3200 Riverside Drive, Columbus, OH 43221-1725

THE RELATIONSHIP BETWEEN YOUR PRACTICE'S BALANCE SHEET AND INCOME STATEMENT AND WHY IT MATTERS

Greg Michel, MBA, CVA
WTA Veterinary Consultants
3200 Riverside Drive, Columbus, OH 43221-1725
614-486-9700
gmichel@wellmp.com

You likely have a general idea of the look of your practice's balance sheet and income statement. The balance sheet is a snapshot in time of what you own and what you owe. The income statement, also known as a profit and loss statement, reports how much money you made and spent over a specified time period. As a refresher, the formulas are:

Balance Sheet

Assets = Liabilities + Owner's Equity

Income Statement

Net Income = Sales – Expenses

This all seems straightforward. However, the connection between these two reports is easily overlooked. Knowing the interaction between these two statements helps us make better asset purchase decisions.

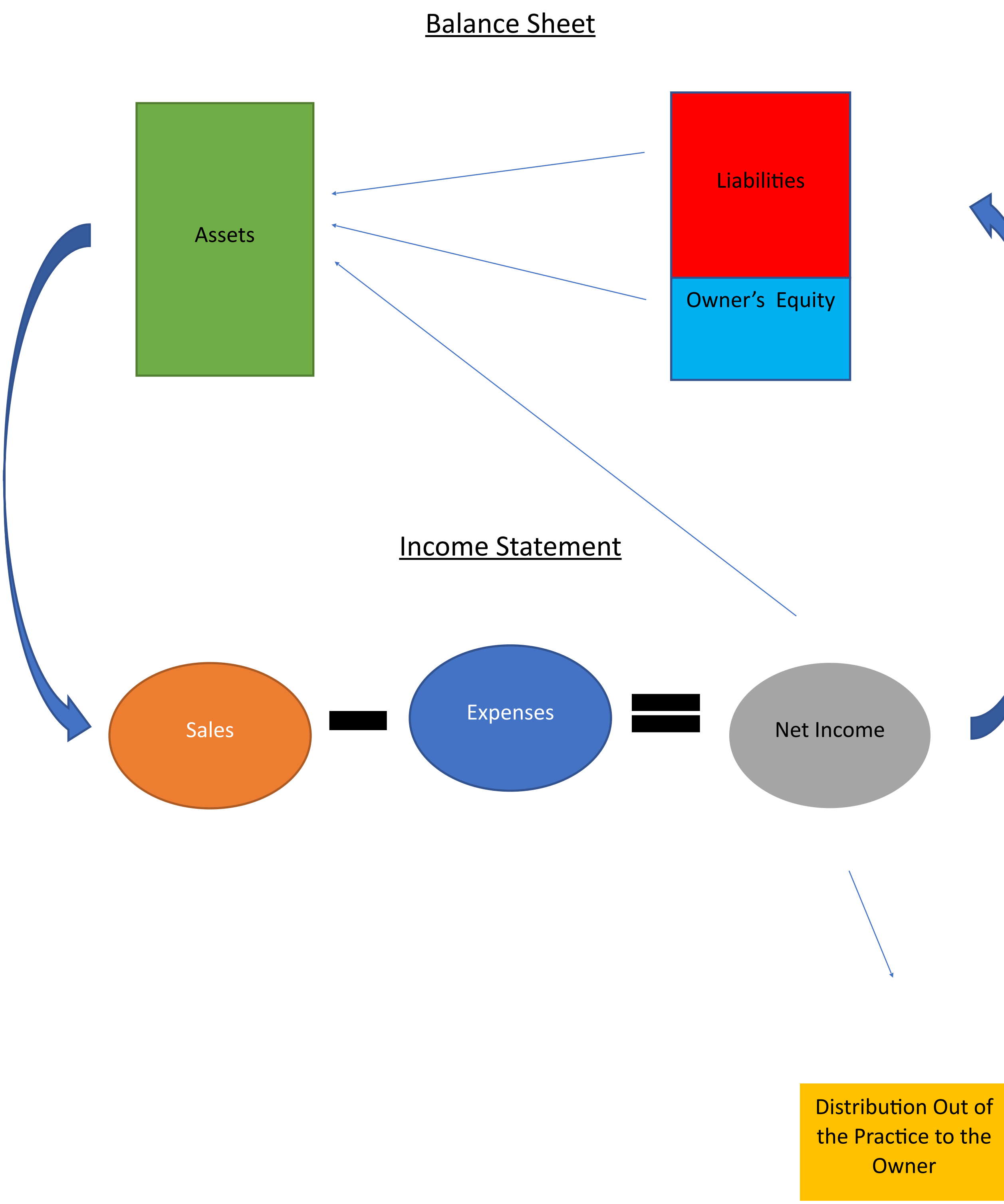
When you started or purchased your practice you likely funded this asset with a combination of debt and equity. The loan or mortgage is the debt and the money you put down for the purchase or start-up is your beginning owner's equity. The money from the loan was used to purchase assets such as equipment and inventory.

But what good are assets and why do you have them? The answer is that you need the assets to generate sales that bring in profits for the business. The liabilities and owner's equity on the balance sheet fund the assets that are used to create the net income found on the income statement. We need the assets to generate sales, which become net income after we pay expenses, which is the first tie-in between the balance sheet and income statement.

A second relationship between the balance sheet and the income statement regards the use of the net income. It may flow back to the balance sheet to purchase assets, pay down liabilities/debt, or remain as excess cash not needed for daily practice operations. The net income can also be taken out of the practice as a distribution to the owner.

Assets sound like a good thing as they generate net income. However, buying assets requires spending cash or taking on debt. That doesn't sound so good. So, are assets good or bad? It depends. If acquiring more assets leads to more income, they are good. If acquiring more assets leads to losses because the cost of the liabilities is greater than the net income the assets generate, they are bad. To summarize, assets can either be good or bad, it depends if they provide a positive return.

To maximize income, we need to purchase assets that pay for themselves. Our goal is to create the greatest amount of net income with the least amount of assets. The following page graphically displays the relationship between the balance sheet and the income statement. The next installment of this article will describe a handy spreadsheet used to determine if your next planned asset purchase will increase or decrease your practice's net income.



Tracking the Flow of Cash

1. Liabilities and owner's equity fund assets.
2. Assets are used to generate sales.
3. The proceeds from sales after paying expenses is net income.
4. Net income can flow to multiple areas, based on the owner's decision:
    a. Back to the assets on the balance sheet as excess cash
    b. The purchase of more assets that will appear on the balance sheet
    c. Pay down liabilities on the balance sheet
    d. Out of the practice as a distribution to the owner