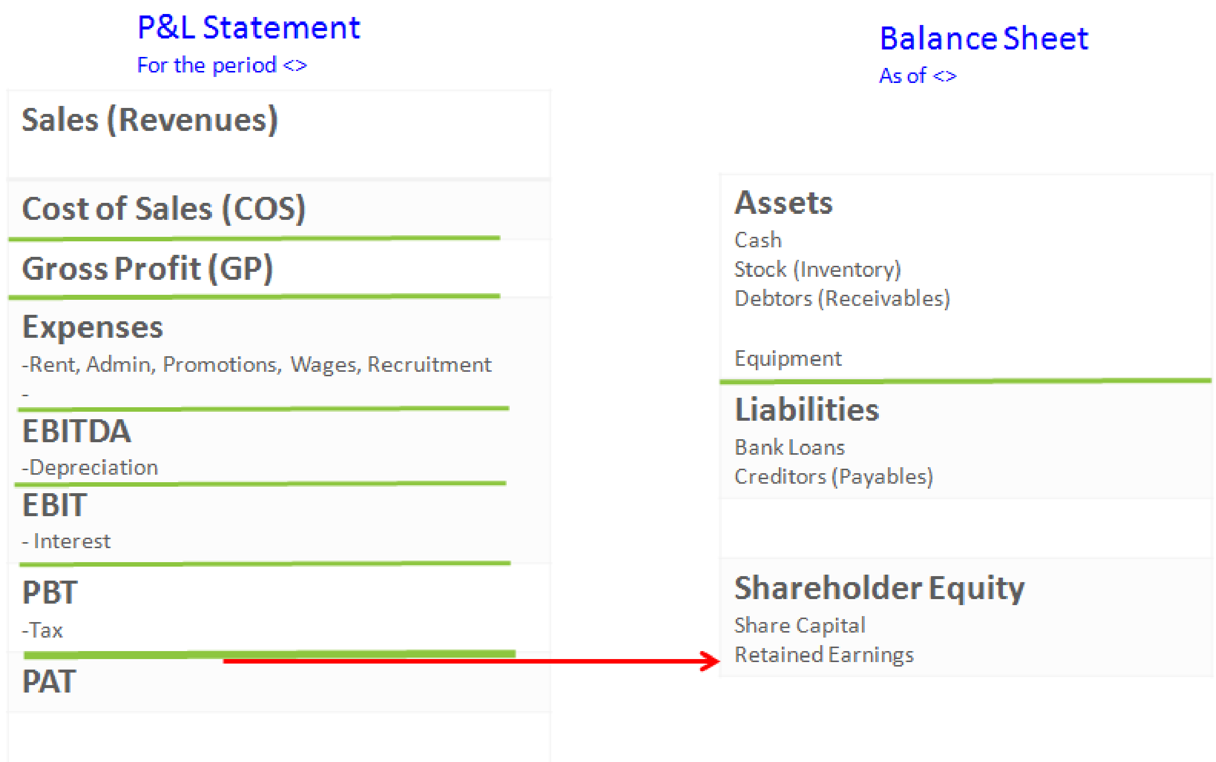

Figure 3. The Connection between PAT (P&L) and Retained Profits (Balance Sheet)

B. Revenues & Cash, Debtors

In real life, *Revenue* is recorded in the *P&L Statement* when products and services are delivered to the customer within a particular month. This essentially means that Revenue is recorded in the *P&L Statement* when a company bills (or invoices) its customer for products and services delivered.

When the customer is invoice (or billed), the customer may pay the company immediately in Cash (COD) or after a certain period depending on the payment terms that you have agreed with the Customer before delivery of the product or service. This period can range anything from 30 to 90 days. (Figure 4)

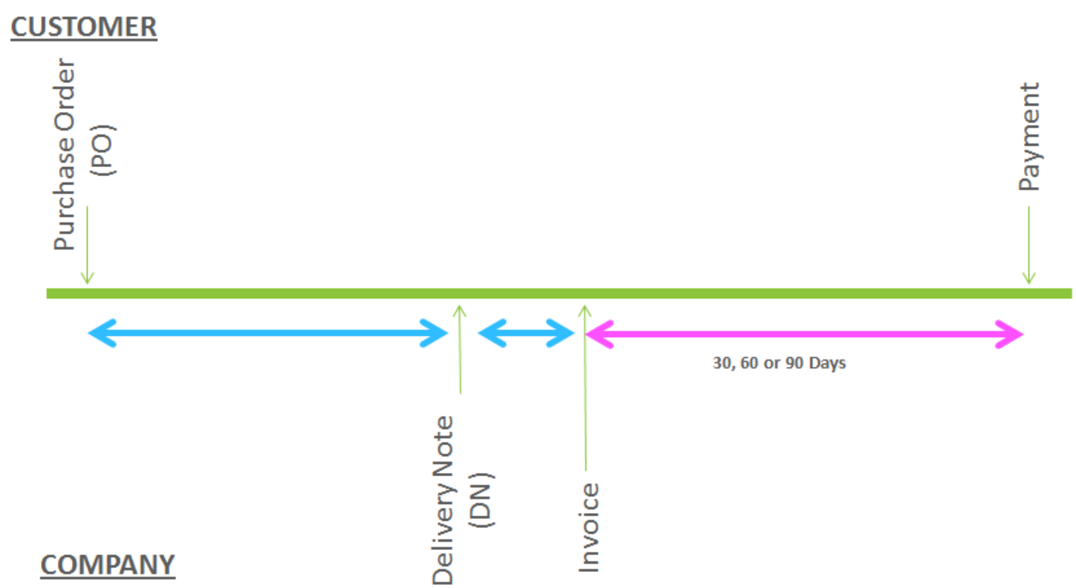

Figure 4. The Delivery, Invoicing and Collection Timeline

Note : Revenues are usually recorded in the P&L after invoicing (and delivery).

There are however exceptions to this rule.

Check with your Finance Team on these exceptions.

Two things may happen in the *Balance Sheet*. If the customer pays cash, the *Cash* item in the *Balance Sheet* will increase corresponding to the *Revenue* value in the *P&L Statement*. If the company has allowed the customer to pay after 30-90 days, the *Debtors (Receivables)* portion of the *Balance Sheet* will increase corresponding to the *Revenue* value in the *P&L*. When the customer eventually pays, the *Debtors* portion in the *Balance Sheet* will be reduced while the *Cash* portion will increase proportionately. Do note that the *P&L Statement* is not affected by all the above transactions in the *Balance Sheet* as the *Revenue* has already been recorded in the month when the customer was invoiced (billed).	

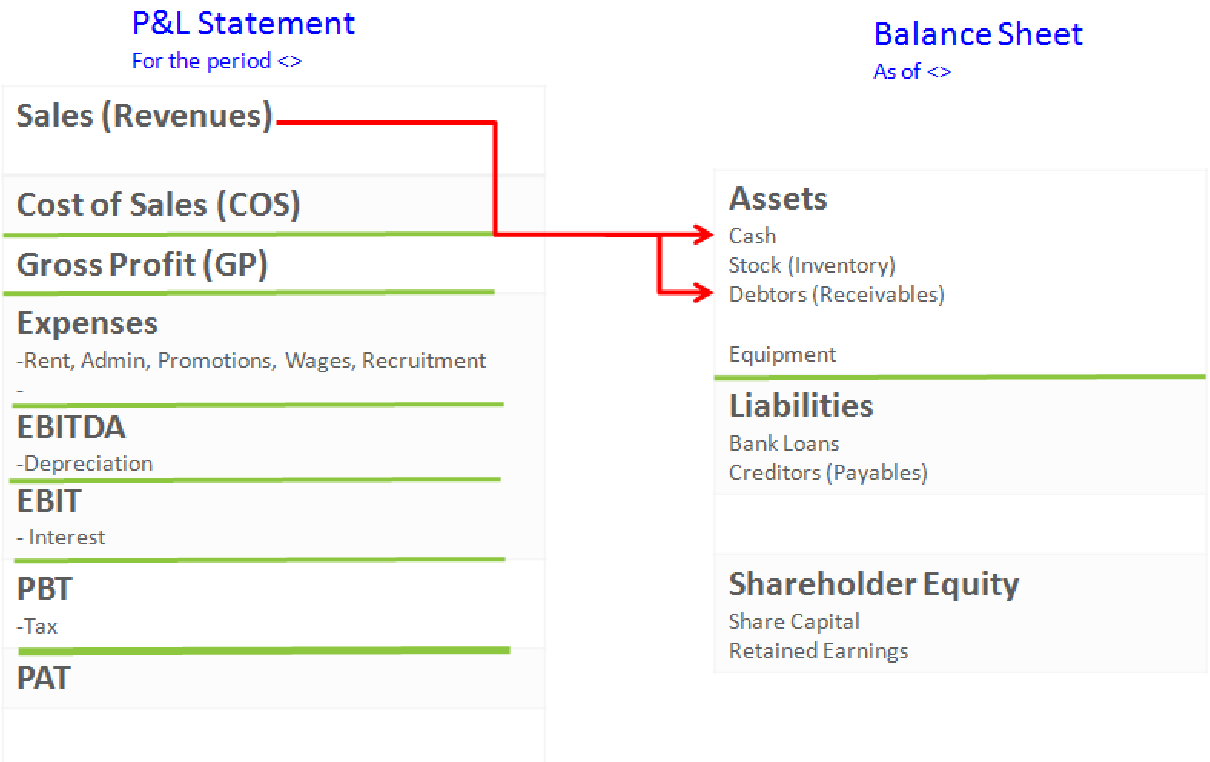

Figure 5. The Connection between Revenue (P&L) and Cash & Debtors (Balance Sheet)

C. Cash, Stocks & Creditors

When a company purchases *Stocks* (*Inventory*) from Suppliers, the company can opt to pay cash or to request a credit term from the Supplier.

When cash is paid (COD) after receiving *Stocks*, the *Cash* portion of the *Balance Sheet* reduces accordingly while the value of *Stocks* (in the *Balance Sheet*) increases proportionately.

Alternatively, if the Supplier has allowed the company to pay in say 30 or 60 Days after receiving the stocks, the *Creditors* (*Payables*) portion of the *Balance Sheet* increases accordingly.

(The value of *Stocks* (in the *Balance Sheet*) also increases proportionately just as when the stocks are purchased with cash)

When it is time to pay the Supplier after 30 or 60 days, the value of *Creditors* and *Cash* in the *Balance Sheet* reduces accordingly equivalent to the value of the payment that has been made to the Supplier.

All the above *Balance Sheet* transactions, conforms to the *Balance Sheet* equation ie.

Assets = Liabilities + Shareholders' Equity

Do note, that at this point, there have been no transactions in the *P&L* as no products have been sold, delivered and invoiced as yet. There are also no changes to the value of the *Stocks* in the Balance Sheet apart from the initial increase when the stocks were first received from the Supplier.

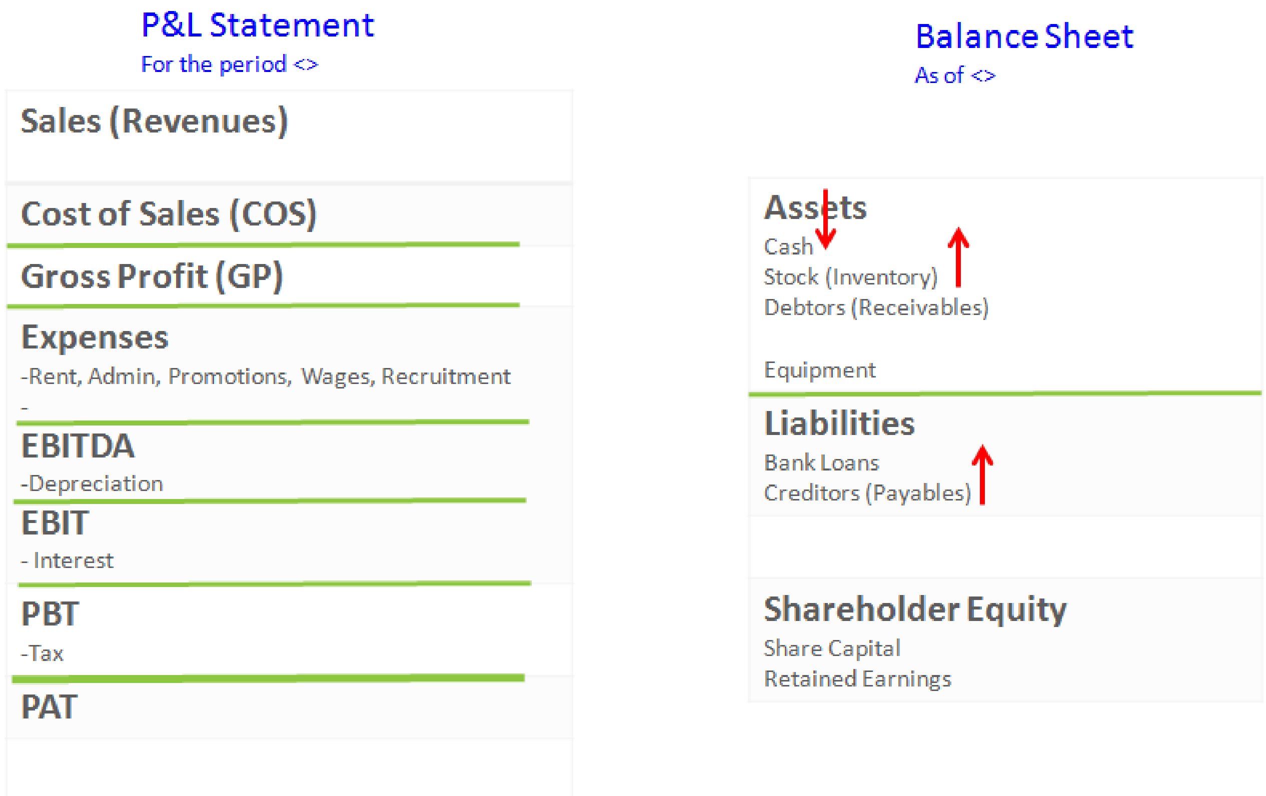

Figure 6. The Connection between Cash, Creditors and Stocks (Balance Sheet)

D. COS & Stocks

When all the *Stocks* have been sold at a certain price. *Revenues* as well as the corresponding value (COS) of the *Stocks* will be recorded in the *P&L Statement* for the month. The value of *Stocks* in the *Balance Sheet* will then decrease by the same amount.

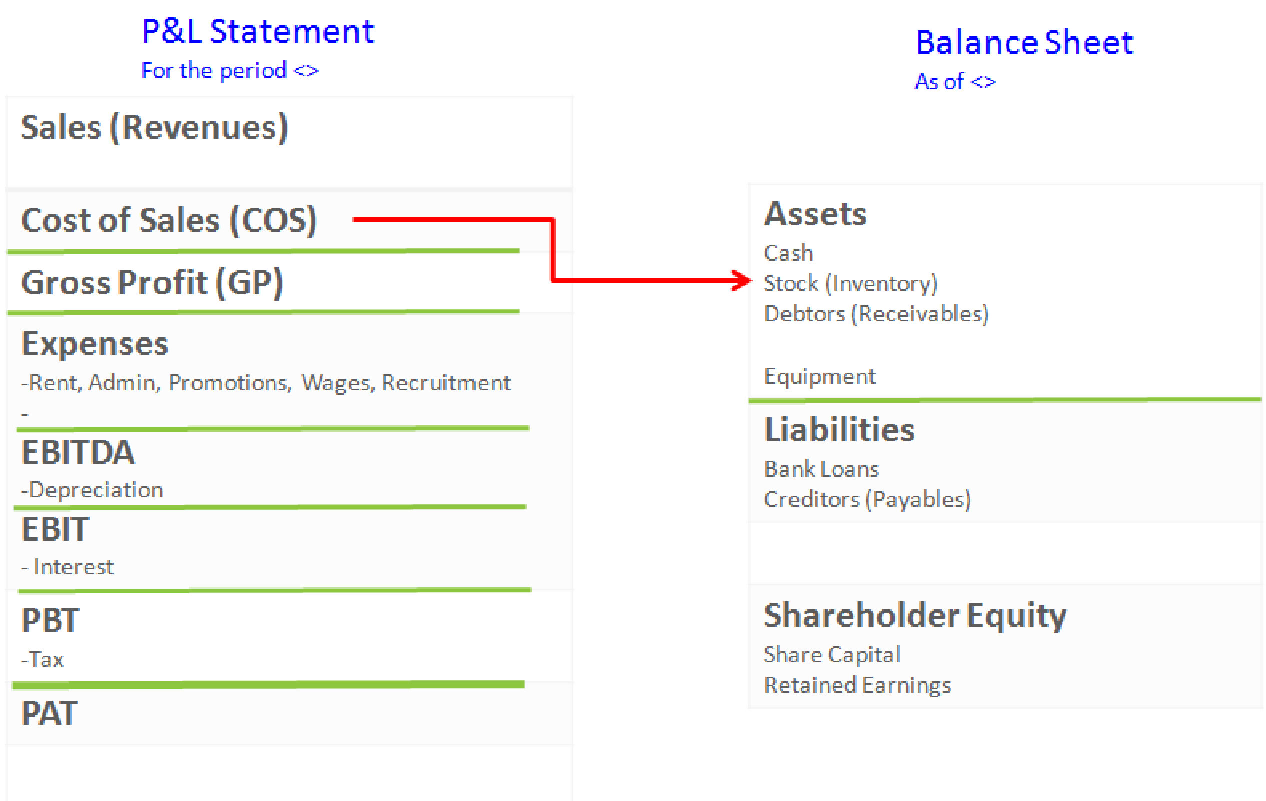

Figure 7. The Connection between COS (P&L) and Stocks (Balance Sheet)

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