

UNDERSTANDING THE PROFIT AND LOSS ACCOUNT

FINANCES





AUTHOR: OTHMAN LOUANJLI

UNDERSTANDING THE PROFIT AND LOSS ACCOUNT

The profit and loss account is an accounting tool that is used to show how a business performed during a particular period of time. The contents of the profit and loss account will vary from business to business, but they will always contain some key elements.

The profit and loss account is an important tool to understand whether the business in question has been successful in delivering on the primary objective of delivering a profit from its activities.

SALES

This is the total amount of cash generated from sales activities.

COST OF SALES

This is a variable expense that comes from the activities you undertake to either make or buy the goods that you sell.

GROSS PROFIT

This is calculated by subtracting the cost of sales from sales.

EXPENSES

These are costs incurred by the business that are not directly involved in either producing or buying the goods you sell. These can include heat, power, insurance, wages, sales, marketing, bank fees, rent, etc.





NET PROFIT

This is the expenses subtracted from the gross profit figure. Generally, businesses issue their dividends and pay tax based on this figure.

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