

# 2

## Understanding management reports

- Profit & Loss report
- Performance analysis
- The Balance Sheet
- Adjustments to accounts



## Introduction

In this chapter we'll look at the main type of report that you will need to help you manage your area better – the *profit and loss report*. For different departments you'll see reports that include not only monetary figures but also percentages for the actual amounts, the amounts that were budgeted, and the difference between them. Later in the chapter we'll see how to use these.

There are also statements used by the general manager – a summary profit and loss (P&L) and then the balance sheet which is important when managing stocks, cash and debtors as well as showing the total value and stability of the business. In order to know how all these accounts are put together we will also examine the activities that need to take place at the end of each month.

So by the end of this chapter you should be able to:

- Identify different items that appear in a profit and loss report
- Calculate profits for a simple business
- Calculate variances and percentages
- Assemble a balance sheet
- Calculate accruals, prepayments and depreciation.

## Financial reports

Some of this may seem a bit 'dry' but you do need to understand the basics of accounts before you can use the information to help you. So please persevere with the 'theory' and then the next chapter will have more practical applications which will seem more relevant to your job, either now or in the future.

Before we look at the P&L we need to clarify what is meant by 'financial reports'. There are two types produced for a commercial business – generally classified as 'financial accounts' and 'management accounts'.

*Financial accounts* are produced yearly (and half-yearly) and are formal, official records that have to be submitted for legal reasons to tax and company authorities. For a large company they may also be known as 'published accounts'. There are a lot of rules as to how these are presented and some of these will be covered further in Chapter 10 of this book.

*Management accounts* are used within the business by the managers to help them be more effective – so they should be designed to suit the manager's needs. They are usually produced every month (or period)

which may be a calendar month (so 12 a year) or four weeks (13 a year). Some businesses also have two four-week months and then a five-week month (so 12 in a year again) although this structure can be a bit awkward to manage.

Now let's look at the main accounting statement that a manager needs – the 'P&L' or profit and loss report. (By the way – you can't get profit *and* loss together, can you? But it's always called this – and always abbreviated to P&L, which is what we will call it too).

## Profit & Loss Report

This is a statement of the revenue and expenditure (also called sales and costs – the terms tend to be interchangeable) and one minus the other equals profit or loss. We try to avoid using the word 'income' as in the UK it means what we earn and in the USA can mean net profit.

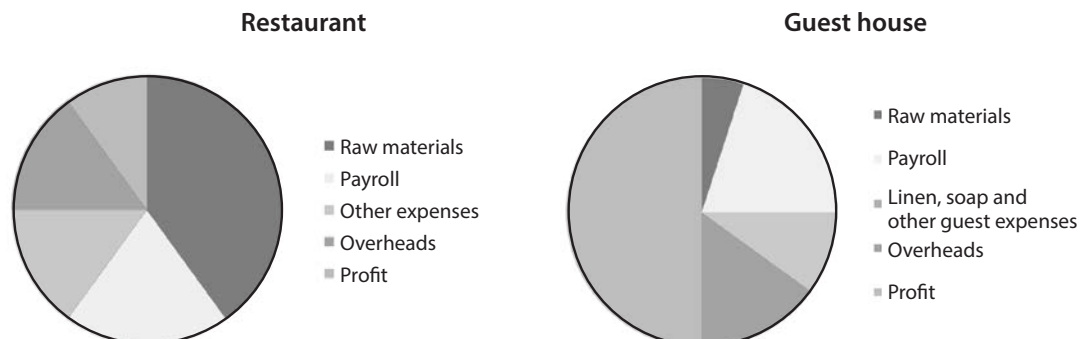
A department which has sales is called an 'operating department' and is a 'profit centre'. You can also have statements for departments that don't have sales – such as maintenance – that are called 'cost centres'. As we saw in Chapter 1, some businesses such as prison catering may only have costs.

So, what is 'profit'? These definitions come from a variety of sources:

- Excess of revenue over expenditure
- Excess of sales over related costs
- Reward for the entrepreneur (owner).

You can also look at the P&L as being a sharing out of the sales, if you have them. Figure 2.1 is an example where the 'cake' represents the sales and the slices the costs and profit.

**Figure 2.1:** Costs and profits



Generally the most profitable type of business is accommodation although the costs of running a building can be high. Profits can be very volatile unless it is part of another business, such as spare bedrooms in a farmhouse run as a B&B. Profitability is relative though – what is good in one sector may be modest in another, and some locations are more profitable than others.

## Small businesses

For a simple operation such as a pub, a small restaurant or a bed-and-breakfast you might not need a complicated report – just one that shows you where your money has come from, and gone to. There's no point in wasting time doing extensive accounts if you don't need them (but you *do* need to do some accounts for tax reasons).

For 'Billie's B&B' there isn't a need for complicated accounts – the owners' time is better spent with their customers – so here's the sort of statement that is useful to them:

	£
Sales	20,000
Less cost of sales	<u>(2,000)</u>
Equals gross profit	18,000
Less payroll	(3,900)
Less other controllable expenses	<u>(2,400)</u>
Equals gross operating profit	11,700
Less fixed costs	<u>(5,200)</u>
Equals net profit	<u>6,500</u>

Before we go through line-by-line, a couple of things to tell you. First, you'll see that the figures are laid out in columns. Accounts are always done like this as they are easier for you to read, and it helps the adding and subtracting if this has to be done manually (and spreadsheets, if you use them, are columnar too). The figures are always 'right justified' so that the thousands are always in the same place – again it's easier to read. The titles ('sales' and so on) are left justified although sometimes you may see them indented. For a P&L you don't need to show pence, just round pounds, although when we come to ratios this will change.

Another thing that makes the accounts easier to read is using brackets for minus figures – subtracting is quicker like this than reading a small dash sign. The only problem is that some spreadsheet packages don't have brackets set up automatically so you may need to set this up using Custom