

5-29-2013

Boise State on Business: These Tools Can Help Make the Most of Profit and Loss Data

Michael Lee
Boise State University

Michael Wright
Boise State University

■ BOISE STATE ON BUSINESS

These tools can help make the most of profit and loss data

In his recently published book, "Doing More With Less: The New Way to Wealth," Bruce Piascecki suggests that frugality and industriousness are the ways to wealth. Frugality is certainly with us, and companies are starting to reap the benefits of this mindset through earnings growth. But more is needed. Industriousness is really about taking what we have and exploiting it. Take the humble profit and loss statement as a case in point.

Companies invest heavily in creating the traditional profit and loss statement because it is a periodic requirement that measures business performance. The problem is that manage-



MICHAEL LEE

Assistant professor of accountancy

and MICHAEL WRIGHT

Graduate assistant in accountancy

ment is framed into thinking about summarized information, routine reporting and often irrelevant historical performance. Rather than treat it like a mandatory reporting necessity, a periodic photograph of the past that

reminds them of what once was, we suggest that companies exploit this versatile tool by adding our three applications that will provide insights into what can be.

We engaged in a "learning in action" accounting project to help a company extract the most out of its profit and loss statement. We were industrious and introduced the company to three modern uses for the statement: profit planning, profit analysis and market analysis.

Profit planning involves taking the existing profit and loss statement and using its contents to forecast future performance by line items. Sales, for example, can be forecast using last

year's sales, adjusting for inflation, product mix, market share, market size and other economic factors. The profit plan forces a company to think about its future targets and how its performance can be achieved. It is an application of goal setting, and goals help motivate, and control and focus management and staff through a feedback process that uses targets or standards for the line items in the profit and loss. Specifically, targets are developed for quantities, prices and costs for each line item. Profit planning helps sustain margins by highlighting variances in revenue and cost to management and staff. So, how do you know what to do

with the variances in revenue and cost?

Profit analysis is used to explain revenue and cost variances by breaking them up into pricing effects, cost effects, quantity effects, efficiency effect and product mix. With both actual and planned data on the price and quantity of sales, cost and quantity of cost of goods sold and, in the case of a manufacturer, cost and quantity of materials and labor used, companies can analyze the differences between actual and planned data to pinpoint the causes for a variance. Management would normally apply their limited time to an item they know to be a large variance (for example, a cost variance), delve

into the cause of the variance (cost effect? quantity effect?) and make improvements (for example, reduce materials or labor costs).

Companies can include market analysis into their profit plan and profit analysis. Essentially, companies record the market size and calculate their market share for their products and services. This enables them to explain their sales volumes in relation to the size of the market and their share of the market. While an increase in sales volume indicates increased sales performance, it is only a good performance if it exceeds the growth in the size of the market.

michaelllee2@boisestate.edu
michaelwright@boisestate.edu