## *Finance Factsheet:* Profit and Loss Accounts

A profit and loss (P&L) account shows exactly what has happened to your business in terms of income and expenditure during a specified period, such as a month or a year. This factsheet explains its main features and content.

### Summary of what a P&L account shows A P&L account shows:

- The sales turnover and any other income for the specified period
- The expenditure for the period
- The level of profit (or loss) and how the profit has been divided.

### Typical content of a P&L account (plus explanation)

| Profit and Loss accounts for year ended xxxx | | | |
|---|---|---|---|
| | **Cost (£)** | **Income (£)** | **Explanation** |
| Sales Income | | 500,000 | ***Sales income:*** amount of sales (not cash received from customers), excluding VAT |
| Cost of sales<br>Raw Materials<br>Sub-contract | 50,000<br>120,000<br>170,000 | | ***Cost of sales*** (also known as direct costs): costs that can be attributed directly to sales. Does not include stock and materials purchased but not used in the period covered. |
| Gross profit | | 330,000 | ***Gross profit:*** sales income minus cost of sales. ***Gross profit margin*** is gross profit divided by sales, expressed as a percentage. |
| Overheads<br>Employment costs<br>Depreciation<br>Other operating costs | 150,000<br>20,000<br>80,000<br>250,000 | | ***Overheads*** (also known as ***fixed costs***): recorded on P&L account when provided in advance of bill or when paid in advance, as in case of rent.<br>***Costs*** include your salary if you have set up as a limited company but not if you are self-employed (when the money available to you is the profit.)<br>***Depreciation*** is charged to show that the use of fixed assets is one of the costs (see factsheet on balance sheets.) |
| Profit before interest and tax | | 80,000 | ***Overheads*** are deducted from gross profit to give net profit. ***Net profit margin*** is net profit divided by sales, expressed as a percentage. |
| Interest payable | | 10,000 | Some businesses show deduction of interest, particularly for long-term loans. |
| Profit before tax | | 70,000 | |
| Tax<br>Profit after tax<br>Dividends<br>Net profit or retained earnings | 15,000<br><br>5,000 | <br>55,000<br><br>50,000 | It is usual at the bottom of the P&L account to show an ***appropriation account***, which explains how the profit is divided (between tax, shareholders/owners and the business, where it is used as working capital) |

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## Using P&L accounts

Regularly reviewing your P&L account enables you to keep an eye on how your business is doing. It is a good idea to produce a budget forecast of a P&L for each month or year, and compare it with the actual figures you achieve.

Always keep an eye on both the gross profit margin and the net profit margin, as dramatic reductions in either can be a sign of trouble.

Based on Cobweb information: *A guide to understanding profit and loss accounts*