

WHICH PROFIT & LOSS STATEMENT DO I USE?

There are 4 Profit & Loss (P or L) Statements you might find for a business. Sometimes all 4 are the same – but not very often.

The first one is the reported P or L – usually the Tax Return. As far as a Buyer is concerned it is the least reliable and most prone for over and/or under statement of income and expenses – for all kinds of reasons – some justifiable – some not.

The Tax Return is usually put together from a businesses financial statements. This P or L is usually more detailed and shows a lot of items that are not on the tax return or are disguised as part of larger categories. These statements are helpful because they give you more detail than the Tax Return. They can also confuse you because you may not be able to reconcile the financial statement to the tax return without the trial balance which you seldom see.

The third and most helpful is the normalized P or L. This P or L eliminates personal, extraordinary and one time items and adds items that should be relevant to the normal operation of the business. For example it adds back cash labor to Labor Expense & Sales Revenue. It also may show sales the new Owner should experience along with expense updates like the current rent amount that will be paid for the next year of operation. Most Buyers develop and like to work with this P or L because when the adjustments that were made are verified along with the items not adjusted the Buyer can get an idea as to the true or actual profitability or lack thereof of the business. This P or L helps a Buyer determine if the business satisfies his/her financial requirements and helps justify the Seller's asking price.

This P or L sometimes referred to as a budgeted P or L is a picture of what the new Owner thinks he/she will do in the first year of operation based on the businesses track record and the changes that are planned. This is probably the best tool the new Owner can have – but if not experienced in budgeting – this P or L can easily be too optimistic or pessimistic.

In any event a business Buyer should develop a verified normalized P or L from the Tax Returns, financials or by using a blank piece of paper. This is part of the Due Diligence you should do when it's time to check the Books & Records of the business you are thinking of buying.