The Dna Of A Profit & Loss Statement – Session Notes

The profit & loss statement (or income statement as some might say) shows us a historical view of how the company has *performed* over a certain period of time. It shows us the income that the company has generated as well as the expenditure the company has incurred.

If we can see that the income of the business exceeds the expenses then we're looking at a profit, if however, the expenses outweigh income then we'll be looking at a loss. Simple! It's a formula no more complex than that.

You're likely however to want a little bit more detail in respect to the income and expenditure whilst also including subtotals so that you can see important parts of the detail.

The common place to start in the statement is with the business's major activities. Whether that be the company supplying a service or producing and selling a product.

We will first of all show the income the company has made from this activity, you may refer to this as 'sales' or even 'revenue' depending on your business. Once you've shown this income, it would make sense to see what costs the business has incurred making these products or services. This is known as "cost of sale".

By quickly doing a subtotal, we can see what profit has been made from producing and selling our major business activity. In other words, we can see if we have successful **products** that our customers want to buy.

This subtotal is known as the "Gross Profit".

Below the Gross Profit line, we will now start subtracting all the other expenses that a business incurs, such as the admin costs of a business, the selling costs of a business and the distribution costs. We will also include any other income that we are able to make which we don't consider to be our core activity.

Once we have done this then we finally have our "Net Profit". This will finally show us how well our **overall business** has performed.

Now the scary bit! Not really, but this is a little funky….

The Profit or Loss Statement is prepared on something known as "an accruals basis".

This means that income is recorded only when it is *earned*, whilst expenditure is recorded once it has been *incurred*. The payment of cash has no bearing on this.

For example, a customer may pay a 20% deposit for a product, however no revenue will be recorded until that product is delivered to the customer. Likewise we may only see electricity bills once a quarter, but we should be recording the electricity expense whilst we use the electricity, not when we pay the bill.

To summarise then,

The profit or loss statement is showing all the income earned by a company with all the expenses incurred.

We start by looking at the income and expense or our core activities to get our gross profit, before adding in all the other income and expenses our business deals with to reach our net profit.