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Author: FinanceFrameworks.com

FF-WC-001

Why the Bank Account Does Not Match the P&L

A Monthly Cash-Profit Bridge for SMEs

A small business owner sees a profitable month on the P&L, but the bank account declined. The usual reaction is confusion, followed by decisions made on incomplete information: delaying a needed investment, taking a distribution too early, cutting costs in the wrong place, or questioning whether the accounting is reliable. The problem is not always that accounting is wrong. Often, the real problem is that profit and cash answer different questions.

> **This is not a GAAP cash flow statement.** It is a monthly management bridge that explains why reported profit did or did not become cash — built from books you already have, designed to keep SME owners from making decisions on net income alone.

Two Different Questions

Most SME owners read the income statement (P&L) and the bank balance as if they should tell the same story. They don't, and they were never designed to.

Profit answers:	Cash answers:
Did the company earn more revenue than expenses during the period?	*Did money actually enter or leave the bank account?*
Measured under accrual accounting.	Measured by what hit the bank.
Includes: sales billed, expenses incurred, depreciation, accruals.	Includes: collections, payments, debt principal, capex, taxes, owner draws.

Found on: Income Statement (P&L).	Found on: Bank statement / Cash Flow Statement.

If profit and cash always moved together, you wouldn't need this framework. They almost never do — especially in a growing business, a seasonal business, or a business that just bought equipment, took on debt, or paid the owner.

Scope / Trigger

This framework applies to any company where the income statement and the bank balance tell different stories from one month to the next, and where management struggles to explain the difference.

Typical trigger conditions:

- The company is growing — sales are up but cash is flat or down.
- The owner asks "if we made $40K, why is the bank account smaller?" and nobody can answer in one minute.
- Distributions, debt payments, capex, or tax payments happen and surprise everyone.
- The accounting team produces the P&L every month but no cash flow statement, or one that nobody reads.
- Management makes decisions on net income alone, with no view of working capital movement.

Useful diagnostic threshold: if you cannot, in under five minutes, explain why this month's net income and this month's cash movement are different — this framework is relevant.

Failure Mode

Owners and managers conclude the business is broken when it's not, or conclude the business is fine when cash is hemorrhaging.

Both errors lead to the wrong decision. Cutting costs when the issue is collections. Distributing cash when the issue is working capital. Refusing a profitable deal because "we can't afford it" when the deal would have generated cash. Taking on debt when the cash gap is timing-only and would have closed naturally next month.

The deeper failure is that without a bridge, every month becomes a guessing game:

> *"Maybe sales aren't real."*
>
> *"Maybe expenses are too high."*
>
> *"Maybe accounting is wrong."*
>
> *"Maybe the business isn't profitable."*

Sometimes one of those is true. Most of the time, the missing cash is sitting in receivables, inventory, prepaid expenses, debt repayment, capex, or distributions — places the P&L doesn't show. Without a bridge, the company cannot distinguish a real profit problem from a working capital problem from a financing decision.

The Eight Reasons Cash and Profit Disagree

These are the lines that appear on the bridge. Most common cash-profit differences in an SME will fall into one of these lines, or a combination of them. Less common items (loan proceeds, customer deposits, sales tax, payroll tax) get added as named lines when material — see the next section.

What happened	Why cash went down even though profit was positive
Customers haven't paid yet	Sales were recognized on the P&L when invoiced. Cash only arrives when the customer actually pays. Faster sales growth = more cash trapped in receivables.
Inventory increased	Cash was used to buy or make goods that haven't been sold. The cost only hits the P&L when the goods are sold. Stockpiling = cash sitting on the shelf.
Suppliers were paid faster than customers paid you	AP went down or stayed flat while AR went up. Vendor terms tightened or AP staff cleared their queue. Either way, cash went out before it came in.
Debt principal was repaid	Principal payments do NOT show up on the P&L (only interest does). Cash leaves the bank, but profit looks unchanged. Common surprise for SMEs paying down a term loan.
Equipment / capex was purchased	Capex is capitalized on the balance sheet, then depreciated over years. Cash leaves the bank now; profit only sees a small monthly depreciation hit.
Tax payments were made	Quarterly estimated taxes or annual settlement payments hit cash in lump sums. The P&L shows tax expense smoothly across the year as accrual.
Owner distributions / dividends	Money taken out by owners is not a P&L expense — it's a draw against equity. Cash leaves the bank; profit is unaffected.
Old bills got paid	Expenses booked in prior months are paid in cash this month. The P&L hit happened months ago; the cash hit happens now.

Control Rule + Owner

The rule:

Every month, before the close is considered complete, the controller produces a one-page cash-profit bridge that reconciles net income to actual change in cash. The bridge is presented to the owner / GM / CEO alongside the P&L — not buried in the balance sheet.

Owner:

The controller (or whoever runs the monthly close). The bridge is built as the final step of close — not as a separate exercise. If the close happens, the bridge happens. No bridge = close not finished.

Audience:

Whoever is making decisions on the P&L. For most SMEs that means the owner, the GM, or the CEO. The bridge is the second page they see, immediately after the P&L.

Trigger threshold for written commentary:

The bridge requires a one-paragraph written commentary if either of these is true:

- The gap between net income and cash movement exceeds 25% of net income (or another threshold management defines as material).
- The gap is large enough to affect a real decision this month — a distribution, a hiring choice, a vendor payment, a debt draw, or a capex commitment.

The second condition matters more than the first. A small percentage gap can still drive a wrong decision if a distribution is on the table.

Allowed exceptions:

- Months with one-time large events (acquisition, major asset sale, large tax settlement) may need a separate one-time line on the bridge with a footnote, rather than blending the event into normal operating lines.
- Multi-entity SMEs may need a separate bridge per entity if intercompany flows distort the consolidated view.

The Bridge — Step By Step

This is the eight-line monthly bridge. Built from numbers that already exist in the P&L and the balance sheet. No new systems, no new software.

Worked example: a $2.4M-revenue SME in growth mode, mid-year, that just took on a larger customer with 60-day terms and bought a new piece of equipment.

#	Line	Amount	Running

1	**Net income (from P&L)**	**+$40,000**	**+$40,000**
2	Add back: Depreciation & amortization (non-cash)	+$8,000	+$48,000
3	Subtract: Increase in Accounts Receivable	−$25,000	+$23,000
4	Subtract: Increase in Inventory	−$30,000	−$7,000
5	Add: Increase in Accounts Payable	+$15,000	+$8,000
6	Subtract: Debt principal paid (not in P&L) *Interest is already in net income — do not double-count.*	−$10,000	−$2,000
7	Subtract: Capex (equipment, vehicles, capitalized assets)	−$20,000	−$22,000
8	Subtract: Owner distributions / dividends	−$12,000	−$34,000
=	**Actual change in cash this month**		**−$34,000**

How to read it:

The P&L shows net income of +$40,000. The bank balance shows a decrease of $34,000. The bridge explains the $74,000 gap, line by line:

- $8,000 of "profit" was depreciation — a non-cash expense, added back.
- $25,000 went into accounts receivable — sales made but not yet collected.
- $30,000 went into inventory — produced or purchased, not yet sold.
- $15,000 was deferred via accounts payable — vendor credit cushioning the cash hit.
- $10,000 went out to debt principal — a real cash outflow that doesn't appear on the P&L.
- $20,000 went into new equipment — capitalized, not expensed.
- $12,000 was taken out as an owner distribution — reduces equity, not P&L.

The conclusion is clear and defensible: the business was profitable on paper, and cash declined because profit was absorbed by working capital growth, debt service, capex, and a distribution. None of that is a sign the business is broken. It's a sign that growth is being financed out of operating cash, and the owner needs to plan accordingly.

Simple in Normal Months. Expandable in Unusual Months.

The eight core lines cover the vast majority of cash-profit differences in an SME. But some months are not normal — money was borrowed, a customer paid a deposit upfront, the company remitted a quarter of sales tax, an insurance settlement arrived. Those flows belong on the bridge as named lines, not buried in a vague "other" bucket.

The rule: name the line. Tell the story.

Common optional named lines, used only when material:

- Add: Loan proceeds received (the company borrowed money — cash in, but not on the P&L)
- Add: Customer deposits received (cash in, revenue not yet recognized)
- Subtract: Prepaid expenses paid (cash out for insurance, rent, software paid in advance)
- Add or Subtract: Sales tax payable movement (cash collected but owed to the state, or remitted)
- Add or Subtract: Payroll tax liability movement (timing between accrual and remittance)
- Add or Subtract: Shareholder loan advances or repayments (often hidden distributions — see When It Stops Working)
- Add: Insurance settlement received (cash in, often partial revenue recognition)
- Subtract: Large one-time legal or settlement payments
- Add or Subtract: Intercompany transfers (multi-entity SMEs)

Rule of thumb: if a line is large enough to change the bridge's conclusion, name it. Do not create a generic "Other working capital" bucket — it hides the story instead of telling it.

One operational note — use total company cash, not one bank account.

If the business operates from multiple bank accounts, the bridge ties to the total of all of them. Transfers between accounts are not cash movement — they are reshuffling. Many SMEs make the mistake of building the bridge against the operating account alone and then chasing a phantom gap that turns out to be a transfer to the savings account.

Reading The Bridge: Three Common Health Signals

Once the bridge is in place, three patterns show up. Each demands a different response.

Profit positive, Cash positive	Profit positive, Cash negative	Profit negative, Cash positive
Healthy month. Operations and timing aligned.	Either growth is consuming working capital (often OK), or distributions / capex / debt are draining cash (need to confirm).	AR collected from prior months, inventory liquidated, or AP stretched. Survivable short-term, but the P&L tells you the business needs attention.
Action: continue normal operations.	*Action: identify which line on the bridge is the cause. Decide if it's expected or a problem.*	*Action: do not take comfort in the cash. Address the profitability problem.*

The most dangerous of the three is the third — profit negative, cash positive — because the cash position can lull management into ignoring a real profitability problem. AR collections from prior strong months can mask a current weak month. The bridge surfaces this honestly.

Minimum Viable Implementation

Implementing this framework takes a controller about two hours the first month, and 15-20 minutes every month after.

1. Pull net income from this month's P&L.
2. Pull non-cash expenses (depreciation, amortization, non-cash provisions) from the GL or P&L footnotes.
3. Pull the change in Accounts Receivable, Inventory, Accounts Payable, and prepaid expenses from the balance sheet (current month vs. prior month).
4. Pull cash basis amounts for debt principal paid, capex, and owner distributions from the GL.
5. Lay out the eight lines on a single page, in the same order every month.
6. Compute the bridge total. It MUST tie to the actual change in cash on the balance sheet to within $1. If it doesn't, the bridge is wrong — find the missing line.
7. Write one sentence per material line explaining the why. Not the math — the business reason.
8. Present alongside the P&L. Not as an attachment. Not in a separate review. Page 1: P&L. Page 2: Bridge.

Once the format is set, the bridge becomes part of the close and runs automatically. Most SMEs are surprised how little time it takes once the template exists.

What you do NOT need:

- New software. Excel or Google Sheets is fine.
- A full GAAP cash flow statement. The bridge is simpler and more readable for SME owners.
- An FP&A team. Any controller can build this.
- Monthly reconciliation between operating, investing, and financing activities the way GAAP requires. The eight-line bridge collapses all three into one view, which is what SME owners actually want to see.

Impact Logic / Cost of Inaction

The cost of not running this framework is concrete: wrong decisions, made on incomplete information, that destroy value or amplify a real problem.

Three illustrative scenarios:

Scenario 1 — Wrong distribution.

Owner sees +$40K profit, takes a $30K distribution. Three months later, payroll is short. Owner draws on a line of credit at 12% APR. If the line of credit is drawn for six months at $30K, that's $1,800 in interest the company didn't need to pay. Multiply that by 2-3 cycles per year of misread profit signals, and the cost is real money — entirely avoidable.

Scenario 2 — Panic cost-cutting.

Owner sees cash declining and assumes operations are unprofitable. Cuts a salesperson, freezes hiring, delays a planned investment. Three months later, the bridge would have shown the cash decline was driven by a one-time tax payment plus a planned inventory build for the busy season. The salesperson is now at a competitor, hiring is delayed by two quarters, and the inventory build sells profitably anyway. The cost is the lost revenue from the missing salesperson and the lost growth from the delayed hire.

Scenario 3 — Refusing a profitable deal.

A new customer offers a $200K order at 35% gross margin but on 90-day terms. Owner says no because "we don't have the cash." The bridge would have shown the deal generates $70K of gross profit, requires roughly $30K of working capital for 90 days, and produces net positive cash by month 4. The company turns down a $70K profit because it can't see the cash flow shape clearly.

What the framework actually costs:

A spreadsheet template. 15-20 minutes per month after the first build. Zero software. Zero headcount. The ROI is whichever wrong decision you avoid first — usually within the first 90 days of deploying it.

Note: *the dollar amounts in these scenarios are assumed for illustration. Companies should compute their own based on their typical net income, working capital cycles, and historical decision patterns.*

When It Stops Working

Owner distributions get hidden as "loans."

Some owners take "shareholder loans" from the company instead of declaring distributions, to keep the bridge looking better or to avoid tax consequences. Mechanically the cash still leaves the bank, but it's classified as an asset (a loan receivable) rather than an equity reduction. The bridge needs to flag any change in shareholder loan accounts and treat it as an effective distribution. Otherwise the bridge tells a falsely optimistic story.

Inventory write-downs masquerade as harmless non-cash adjustments.

A write-down is technically non-cash this month, so it gets added back like depreciation. But it's a signal that cash spent in prior months on inventory is now worth nothing — the cash damage

already happened. Don't smooth it away. Note write-downs as a separate line on the bridge with commentary explaining what they represent.

The underlying ledgers aren't reconciled.

The bridge is only as good as the GL it's built on. If accounts receivable sub-ledger doesn't reconcile to GL, or AP isn't closed, or inventory hasn't been counted, the bridge produces fiction. This framework assumes a clean monthly close. If the close itself is unreliable, fix that first.

One-time events distort the trend.

A single large capex purchase, a tax settlement, an acquisition payment, or a one-time legal fee will dominate any single month's bridge. Read the bridge over rolling 3 or 6 months for trend, not month-by-month for verdict. A bad month with a clear one-time cause is not the same as three bad months in a row from a structural pattern.

Bridge becomes a ritual rather than a tool.

If the controller produces the bridge every month but the owner never reads it, the framework has stopped working. Counter by tying the bridge to a specific decision: "distributions this month require the bridge be reviewed." "Capex above $X requires the bridge be discussed." Make the bridge the gate to the action, not a report after the fact.

Cash basis SMEs.

On cash basis (legal under IRS rules below ~$30M revenue for most service businesses), the bridge is simpler because AR, AP, and accrual timing are reduced or absent. But cash and reported income can still differ — debt principal, capex, owner distributions, loan proceeds, tax payments, credit card timing, and balance sheet movements all create timing gaps even on cash basis. Build a 4-line bridge instead of 8 (net income → debt principal → capex → distributions → cash change), and add named lines for anything else material.

Changelog

Version	Date	Description
1.0	Apr 28, 2026	Initial publication