

FINANCE AT A GLANCE

Where the Profit Goes

Lesson 31

In the preceding lesson, the income statement of ABC Inc. showed a Net Profit After Tax of \$2.4 million. This amount could be fully reinvested into the business, or just partially reinvested and the rest could be distributed to the shareholders. In case of the latter, the amount distributed to the shareholders is called **Dividend**.

The disclosure of the amount of Dividend and the amount reinvested is done by way of the **Statement of Retained Earnings** (which is actually a continuation of the Income Statement). ABC Inc.'s Statement of Retained Earnings would appear as follows if \$400 thousand was the Dividend amount. For illustration purposes, let us assume that the balance sheet as of the end of 2007 showed Retained Earnings of \$10 million.

ABC Inc.	
Statement of Retained Earnings	
For the Year Ending December 31, 2008	
	\$000
Retained Earnings as of December 31, 2007	10,000
Plus: Net Profit After Tax in 2008	2,400
Less: Dividends in 2008	400

Retained Earnings as of December 31, 2008	12,000

Recall from Lesson 11 that Retained Earnings is a part of the Equity portion of the balance sheet, and that it is the item that carries the accumulation of profits made in previous periods that were reinvested into the business. We have just shown above how this accumulation of profit gets reflected in the balance sheet. The Retained Earnings increased by \$ 2 million from December 31, 2007 to December 31, 2008.

Now imagine if instead of the Net Profit After Tax of \$2.4 million, the business made a loss of \$1 million. There would be no Dividend in 2008, since there was no profit in that year from which to take out Dividend. The statement would have appeared as follows, wherein the Retained Earnings dropped over the 12-month period, because a negative figure was added to it.

ABC Inc.	
Statement of Retained Earnings	
For the Year Ending December 31, 2008	
	\$000
Retained Earnings as of December 31, 2007	10,000
Plus: Net Profit After Tax in 2008	-1,000

Retained Earnings as of December 31, 2008	9,000

Now here is a hypothetical situation to imagine. Assume that in all of the subsequent years beyond 2008, the business makes nothing but losses. That means that a series of negative figures will be added to the Retained Earnings each year, thus depleting it, and even to the extent that the Retained Earnings itself becomes negative figure. It can be as high a negative figure as that which can make the Liabilities + Equity side of the balance sheet equal to zero. And that means that the Assets side (which always equals the Liabilities + Equity) is also zero. At that point, the business is said to have been completely wiped out by losses that piled up over the years.

Until the next lesson,

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