



TOOLBOX



Profit and Loss Statement

Definition

A profit-and-loss statement depicts the financial results of a business over a given period of time. $\text{Income (revenue)} - \text{Expenses} = \text{Profits (net income)}$.

How it Works

Profit-and-loss statements can be used in a variety of ways to evaluate the financial performance of a business. They can answer these questions.

- Have profits increased over time?
- Have sales increased since last year?
- Have costs of production been reduced?
- How does this business compare with other businesses?
- How does this business compare with other industry averages?
- How does this product compare with one in a completely different line of production?

Profit is the return the business owner receives on his money, management skills, and the risk he takes in starting the business. Any other factors that went into the success of the business should be included as expenses. Profit is the "bottom line" of the statement. It tells whether the business made or lost money, and is a very important indication of whether the business will survive.

Pros, Cons, and Other Uses

Clearly an understanding of profit and loss is essential to evaluating project impact on assisted businesses. And, profit-and-loss statements provide the simplest way to track that information. The problem is that not all businesses keep these records. Some owners are illiterate. Many feel they can maintain a sufficiently accurate understanding in their heads. Others are fearful of tax collectors and government interference.

One advantage of keeping records with small businesses is that it teaches business people to keep business finances separate from household finances. This, in turn, enables them to invest more in the growth of their business. They can also compare profits according to different marketing techniques or with alternative sources of supply. For these reasons, many projects provide training in record keeping as part of their package of assistance.

There are also more sophisticated ways to interpret profit-and-loss statements. Some ratios to calculate include return on equity, return on assets, return on interest-earning assets, and return on total income.

A typical statement includes these items:

Profit-and-Loss Statement

January 1 to 31, 2007

INCOME	
Sales	
Interest received	
Value of products consumed	
Total Income	
EXPENSES	
Raw materials purchased	
Salaries and benefits	
Wages and benefits	
Family labour	
Rent	
Electricity	
Telephone	
Transportation	
Interest paid	
Equipment and building repairs	
Taxes	
Depreciation	
Total Expenses	
Net profit or (Loss)	

Key terms on the statement include:

raw material	– any supplies used in producing the final product
salaries	– fixed amounts paid to managerial personnel, usually quoted monthly or annually
wages	– amounts paid to workers per hour, day, or per piece produced
benefits	– 13 th month of salary, retirement, separation pay, health care, insurance
depreciation	– an accounting device that allows you to include durable purchases by prorating them over time. It is used for large expenses such as land, building, or equipment. Straight line depreciation is calculated by estimating how long the item will be useful and dividing the full purchase price by that amount. A building that cost \$15000 might be expected to last 20 years. That means the building would cost \$750 per year. Divide that price by 12 to include the correct amount in a monthly profit and loss statement.

Other items are self-explanatory.