PROFIT FIRST OVERVIEW

THE PROFIT FIRST FORMULA

The GAAP (Generally Accepted Accounting Principles) formula for determining a business's profit is Sales – Expenses = Profit. It is simple, logical and clear. Unfortunately, it's a lie. The formula, while logically accurate, does not account for human behavior. In the GAAP formula profit is a left over, a final consideration, something that is hopefully a nice surprise at the end of the year. Alas, the profit is rarely there and the business continues on its check to check survival.

~~Sales – Expenses = Profit~~
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With Profit First you to flip the formula to Sales – Profit = Expenses. Logically the math is the same, but from the stand point of the entrepreneur's behavior it is radically different. With Profit First, you take a predetermined percentage of profit from every sale first, and only the remainder is available for expenses.

PARKINSON'S LAW

Author and historian C. Northcote Parkinson theorized that our demand for a resource increases to meet the supply of it. That is why when we are given two weeks to do a project it takes two weeks, and when we are given eight weeks to do the same project it takes eight weeks. That is why when given $1,000 to complete our work we get it done with $1,000 and when given $10,000 to complete the same work, it takes $10,000. Profit First makes Parkinson's Law an asset. By taking profit first the money available for expenses lessens, and we are forced to find ways to get the same things done for less money.

BANK BALANCE ACCOUNTING

Most entrepreneurs don't have the time or gumption to read the different accounting statements necessary to manage the financial aspect of their business. Theoretically you should review and correlate your Income Statement, Balance Sheet and Cash Flow Statement monthly (or more frequently), but few entrepreneurs do. Most resort to "bank balance accounting," where we check our bank balance every day and make financial decisions based upon what we see. Per Parkinson's Law, we consume what we see in our bank account. Profit First encourages the entrepreneur to continue "bank balance accounting" by first allocating money to profit (and other accounts) so that the entrepreneur sees the actual portion of deposits that are available for expenses and they automatically adjust their spending accordingly.

DON'T CHANGE HABITS, LEVERAGE THEM

Many entrepreneurs try to force themselves to become better at accounting and to become more disciplined in their fiscal management by pure willpower. But just like a muscle, willpower can be drained. And in a moment of financial stress or bigger than expected expenses the entrepreneur will break their own fiscal rules and spend the money they have. The Profit First principle does not try to change your habits (that is nearly impossible to do), Profit First works with your existing habits. By first allocating money to different accounts, and then removing the temptation to "borrow" from yourself, your business will become fiscally strong and you will benefit from regular profit distributions.

PROFIT FIRST ONE-SHEET

One Time Set-up

STEP 1 **Setup the key five banks accounts with your current bank.** We'll call this bank, *Bank 1*.
1. Income (Checking); 2. Profit (Savings); 3. Owner's Pay (Checking); 4. Taxes (Savings);
5. Operating Expenses (Checking)

2 **Setup two new accounts at a different bank.** We'll call this bank, *Bank 2*. The purpose for these accounts is to remove the temptation of "borrowing" from these accounts.
1. Profit; 2. Taxes

3 **Determine the TAPs** (Target Allocation Percentages) for your business using the Instant Assessment (available for free download at www.MikeMichalowicz.com/Resources). But, start with percentages that your business can reasonably do for each account the remainder of the quarter. The percentages you determine are called your Allocation Percentages.

Every Day

STEP 1 All receipts from sales go into the Income account at *Bank 1*.

2 If you are doing Advanced Profit First, deposit receipts for things like reimbursable in the respective account.

3 Spend a minute to review your account balances at *Bank 1* daily, to see cash flow trends for the key aspects of your business. That's all the time you need to see where things stand!

Every 10ᵗʰ & 25ᵗʰ

STEP 1 Transfer all funds that have accumulated in the Income account at *Bank 1* to the other accounts at *Bank 1* based upon the Allocation Percentages you are using.

2 Transfer all the money in your Profit account at *Bank 1* to the Profit account at *Bank 2*. Transfer all money in your Taxes account at *Bank 1* to the Taxes account at *Bank 2*. This will leave a $0.00 balance for Profit and Taxes at *Bank 1*.

*3 If you are doing Advanced Profit First, transfer Employee Payroll or other fixed dollar amounts from Operating Expenses to the respective accounts.

*4 Disburse the salaries for the business owner(s) from the Owner's Pay account.

5 Pay your bills from the Operating Expenses account.

Every Quarter

STEP 1 Take 50% of the money that has accumulated in the Profit account at *Bank 2*, as profit distribution. Remember this money is for the business owner's and not to be used to "plowback" into the business.

2 Pay your tax liabilities from the Tax account at *Bank 2*.

3 Meet with a Profit First Professional and adjust the Allocation Percentages for the Profit, Tax, Owner's Pay and Operating Expenses to maximize your financial health.

Every Year

STEP 1 Review your financials with your Profit First Professional accountant and financial experts.

*2 Make year end contributions to the Vault account, retirement accounts, or make capital purchases as determined by you and your Profit First Professional.

STAYING ACCOUNTABLE

Just like going to the gym and trying to lose weight, we all know what to do and how to do it, but the best workouts are overseen by personal trainers. A Profit First Professional is your financial trainer. Use them!

*Certain steps in Profit First can be further configured optimally for your business. Please refer to the Profit First book for these advanced options and configurations.