BAS ASSOCIATES

making it all add up

OUR GUIDE TO YOUR PROFIT & LOSS REPORTS

Introduction

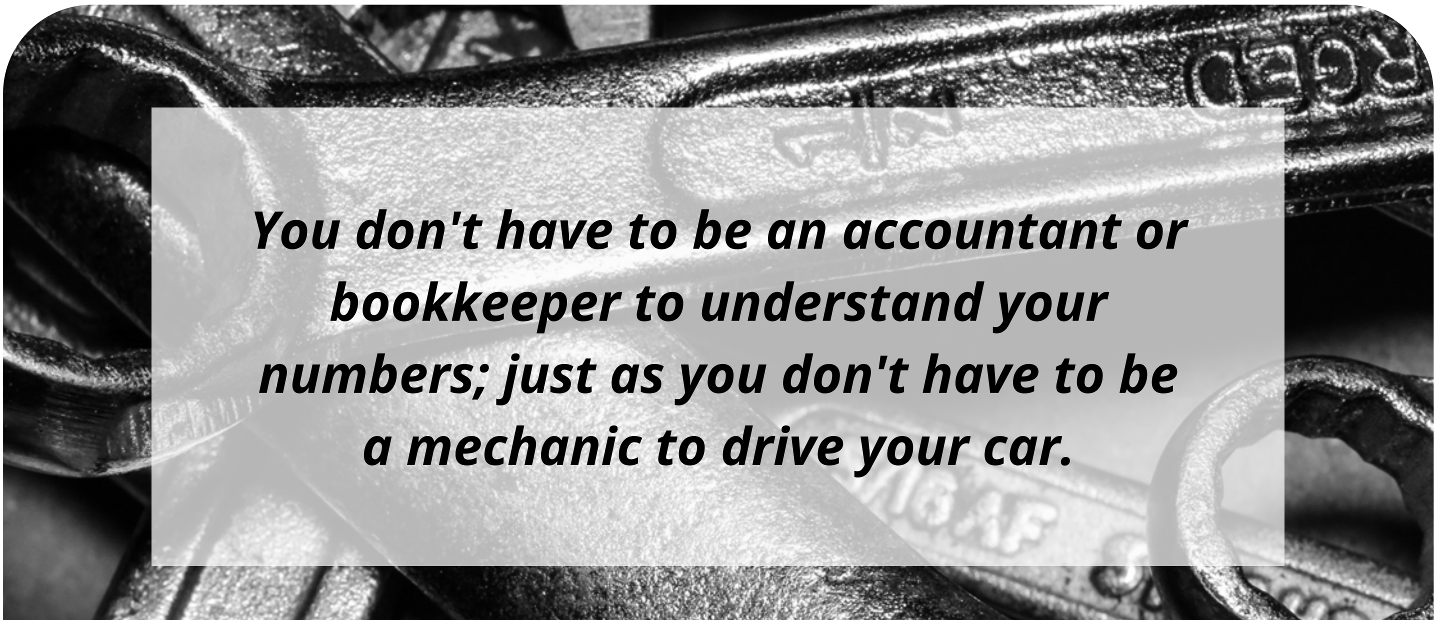
Your financial reports tell you the story of your business; allowing you to interpret the results of your business activity. The better you understand your financial reports, the better your decision-making and results will be.

We want to share the benefits of understanding your numbers, give you an overview of the standard reports and provide helpful tips on using them to improve your business. Where possible, we've avoided jargon and 'Accountanese'.

However, this guide is no substitute for specific one on one advice. We are available to talk to you about your unique situation and how we can help you and your business.

The benefits of knowing your numbers:

- Understand if your business is growing or shrinking
- Identify and track trends
- Compare results to your expectations (as set in your budget)
- Compare results between years or different periods
- Identify areas of strengths and weakness
- Measure your business efficiency
- Measure the value of your business
- Identify symptoms of underlying problems
- Measure your cashflow
- Make better business decisons



Tips for beginners

No matter which report you're looking at, there are fundamentals to consider and understand:

1. Is the data 'clean'? Most software packages allow you to export your own reports. While this gives you flexibility, the data can be unreliable if transactions haven't been coded correctly or bank statements haven't been reconciled. Likewise, if monthly invoicing hasn't been completed, sales reports could be understated. Contact us for information on the monthly procedures you should follow to keep your data 'clean'.

2. Inspect what you expect. Your reports are a representation of what you planned for your business. For example, you may have set a sales or gross profit target in your Business Plan and Cashflow Forecast (what you expected). Your reports can then be used to inspect if you're on track to achieve those targets.

3. Know which reports to use. Profit & Loss Statements measure income and expenses; the Balance Sheet measures assets, liabilities and net worth. There are different versions of each report, e.g. for the Profit & Loss you can measure this year vs last year, this period vs the same period last year, or this period vs the budget you set. Talk to us about the most appropriate reports for your business.

Tips for beginners cont.

4. Go horizontal and vertical when analysing your financial reports. A horizontal analysis compares the results of previous periods, e.g. comparing your 2020 Gross Profit to your 2019 Gross Profit. This shows whether your results are improving over a specified period. A vertical analysis calculates each item in the statement as a percentage of a base item, e.g. calculating expenses as a percentage of sales in your Profit & Loss. Conducting both helps identify specific areas of potential improvement.

5. 'As at' or 'for the period ending'. An 'as at' report shows the balances at the end of a specific period, e.g. the Balance Sheet shows asset and liability balances at the end of the financial year. A 'for the period ending' report shows the results over a period of time, e.g. the Profit & Loss shows your Gross Profit or Net Profit over the specified period.

6. Choosing the date range. For a period ending report, ensure you correctly specify the start and end date for the period you want to measure. For example, reporting on the current month and the year to date (the period from the start of this current financial year to the date required). It's best practice to choose a date that is a month end date, e.g. if you want to print a report on 15 July, set the date range to end on 30 June, as you should have all income and expenses coded and reconciled for the period ending 30 June, but may not have coded and reconciled them for July yet. Not to mention reoccurring monthly expenses may not be included if using a mid-month date.

Your key financial reports

The rest of this guide provides an overview of your key financial reports, what each report tells you about your business, some key ratios to use to track your results, and some tips on how to make good use of the reports.

Key ratios:
By calculating key ratios, you can compare your results over a number of periods, compare the profitability of different product lines, divisions or locations, and compare your results to your industry benchmarks.

All of this provides information which should be used in your decision-making. It’s important to only compare your ratios with companies in the same industry; what may be viewed as a 'good' ratio for one industry, may be 'poor' in another.

Below is an overview of the Statement of Profit & Loss report.

To ensure you have a rounded view on your business numbers it is essential that you also understand the following reports:

1. Your Trading Account.
2. Balance Sheet.
3. Statement of Changes in Equity.
4. Shareholder Current Account.

Statement of Profit & Loss

Your Statement of Profit & Loss, or Income Statement, tracks the overall performance of your business. It begins with the Gross Profit from your Trading Account then lists all overhead expenses, giving you the Net Profit. Some software combines the Trading Account and the Profit & Loss into one report, so the items from the Trading Account appear at the top of the Profit & Loss.

The basic format for your Statement of Profit & Loss is:
Net Profit = Sales - Cost of Sales + Other Income - Expenses - Tax

Descriptions & when to use
Sales: If Trading Account not reported separately
Cost of sales: If Trading Account not reported separately
Other Income: Interest received, dividends received, rental income
Expenses: this can be broken down into sections, e.g. admin expenses, selling expenses, finance expenses etc.
Tax: Amount of tax payable on Net Profit Before Tax.

In the annual financial statements, depreciation is also included in the Statement of Profit & Loss. Your Net Profit (or loss) is the amount left over after all expenses have been paid, including tax. Unlike the Trading Account, your Profit & Loss shows all fixed costs. These are the costs which remain the same no matter what your sales level is, e.g. electricity, office expenses, bad debts, accounting fees, vehicle expenses, depreciation, etc.

Statement of Profit & Loss

Key Ratios:
Net Profit Percentage = (Net Profit / Sales) * 100

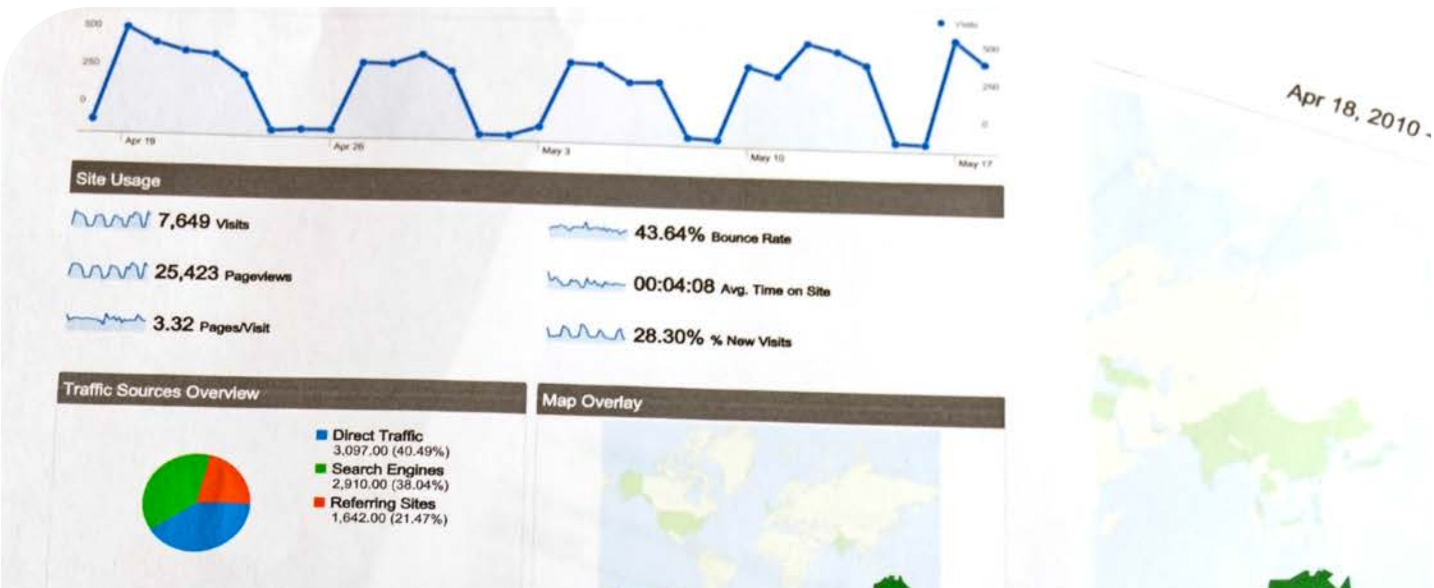
This is the amount of Sales available as profit after all expenses, including tax, have been paid. For example, if Net Profit is £100,000 and Sales are £1,000,000, the Net Profit Percentage is 10%, so you make 10p profit for every £1 of sales.

The higher the Net Profit Percentage, the better, as it shows how profitable your business is. To increase your Net Profit Percentage, review your fixed costs and find areas to save or increase your sales or margin.

Overhead Ratio(s) = (Overhead Cost / Sales) * 100

This shows the percentage of Sales spent on Overheads. The goal is to have a low Overhead Ratio; spending less on Overheads and retaining more as profit. For example, if total Overheads are £150,000 and Sales are £1,000,000, the Overhead Ratio is 15%, so for every £1 of sales, 15p is spent on Overheads.

If you're spending £10,000 per year on advertising, check if 1% is in line with industry benchmarks for your business (or compared to the percentage in prior years or in your budget).



Statement of Profit & Loss

To reduce your Overhead Ratio, go through each overhead expense and determine whether it could be reduced or cut completely. For example, online meetings instead of in-person meetings will likely save a significant amount.

Be careful when cutting Overheads, as some may indirectly contribute to your profit. For example, before cutting advertising costs from 1% to 0.5%, establish the level of sales generated from current advertising. Spending 1% may still be the right decision, but the £10,000 could be better directed at your most effective marketing channel.

Profit & Loss Tips

A. Profit is a driver of business value. Most businesses are valued using a multiple of profit (usually Earnings Before Interest and Tax or EBIT) so, the higher the profit, the higher the business value.

B. Accounting / bookkeeping fees should be an investment, not a cost. If you view what you pay us as a cost, that cost ought to be cut; but if you see us as a strategic partner, helping you run a more successful business, then our fees are an investment in your business, not a cost to cut.

C. Fixing the Balance Sheet can fix the Statement of Profit & Loss too. Looking at the Profit & Loss in isolation won't reduce certain costs. For example, slow collection of debtors may mean a higher overdraft and more interest, increasing costs in your Profit & Loss. Likewise, you may be incurring bad debts or debt collection costs.

Having loans structured incorrectly could mean you pay more interest than necessary. For example, an overdraft carries a higher interest rate than a term loan, and banks usually charge less than finance companies.

Profit & Loss Tips

D. Make sure you're accounting for a fair wage to working owners. Consider what you're being paid for the hours you work. You may be making a profit, but if you divide that by the total hours worked, you may be working for below minimum wage. Paying yourself a fair wage ensures the true cost of running the business is reported.

There are tax implications to consider, so talk to us about the best way to record your effective wage cost.

E. Tax savings increase your profit and cashflow. Talk to us about strategies to legitimately minimise your tax.

"If you'd like to learn more about your financial reports, the key financial ratios you should be measuring, and how to improve your results, get in touch to find out how we can help."

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