

Is the IRS Getting in the Way of How you Run your Business?

Category: Profit and Loss

A number of business owners that I meet tell me that the reason they're on a cash basis is because they report to the IRS. We pay taxes on a cash basis, as we have to pay our vendors that way. This is so shortsighted that it borders on the absurd. How you pay taxes is irrelevant to how you run your business. You should have some separate tax mistakes made as a result.

The top mistake is thinking you're making more money than you actually are, and there are countless examples of businesses that spend the cash they have in the bank and then get surprised by bills they have overlooked that need to be paid (vendors, insurance, taxes etc)

You should own your numbers and use them to give you realistic, real-time information. Keeping them on a cash basis has no practical benefit whatsoever unless you don't understand what a cash flow does, and it is the prime example of how people who hate "big government" willingly and enthusiastically embrace what it tells them to do.

There are three different financial tools you should use. I'm not going to go into the balance sheet here, but just look briefly at the P&L and cash flow and how they differ.

The Profit and Loss Statement identifies the amount of profit that you have actually made during a given period. It should contain all the revenues that you have generated and all the costs that you incurred in that time period. It exists for the single purpose of telling you how the business is performing.

The Cash Flow identifies the amount of cash that you have generated and used in a given period. It has nothing to do with uncollected receivables or the commitments that you have entered into, only the cash in and out. It exists for the single purpose of measuring the how much cash you have and forecasting how much you need.

The reason that there are two separate reports is because they do completely different things. To try to use the Profit and Loss to measure cash or the Cash Flow to measure Profit and Loss makes no sense and leads business owners to make serious mistakes.

If you are running your business on a cash basis because that's how you report to the Government then the Government may inadvertently be the reason your business fails!