14 The other financial statements

A The profit and loss account

Companies' annual reports contain a **profit and loss account**. This is a financial statement which shows the difference between the revenues and expenses of a period. **Non-profit** (or **not-for-profit**) **organizations** such as charities, public universities and museums generally produce an **income and expenditure account**. If they have more income than expenditure this is called a **surplus** rather than a profit.

At the top of these statements is total **sales revenue** or **turnover**: the total amount of money received during a specific period. Next is the **cost of sales**, also known as **cost of goods sold** (**COGS**): the costs associated with making the products that have been sold, such as raw materials, labour, and factory expenses. The difference between the sales revenue and the cost of sales is **gross profit**. There are many other costs or expenses that have to be deducted from gross profit, such as rent, electricity and office salaries. These are often grouped together as **selling, general and administrative expenses** (SG&A).

Searby PLC

Annual Profit and Loss Account, 1/20_ _

	(£'000)
Sales Revenue	48,782
Cost of Sales	33,496
Gross Profit	15,286
Selling, General and Administrative Expenses	10,029
Earnings before Interest, Tax, Depreciation and Amortization	5,257
Depreciation and Amortization	1,368
Earnings before Interest and Tax	3,889
Interest expenses	257
Income Tax	1,064
Net Profit	2,568

The statement also usually shows **EBITDA** (earnings before interest, tax, depreciation and amortization) and **EBIT** (earnings before interest and tax). The first figure is more objective because depreciation and amortization expenses can vary depending on which system a company uses.

After all the expenses and deductions is the **net profit**, often called the **bottom line**. This profit can be distributed as dividends (unless the company has to cover past losses), or transferred to reserves.

BrE: net profit; AmE: net income
BrE: profit and loss account; AmE: income statement

B The cash flow statement

British and American companies also produce a **cash flow statement**. This gives details of cash flows – money coming into and leaving the business, relating to:

- **operations** – day-to-day activities
- **investing** – buying or selling property, plant and equipment
- **financing** – issuing or repaying debt, or issuing shares.

The cash flow statement shows how effectively a company generates and manages cash. Other names are sometimes used for it, including **funds flow statement** and **source and application of funds statement**.

British companies also have to produce a **statement of total recognized gains and losses** (**STRGL**), showing any gains and losses that are not included in the profit and loss account, such as the revaluation of fixed assets.

14.1 Which figure in each of the following pairs is higher for a profitable company? Look at A opposite to help you.

1 cost of sales / sales revenue
2 gross profit / net profit
3 EBIT / EBITDA
4 net profit / pre-tax income
5 income tax / net profit

14.2 Complete the text with words from the box. You will need to use each word more than once. Look at B opposite to help you.

financing	investing	operations

(1) .... means making money by selling goods and services. (2) .... is spending cash, for the business's future growth, including cash acquired by selling assets. (3) .... involves raising money by issuing stocks and bonds (and also paying dividends and interest and repaying bonds). It is better for the company if it can pay for future growth out of money from (4) .... , without having to use (5) .... So a 'healthy' cash flow means that the amount of cash provided by (6) .... is greater than the cash used for (7) ....

14.3 Would the following appear as operating, financing or investing activities on a cash flow statement? Look at the example below to help you.

Changes in operating assets and liabilities	Payments to repurchase stock
Dividends paid	Sale of property
Purchase of plant and equipment	Depreciation and amortization expenses
Net income	Income taxes payable
Issuance of stock	Repayment of debt

Godwin-Malone Inc, New York

Cash flow statement ($'000)	**20__**	**20__**
Earnings	1,811	1,274
Amortization	924	683
Other adjustments to Earnings	33	–6
Net cash provided from operations	**2,768**	**1,951**
Proceeds from issuing new stock	234	167
Stock dividends paid	–14	
Net cash provided from financing	**220**	**167**
Additions to property, plant and equipment	–2,351	–1,755
Net cash used for investing	**–2,351**	**–1,755**
Change in cash and equivalents during year	**356**	**97**
Cash and equivalents, beginning of year	2,150	2,014
Cash and equivalents, end of year	2,506	2,111

Over to you

Look at cash flow statements in company annual reports, and at the share prices of those companies over the past years. What happened to the share price of companies that generated more cash than they spent, and what happened to those that spent more than they generated?