

Reading Your Financial Statements

In trying to determine a topic that our Members might find educational, I asked a friend of mine, “What I should write my newsletter article on?” Her response was “How to Read Financial Statements”. Now most people would rank this subject up there with root canals and childbirth. I will do my best to make reading financial statements less painful than the other two however, I make no promises. Now, I must warn you to remove all sharp objects off your desk prior to going any further.

Financial statements are presented in two sections. The first is the Balance Sheet and the other is the Profit and Loss Statement. It helps to think of the Balance Sheet as the history page of the company. That is where the results of all the data from the inception of a business are reflected. The Balance Sheet lists all of the company’s assets. Assets are listed in order of liquidity. That is why you always see cash as the first item on the balance sheet as it is the most liquid. Assets are listed as current, those that will be consumed in a year. There are fixed assets/ property, plant and equipment, which won’t be consumed in one year. In the fixed asset section you will find building, office equipment, computers and other equipment. These fixed assets are always stated at the cost that the company paid for them even though they could be worth substantially more or less than the purchase price. Long-term assets are those that will not be consumed within one year.

Also, included on the Balance Sheet are the liabilities and equity of the company. The liabilities are listed in the order that they will be paid. The liabilities that will be paid in the current year will be listed first. Examples would be payroll taxes payable, current portion of notes payable, pension fund payable and so on. Liabilities that will be maturing after one year would be classified as long term. Included in this section would be note payments that won’t be paid within the current year and other payables maturing after one year.

The next section included after the liabilities would be the equity section. Here you will find what the company has after you subtract the total assets from the total liabilities. Therefore, when you add the liabilities to the equity you should have a balance equal to the total assets; thus the name “Balance Sheet”.

The next portion is called the Profit and Loss Statement. This statement is where most of us concentrate our time and efforts in reviewing and for good reason. The Profit and Loss statement reflects the transactions that have occurred during an operating cycle, typically a period of one year. We want to know what is the “bottom line” and here is where we will find that answer. The Profit and Loss Statement reflects the gross income we have generated and the expenses we have paid during the year. Profit and Loss Statements (also known as P and L Statements) tell us if we made a profit or incurred a loss during the operating cycle (thus the name). It generally lists the revenues first and the deductions from the revenue such as patient refunds to come up with net revenues. After revenues, expenses are listed. These are usually in alphabetical order but they can be listed other

ways. The important thing is that they are presented in a manner that is useful to the end user. To determine if you have a job in the coming year, you want the revenues to exceed the expenses. If they do, then you can go ahead and pile up the personal debt as you should still be employed.

As somewhat of an aside, most financial statements in a medical practice are presented on the cash and/or the modified cash basis. What this means is that revenues are listed on the statement when collected and expenses are listed when paid. That is the reason that you do not usually see accounts receivables or accounts payable listed on the financial statements.

I certainly hope this short course in “how to read financial statements” was not more information than you ever cared to know however, it is just plain hard to make this subject sexy.