

DECIPHERING INCOME STATEMENTS

By being able to read them effectively, you can chart the course and future of your business.

by Dan Sautner
Padgett Business Services

■ The statement on this page can be called an income statement, a statement of operation, a profit-and-loss (P&L), or the simple revenue and expense. They all tell the same thing: financial results of operating the business for a specified period of time.

The second line uses the phrase "for the 5th month Ended 05/31/91." This phrase gives you the period of time under consideration. The statement shows the current period (May) and the year-to-date totals. In an annual statement, you may see this year and last year, which titles will note.

Sales—Statements always start with sales, followed by expenses. "Sales" lines tell you the composition of the business in terms of gross dollars.

In the example, sales are essentially based on providing services rather than products. You might ask yourself, "Can the company do better with product sales?" or "Is that an area that can be expanded?" or "Should we ignore product sales altogether?" The low product sales should also indicate a low inventory of product. The sample statement groups together the supplies and the costs of these sales.

Expenses—In this sample, expenses are organized by type. On some state-

ments, they can be listed alphabetically; on others, from largest to smallest in dollar value.

Expenses are aligned into three types:

Variable costs vary with the level or volume of business. Labor, for instance, is included here.

In our sample, the year-to-date labor expenses, as a percentage of sales, is higher than the current period. It would seem that the volume is reaching a level where the labor costs are incremental. This means that we have passed the base sales and the expense should fluctuate with volume. If the percentage is erratic, or constantly shrinking, it could mean that you are under- or over-staffed.

Labor is the largest item on this income statement; that alone means we should examine the return on this expense very closely.

Fixed costs tend to remain the same, within certain wide ranges of volumes. The rent expense, for example, is unlikely to change until such time as more space is needed.

Look at the fixed components of cost to determine the base level of sales that this business can be supported on. Look also in terms of the highest level of business that can be done before an expansion of fixed costs is necessary.

Discretionary costs occur as the result of a specific purpose. In our example, advertising is listed as discretionary. These

	Current Period	%	Year-to-Date	%
Sales:				
Services	2,800	93.3	10,000	94.8
Products	200	6.7	550	5.2
Total Sales	3,000	100.0	10,550	100.0
Expenses:				
Variable:				
Wages	1,050	35.0	3,950	37.4
Supplies	410	13.7	1,450	13.7
Maintenance & Repair	25	0.8	85	0.8
Fixed:				
Rent	250	8.3	1,250	11.8
Depreciation	200	6.7	1,000	9.5
Accounting & Legal	100	3.3	500	4.7
Telephone	60	2.0	300	2.8
Utilities	25	0.8	145	1.4
Discretionary:				
Advertising	150	5.0	400	3.8
Memberships	125	4.2	175	1.7
Total Expenses	2,395	31.2	9,255	87.7
Income from Operations	605	20.2	1,295	12.3

costs should be reviewed in terms of their ability to help the company grow.

What the amount will not show you is how effective the expenditure was. When reviewing these lines, try to understand why the money was spent and what it was meant to achieve. Think in terms of long- and short-term effectiveness.

Compared to most income statements, the one on this page is simple. In this statement, we have shown clear-cut divisions among the three types of expenses. The reality is that every expense is inter-related.

The bottom line—Here is where the sum of activity shows. Is the company profitable? If the statements says "yes," make sure to recognize that this is an accounting profit. Adding back depreciation will give you a close look at cash profits. By better understanding your tax situation, there may be a third type, the taxable profit.

At any rate, strive to be profitable and let accountants sort out the rest.

—Dan Sautner is chairman of Padgett Business Services, Atlanta, Ga. This article is one in a series he is writing specifically for *LANDSCAPE MANAGEMENT*.