

How to Understand a Profit and Loss Statement

What is a Profit and Loss Statement?

Here are some key terms for you to review as you explore Profit and Loss Statements.

- > **Profit and Loss Statement (P&L):** also known as an **Income Statement**; measures net income or loss over a defined period of time.
- > **Depreciation:** a calculation to show how your tangible assets lose value over time. While there are several ways to account for depreciation, the most basic is for an asset's salvage value subtracted from its cost to determine the amount to be depreciated.
- > **Balance Sheet:** a statement that shows your company's assets, liabilities and owners' equity to indicate financial health at a specific point in time. The goal of a Balance Sheet is to make sure that your company's assets are equal to the combination of your liabilities and owners' equity, i.e., **Assets = Liabilities + Equity (Net Worth)**. As such, it shows your collection of total assets plus how they were paid for.
- > **Gross Profit:** calculated by taking your income less cost of goods sold, providing a measure of profit before deducting your other expenses.
- > **Cost of Goods Sold (COGS):** captures the direct cost of producing or purchasing your product or service. COGS is the general term, while some industries, such as retail, use the term cost of sales.
- > **Revenue:** the total amount of money received from the sales of your products and/or services.
- > **Net Income:** how much money your company is making or losing after all expenses (rent, outside services, utilities, etc.) and taxes are deducted, i.e., **Your Net Income = Revenue – Expenses**.

In this example, Jayne's Locksmith Company (JLC), we'll review:

- Revenue from a yearly view to first get the total revenue and then the gross profit
- Expenses from a yearly view to get net profit before taxes and net income

How to Use a Profit and Loss Statement

Revenue (Sales)

Your revenue is calculated from your **itemized list of sales** from products and services.

> Y1 Sales

- JLC completed 800 installations, and each installation cost \$250.
- JLC's customers purchased their own locks; therefore, they did not need to factor in COGS.
- Their gross profit from sales is \$200,000.

> Expenses and Net Income

To arrive at your net income, follow these steps:

1. Total your **itemized list of expenses** for all operational costs.
2. Take your **gross profit** and subtract your **subtotal of expenses**, which will give you **net pre-tax profit**.

> Y1 Expenses

- JLC had a gross profit of \$200,000, and their pre-tax expenses were \$152,640.
- Before taxes: JLC's net profit before taxes is \$47,360.
- After taxes: They will pay \$11,838 in federal and state taxes, which means their net income after taxes is \$35,520.

> How Your Financial Statements Work Together

- Transfer your net income from your **P&L** to your asset list in your **Balance Sheet**.
- Transfer your expenses categories from your **P&L** to your **Cash Flow Statement**.

PROFIT AND LOSS PROJECTION/INCOME STATEMENT EXAMPLE

Company Name: Jayne's Locksmith Company – JLC

Fiscal Year Begins: Jan 20XX

Revenue (Sales)	Y1	Y1 Notes
Installation	\$200,000	Average of \$250 basic for install per lock × 800 locks. Locks bought directly by customer and installed on-site.
Total Revenue (Sales)	\$200,000	
Total Cost of Goods Sold	\$0	
Gross Profit	\$200,000	
Expenses	Y1	Y1 Notes
Salary expenses	\$100,000	Owner salary
Payroll expenses	\$0	
Payroll taxes and benefits	\$15,000	15% of (salary + payroll) FICA, workers' comp., etc.
Outside services	\$0	
Supplies (office and operating)	\$12,000	Office cleaning, postage, printing, copier, etc.
Repairs and maintenance	\$0	

Expenses	Y1	Y1 Notes
Advertising	\$5,000	Email list management, local advertising
Car, delivery and travel	\$5,200	Travel allowance—\$100 per week to owner for use of vehicle
Accounting and legal	\$0	
Rent & related costs	\$6,000	Home office—business pays \$500 per month for use of home office, utilities included
Telephone	\$1,440	Cell Phone
Utilities	\$0	Utilities are included in rent.
Insurance	\$8,000	Liability and individual health insurance
Taxes (personal property tax, real estate, etc.)	\$0	
Interest	\$0	
Depreciation	\$0	
Other expenses (specify)		
Misc. (unspecified)		
Sub-total expenses	\$152,640	
Reserve for contingencies		

Total Expenses	Y1	Y1 Notes
Net Profit before Taxes	\$47,360	
Federal Income Taxes	\$9,470	20%
State Income Taxes	\$2,368	5%
Local Income Taxes	\$0	
Net Income	\$35,520	

Note: The example shown has been created using a modified [SCORE Excel template](#).

Develop Your Own Profit and Loss Statement

Now that you've seen how a Profit and Loss Statement works for a small business, you have a better understanding of how your costs and expenses are used to get your net income, which you will use in your Balance Statement next.

Use the tool you downloaded to practice creating a Profit and Loss Statement for your business.

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Disclaimer: All numbers are used for example purposes only and may not resemble cost and revenue structures in your region or for your company. The business appearing in this work is fictitious. Any resemblance to an actual business is purely coincidental.