

Questions regarding management and business aspects of the veterinary profession may be asked on the NAVLE. This PowerPage provides an overview of the fundamentals of profit and loss statements, the second of three financial statements used to report the financial activities and position of a business. It is recommended to understand the PowerPage on “Reading a Balance Sheet” before proceeding with this topic.

Key Points

- A profit and loss statement is also known as an income statement or an earnings statement
- A profit and loss statement reports the financial performance of a business over a defined period of time (typically a year or quarter)
- The main formula behind a profit and loss statement is:

$$\text{Net Income} = \text{Revenues} - \text{Expenses}$$

- The profit and loss statement is divided into three main sections:
 - Operating results
 - Returns to providers of financing (i.e. interest)
 - Returns to the government (i.e. taxation)
- The operating results section can be further subdivided into:
 - Revenue
 - Cost of Goods Sold
 - General and Administrative Expenses
- Although profit and loss statements follow this general format, the specific line items reported under each section can vary depending on the industry and business

Terms Seen on a Profit and Loss Statement

- Revenue is the amount of money a business receives from its goods and services during a specific period of time. It is also known as “sales” on the profit and loss statement. Many veterinary practices will break down revenue into specific categories such as examinations, vaccinations, pharmacy, surgery, etc. on their profit and loss statements
- Cost of Goods Sold are the direct costs associated with a business producing its goods for sale. It is also referred to as “cost of sales”. Many veterinary practices will itemize these costs with the corresponding revenue categories
- Gross Profit refers to the profit a business makes after subtracting the direct costs from the revenue of the goods produced. It can be calculated as follows: $\text{Gross Profit} = \text{Revenue} - \text{Cost of Goods Sold}$
- General and Administrative Expenses refer to the costs necessary for a business to maintain operations that are not directly attributable to the production of its goods and services. In a veterinary practice, this may include items such as wages, employee benefits, rent, advertising, marketing, maintenance, etc.
- Operating Profit refers to the profit made from a business’ core operations. It excludes profits (such as investment earnings) and costs (such as interest and taxes) not directly associated with the business’ goods and services. It is also referred to as “operating income” and “earnings before interest and tax”.
- Pretax Earnings is a business’ income after operating expenses and interest have been deducted from revenue. It can be calculated as follows: $\text{Pretax Earnings} = \text{Operating Profit} - \text{Interest}$. This value reflects the intrinsic profitability of a business and allows for comparison with other businesses where tax rates may be different. It is also referred to as “pretax income” and “earnings before taxes”.
- Net Income is the residual revenue that goes to the business owner after all expenses and losses are accounted for. It is also known as the “after-tax profit”, “net earnings”, “net profit”, or “bottom line”.

Sample Profit and Loss Statement

Remember, although profit and loss statements follow a similar general format, the specific line items can be tailored to a particular business. Likewise, the sample below demonstrates the format of a profit and loss statement for a veterinary business, however the specific line items are particular to that practice.

<i>Statement of Profit and Loss for 2017</i>	
Sales	
Professional Service Revenue	\$ 80,000
Pharmacy Revenue	\$ 20,000
Laboratory Revenue	\$ 30,000
Surgery, Dental, Anesthesia Revenue	\$ 50,000
Total Sales:	\$ 180,000
Cost of Goods Sold	
Professional Service Costs	\$ 25,000
Pharmacy Costs	\$ 15,000
Laboratory Costs	\$ 20,000
Surgery, Dental, Anesthesia Costs	\$ 20,000
Total Cost of Goods Sold:	\$ 80,000
Gross Profit	\$ 100,000
General and Administrative Costs	
Wages	\$ 35,000
Employee Benefits	\$ 5,000
Building Maintenance	\$ 5,000
Marketing/Advertising	\$ 5,000
Operating Profit	\$ 50,000
<i>Interest</i>	\$ 10,000
Profit Before Taxes	\$ 40,000
<i>Taxation</i>	\$ 15,000
Net Income	\$ 25,000

- The sales are broken down into specific revenue categories where the clinic receives money and then summated to get the total sales. For example, if the clinic charges a client \$30 for an ear medication to treat an ear infection, this would be listed under “pharmacy revenue”.
- The cost of goods sold are broken down into specific costs by category and then summated to get the total cost of goods sold. For example, if the clinic purchased the ear medication from a distributor for \$20, it would be listed under “pharmacy costs..”
- The gross profit is calculated by subtracting the total cost of goods sold from the total sales. Thus, in this example gross profit is \$100,000 ($\$180,000 - \$80,000$).
- The general and administrative costs are listed by type. For example, if the clinic spent \$500 advertising it has a new video otoscope used to evaluate ear infections, it could be listed under “marketing/advertising expenses”.
- The operating profit is calculated by subtracting all the general and administrative costs from the gross profit. In this example the gross profit is \$100,000 and the total general and administrative costs add up to \$50,000 ($\$35,000 + \$5,000 + \$5,000 + \$5,000$). Thus, the operating profit is \$50,000 ($\$100,000 - \$50,000$).
- The profit before taxes is calculated by subtracting any interest owed by the business from the operating profit. For example, if the clinic owes a bank \$500 in interest for a loan that was used to purchase the new video otoscope, it would be listed here. The profit before taxes in this example is \$40,000 ($\$50,000 - \$10,000$).
- Finally, the net income is calculated by subtracting the taxes owed from the profit before taxes. In this example, the net income is therefore \$25,000 ($\$40,000 - \$15,000$).

Relation of the Profit and Loss Statement to a Company's Balance Sheet

The net income on a profit and loss statement reflects the change in equity reported on the corresponding balance sheets. In the example above, the company's balance sheet reported \$255,000 of equity on December 31, 2009 and \$280,000 of equity on December 31, 2010 for a difference of \$25,000 (see PowerPage on Balance Sheets for full information). Likewise, the net income (\$25,000) on the profit and loss statement covering this period reflects this change in equity.

It is worth noting that the net income on a profit and loss statement does not necessarily reflect the change in cash reported on the balance sheet. In the example above, the balance sheet reported \$25,000 in cash at the end of 2009 and \$30,00 at the end of 2010 for a difference of \$5,000. However, this discrepancy is addressed on the last of the three financial statements - the cash flow statement.