



SIMPLE IS BETTER

SIMPLE IS BETTER – ISSUE -8 – OUR LIFE AND INVESTMENT - 2

We have seen in issue 7, that our life and businesses having a relationship & similarities and due to the understanding of our life help us to make better investment decisions.

In the current issue, I try to relate other similarities between our life and the business. I am going to explain profit and loss statement of the company with examples of our life which make it simpler to understand.

Every company prepares a financial statement which contains 1) Balance Sheet, 2) Profit and Loss statement and 3) Cash-flow statement. These three statements are essential for the analysing financial of any company.

Before starting with my detail discussion, let me start with what is the profit and loss account? And why it is essential to study a profit and loss account?

“A profit and loss statement (P&L) is a financial statement that summarizes the revenues, costs and expenses incurred during a specific period of time, usually a fiscal quarter or year.” - Investopedia

“It begins with an entry for revenue, known as the “top line,” and subtracts the costs of doing business, including cost of goods sold, operating expenses, tax expense and interest expense. The difference, known as the bottom line, is net income, also referred to as profit or earnings.” - Investopedia

Particulars	Schedule	Amount (Rs)
Income		
Sales and operating income	1	.....
Other income	2	.....
Total		.....
Expenditure		
Cost of goods sold	3	.....
Operating and other expenses	4	.....
Depreciation/Amortisation		.....
Interest		.....
Total		.....
Add/(Less): Exceptional items		.....
Profit/(Loss) before tax		.....
Less: Tax		.....
Profit/(Loss) after tax		.....

So, profit and loss account helps us to understand what is the income and what can be saved after incurring all expenses.

If we look at the profit and loss statement carefully, then we can say that there are many similarities between our profit & loss statement and profit & loss statement of the companies.

Let us try to understand profit and loss statement of the company with an above example of the profit and loss statement of an individual person. There are many similarities between the statement of individuality and statement of the company.

Let's have a look at it one by one with an example for making it more clear.

Revenue

The first part of the individual and of the company is a revenue. We earn a salary from our work and from that salary, some taxes got deducted (Professional tax, allowance, etc.). So, before taxes, we earn the gross salary and after deducting taxes, it will be a net salary.

₹ in crores			
Particulars	Note No.	For the year ended March 31, 2016	For the year ended March 31, 2015
I Revenue from Operations	22		
(a) Gross sales of products		30,434.29	29,020.98
Less: Excise duty		2,258.21	1,717.65
		28,176.08	27,303.33
(b) Sale of services and other operating revenue		437.65	234.70
Net revenue from operations		28,613.73	27,538.03
II Other income	23	389.08	492.11
III Total Revenue (I + II)		29,002.81	28,030.14

Similarly, with the companies, they earn gross revenue from selling their products/services; from those gross revenue taxes/duties get deducted which resulted in a net revenue.

After getting the net revenue, we add our other operating income (Incentives, bonus, etc.) and other incomes (Interest income, dividend income, etc.). Into net revenue for getting a total income earned by us.

Similarly, with the companies, they also earn some other operating income (provide after sales services, repair products, etc.) and other incomes (Interest income, dividend income, etc.).

$$\text{Net income} + \text{other operating income} + \text{other income} = \text{Total income}$$

After getting total income earn by us, we start deducting expenses for getting the actual picture of our income and expenses. Let's start to compare our expenses with expenses of companies.

IV Expenses:			
(a) Cost of materials consumed	24	19,357.95	19,790.40
(b) Changes in inventories of finished goods and work-in-progress	25	(44.80)	(75.10)
(c) Employee benefits expenses	26	1,343.06	1,178.72
(d) Finance costs	27	11.87	11.70
(e) Depreciation and amortization expenses	13	447.01	540.45
(f) Other expenses	28	3,575.27	3,147.28
Total Expenses		24,690.36	24,593.45

Expenses

1) Raw Material expenses

Raw Material expenses are essential to the keeping the business continues. Without inserting raw materials, we cannot able to generate the finish products.

Similarly, we spent money on purchasing foods, grains, vegetables, fruits, etc. Which is essential for keeping us alive. Without taking foods, we cannot able to survive for the longer period of time.

2) Employee benefits expenses

Employee benefits expenses are payment of salaries to employees, bonuses, provident fund, welfare activities, etc.

Similarly, we also pay the salary for the maid, chef, car driver, etc. in our home. These are as similar as an employee at the organization and getting paid as per their skills.

3) Finance costs

These are interest payments on the borrowings of the company. This expense is as similar as EMI payment of the home loan, car loan, personal loan, etc. This cost is a burden on the company as the company must have to make payment of it though they not able to earn well. Similarly, we also have to pay EMIs though we are earning or not.

4) Depreciation expenses

Meaning of depreciation – “The monetary value of an asset decreases over time due to use, wear and tear or obsolescence. This decrease is measured as depreciation.” – The Economic Times

“Depreciation is an accounting method of allocating the cost of a tangible asset over its useful life.” – Investopedia

This is a non-cash expense and we are generally not making any provision as a depreciation directly.

5) Other expenses

These expenses include power & fuel, rent, advertisement, repair & maintenance, researchers & development, insurance changes, etc.

Similarly, we also make payment for fuel for our vehicles, electricity bills, rent (if we stay at rented home), our development (books, seminars, etc.), repair & maintenance (maintenance of our vehicles, home and sometimes reparations also of vehicles & home), leisure expenses, etc.

So, we pay such major expenses from our earning for ourselves and for the family. We see that these expenses are closely similar to the expenses incurred by the companies.

Total Income – Total Expenses = Profit before exceptional & extraordinary items

V	Profit before exceptional item and tax (III - IV)		4,312.45	3,436.69
VI	Exceptional item - Provision for diminution in value of non current investment (refer note no. 37)		-	144.73
VII	Profit before tax (V -VI)		4,312.45	3,291.96
VIII	Tax expenses			
	(a) Current tax		960.91	899.18
	(b) Deferred tax		301.33	44.27
			1,262.24	943.45

The next point is exceptional & extraordinary items. What are the exceptional & extraordinary items?

“An exceptional item is an unusually large and uncommon transaction charge that must be disclosed. An exceptional item may be either an outgoing charge or an incoming surplus of significant size.” – Investing Answers

“An extraordinary item consists of gains or losses included on a company's income statement from events, which are unusual and infrequent in nature.” – Investopedia

This can be exceptional/rare expenses or gains which are not a regular in nature. Sometimes we faced illnesses, accidents, etc.; these can be a rare expense and sometimes we sold some of our property, vehicles, etc. can be a rare income.

Similarly, the companies sometimes sell their assets, businesses and also met loss due to derivative transactions, fire at the plant, restructuring of business etc.

After adjusting for exceptional & extraordinary gain / (loss), the company needs to pay a tax on the balance amount. And after deducting tax, the company will get net profit for the year.

XII	Profit for the year		3,093.78	2,364.70
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Similarly, we also need to pay an income tax on our income, but the difference is that we do not get deductions for every expense from our income for the income tax.

Net profit comes after deducting every expense which company has incurred.

We have seen that there is not a major difference between profit and loss account of the individual salaried person and of the company. We also keep records of our everyday expenses, though we do not get the deductions from income tax. We keep such records for the enhancing our savings.

If expenses are higher compared to revenue, then the company will report a loss for the particular period. Similarly, when our expenses are higher compared to our revenue than we also incurred a loss.

Our existence in this life is a business. We live it by transactions. We end it by either making profit or loss.

- Victor Onaola

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Issue - 1	Issue - 2	Issue - 3	Issue - 4	Issue - 5	Issue - 6
Issue - 7					

Disclaimer

Above article is just my perception, and perception can be wrong. For me, my perception can be right but for others, it might be wrong.

I am Grateful to

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*As a founder of Lucky Idiot; My mission through **"Lucky Idiot"** is to educate novice investors and to distribute learning to more and more people in a simple manner.*

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