A profit and loss statement is the primary financial statement used to understand business performance.

A P&L tells us about how the company made a profit, and what the profit was. It is a historical statement, meaning it tells us about the previous period it represents, and not the present or future.

There are really two types of profit and loss statements, the detailed version, and the summary version.

1. The detailed version gives all the details of the transactions. (see Support Materials)
2. The summary gives only the highlights of the transactions as totals – a summary.

	Retrofit	Service	New Home	Totals
Sales	$100	$100	$100	**$300**
Cost of Sales	$ 50	$ 50	$ 50	**$150**
Gross Profit	$ 50	$ 50	$ 50	**$150**
Overhead Expenses	$ 20	$ 20	$ 20	**$ 60**
Operating Profit	$ 30	$ 30	$ 30	**$ 90**
Other Gain/Losses	$ (5)	$ (5)	$ (5)	**$(15)**
Net Income	$ 25	$ 25	$ 25	**$ 75**

In this summary example, the company has three market segments, and is tracking them as such. The company made a profit of $75 for the period.

Let's take a closer look at the profit and loss statement and define its components and the terms, and please notice the structure of the accounts. This is very important because later, all the industry benchmarks will focus around this structure.

Account Definitions:

Gross Sales:	Any recognized revenue from customers.
Costs of Sales:	The direct costs associated with doing the work.
Direct Labor:	The labor costs in the field to do the work.
Equipment:	The serial numbered equipment on the job.
Parts & Materials:	The parts & materials to do the job.
Permits:	The cost of the job permit.
Direct Labor Burden:	The benefits paid to the direct labor above.
Sales Commissions:	Any commissions paid as a result of the sale.
Financing/Buy Down:	The costs of financing/promotions of the sale.
Subcontracts:	The costs of paying outside vendors.
Warranty Reserve:	The amount set aside for callback.
Gross Profit/Margin:	Sales minus cost of sales in dollars. Margin is % Which, is gross profit divided by gross sales.
Overhead (SG&A):	The expenses to operate that are not job specific.
Operating Profit (EBIT):	The amount of income generated from operations.
Other Gain/Loss:	Other income, interest, taxes, any losses.
Net Income:	The net resulting profit after all business activities.

There are some additional terms and descriptions that may prove helpful.

Additional Account Definitions:

Separate Materials & Equipment:	It always surprises me to see these lumped together. They are two distinct and separate charts of accounts and NEED to be. How do you know if you are buying well or not, if they are combined?
Above the line – profit line:	The costs of sales, the cost and expense that are above the gross.
Below the line (margin) line:	These are the costs or expenses that are below the gross profit.
Burden:	You will hear this term tossed around. The burden or the allocated fringe benefits are the benefits we pay to our field direct labor force only. The company may be paying benefits to everyone, but we segment the direct labor burden out and match it to the direct labor payroll. The reasons for this come clear in pricing, and our direct labor is a large variable on many jobs. When the labor is higher than anticipated on any job, this burden of benefits is as well, where in our normal course of paying our administrative personnel; their benefit burden remains relatively stable.
Departmental Concepts:	This means the profit and loss statement doesn't just lump all the figures into one summary column, totaling the company, like the total column in our example above. We want the statement to break down the performance by how we operate in our markets (Examples are residential service, residential new construction, residential replacement, maintenance, commercial). The departmental concept can apply to sales, cost of sales, and gross profit (margin). It can also be extended to the overhead expenses. Breaking down a company overhead expense into market segments is a good thing, but it has definite requirements that are beyond this current discussion (you can reference the search function and learn more about departmentalizing overhead). In either case, departmental statements do give us more accurate pictures of how the company is operating.
Variable Expenses:	Some of our overhead (SG&A) expenses can be classified. This will help us later when we use the profit and loss to help our pricing systems. We can break these overhead expenses down into variable and fixed expenses. The variable expenses are called variable because they generally increase or decrease, when sales increase or decrease. If we sell a whole bunch, these expenses go up in a measured fashion with the sales curve. Examples of variable expenses are: Gasoline expense, Vehicle maintenance.
Fixed Expenses:	Are the expenses in overhead that remain fixed, and do not move even though sales may climb, or fall! Examples of fixed expenses are: Rent, Building maintenance.

What elements a P&L should have structurally?

1. Notice the cost of sales accounts in our example above, and while labor, materials/parts, permits, equipment are fairly standard, **you will notice that sales commissions, warranty reserve, and direct labor benefits are part of these costs.** The reason, because they are part of the cost of sales – not the selling expense, but after we begin installing a job, these are costs that track against the jobs labor, making them apply to cost of sales. So many contractors lump all their benefits into an account called benefits. What if the labor goes to long on the job, overhead will look too high because the benefits are down there for the extra labor all lumped in with our support staff. You must separate direct labor benefits out and cost them above the line in cost of sales! **Also, many contractors do NOT EVEN HAVE a WARRANTY RESERVE.** Are there any callbacks or failures? Of course there are, and we need to track them, so we can price for them! Some warranty costs run as high as 2%. If we are not accounting for this in cost of sales, then where? You guessed it, lumped into that massive labor account!

2. NO SUCH THING AS UNAPPLIED TIME: Eliminate this account. You should not have an unapplied time account on your profit and loss or in your chart of accounts, because all time is applied somewhere. Track your labor. If you trained someone, place the labor cost in training, not unapplied time. Wherever your labor went, allocate the costs to a chart of account. Unapplied time is an excuse to have labor dollars flowing into a spot where no one can be accountable for them.

3. A Profit and Loss Statement should match departmental operational characteristics – meaning whatever markets you actively do business in; they should be called out and tracked as a department so you can determine if you make money in this market.

4. A Profit and Loss Statement should have dollars and percentages (both).

5. A Profit and Loss Statement should compare your performance against a budgeted figure so you know where you stand against your plan.

6. A departmental profit and loss should detail the overhead expenses (SG&A).

7. A departmental P&L should show the operating income, so the company understands the performance of operations as a percentage to budget.

8. A detailed departmental P&L should show any other gains of income or losses.

9. A detailed P&L should show the net income as a percentage to the planned budget.

The whole point of being detailed is so you can compare yourself to the industry standards. You will want to reference the industry standards for each chart of account as you move along!

To understand the detailed profit and loss statement follow these steps:

1. First, your profit and loss statement must be organized the way you want it to be.

2. Your accounting team must be diligent in allocating the sales, and costs into the accounts (Chart of accounts detail) that deserve the revenues and costs, or your organization will all be for naught. Many contractors have good organization, but lump all warranty labor calls into service labor, severely affecting the service department labor, making service look unproductive. Therefore, the organization must be good, but you also must be sure accounting and the field labor teams understand how data gets entered into the profit and loss statement.

3. Your profit and loss statement should help you identify how you performed in a given marketplace.

4. Your profit and loss statement should guide you in determining if you need to make mix changes, for example, increasing sales and margin dollars in an area to increase profits. Sometimes higher margin markets are attractive and can be lucrative if you simply spent more time developing them.

5. Your profit and loss statement should also guide you in learning if your pricing systems are recovering your expenses properly. Making assessments from the performance numbers off of the P&L take experience, but you can refer to the EPL Residential industry financial benchmarks to compare the company to the profit and loss in virtually every market segment to see how your performance stacks up against top performing companies.

Why is this critical to your success?

- Your P&L should be detailed enough to give you the data you need to make good decisions.
- The detailed profit and loss should be your guide to making significant changes to improve financial performance.
- The organized, detailed, up-to-date P&L helps you **MAKE MORE PROFITS!**