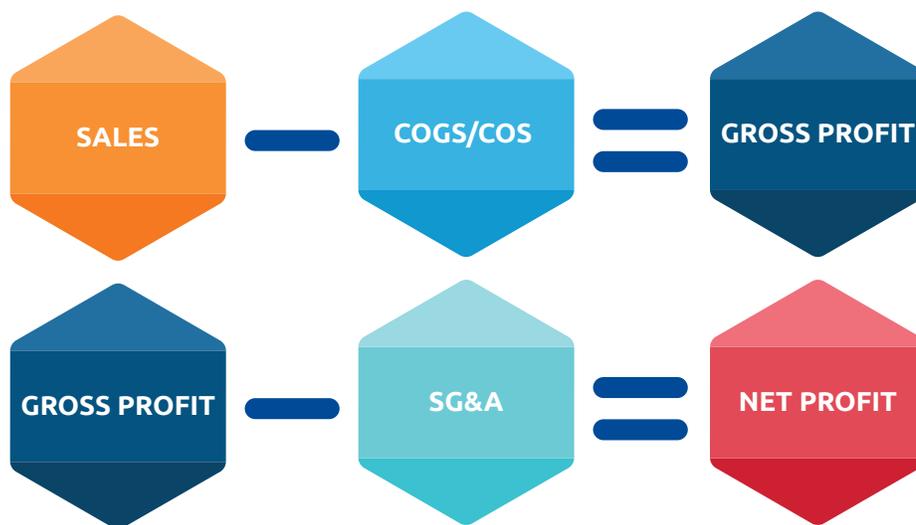




A simple guide to understanding your profit and loss statement

Entrepreneurs start organizations because they are passionate about their business and are not completely comfortable interpreting their monthly financial reports. While we can't teach you to be a CPA, here are the basics components to a Profit and Loss statement (P&L).



P&L

All P&Ls are based on a very simple formula -- sales minus costs equals profit. It really is that simple. Everything else is a matter of breaking out sales or costs into more detail and adding subtotals. Sales are typically shown at the top of the P&L. Costs are shown below sales and profit is at the bottom. You may see a number of subtotals as you look down the column, but it is still sales minus costs equal profit.

Sales

Your company's sales will be broken into multiple components. For example, sales of a restaurant may come from customers who dine in, take out or order catering. In this case, the three components would be added together to total sales. Deciding how to break out sales is key to measuring overall business performance.

Costs

Similarly, costs are broken into various components. For example, you may see material costs, labor costs and overhead broken out separately. There are an infinite number of ways to break out costs, but once you get below the total sales line everything else you see is a cost.

One of the most useful ways to subdivide costs is into those costs that are directly associated with delivering your product/service and those that are not. These costs are referred to as cost of goods sold (COGS) because they can be tied directly to the production of goods. In a service business, this can be called the cost of service (COS).

Profit

Sales minus COGS is known as gross profit (or gross margin). This is the money the business earns after it subtracts the cost of delivering its product and/or services. Other costs are most often referred to as selling, general and administrative costs (SG&A). With this addition, the P&L is now broken down into two parts: sales minus COGS equaling gross profit, and gross profit minus SG&A equaling net profit.

AKAs in Accounting....

- Sales can also be called revenue or income
- Costs can also be called expenses
- Profits can also be called net income
- A Profit & Loss statement can also be called an Income Statement