



Tips and Trends in Healthcare M&A

May 2009

Cash Basis Accounting vs. Accrual Basis Accounting



Most business owners file their taxes on a cash basis. The reason for this is so the business will not be required to pay tax on funds that have not yet been collected. This makes perfect sense from the standpoint of taxation. However, there are certain disadvantages to relying on cash basis financial statements for management and valuation purposes. Cash basis statements are often inconsistent, are not good predictors of cash flow and do not measure revenues that have been earned but not collected. Accrual based financial statements state revenue in the period which it is earned and expenses are stated in the period incurred providing a consistent and accurate measurement of financial performance. Revenue that is earned but not yet collected is stated as accounts receivable, an asset on the balance sheet. Cash basis financial statements do not adequately measure the true performance of the business since there is a misalignment between income and expenses.

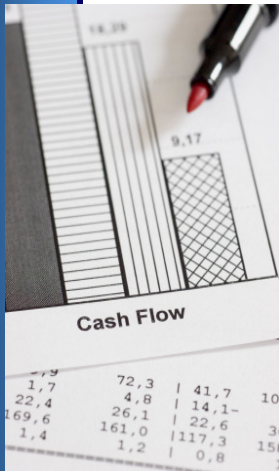
Cash statements are inconsistent and can give a false impression of the company's current performance. Consider a scenario when the month has three payrolls instead of two and the full year's premium for liability insurance is due to be paid. On a cash basis, the financial statement would reflect a big increase in expenses that is not offset by cash deposits. It would appear when trending this data that the company's financial performance has declined, when in reality, it may have actually improved. Using the accrual method, each payroll would

be expensed as the expense is incurred rather than when it is paid and the liability insurance expense would be evenly spread over a twelve month period. Cash basis statements can make it appear that the company's profitability is improving when in fact, the increase in cash could be related to an increase in collection of accounts receivable.

Cash flow as an indicator of performance can be very misleading. In a month where you have a dramatic increase in hours or admissions, your cash flow may suffer even though your profitability is increasing. Since the income and expenses are misaligned, your payroll would go up in a month of increased business but you may still be collecting receivables from previous months reflecting lower cash collections. The cash basis statement would show reduced profitability. Since accrual statements match the payroll expenses incurred with the revenue in the same period it is earned, the increase in profitability would be evident. On the other hand, if business is declining, the reverse situation can occur. As you collect revenues from prior, higher grossing periods, payrolls decrease as business decreases and cash flow improves. This can give owners a false sense of security. By the time a declining trend results in a negative cash flow, it is difficult to reverse the trend and the company may suffer devastating losses. By reviewing monthly accrual statements, these trends can be identified early and actions can be taken to reverse declining trends.

“Cash basis financial statements do not track the collection of accounts receivable”

Cash Basis Accounting vs. Accrual Basis Accounting continued



“Cash flow as an indicator of performance can be very misleading”

Cash basis financial statements do not track the collection of accounts receivable. Since accounts receivable is often the largest asset of a homecare company, it is especially important to monitor it closely. Receivables that are not kept close track of are often never recovered resulting in unnecessary losses. By including accounts receivable as an asset on an accrual based balance sheet, business owners are more likely to take proactive measures to preserve this valuable asset. Changes in accounts receivable affect a number of important measurements that analysts use to determine the health and viability of a company. An accrual based balance sheet can provide information about how long it is taking to collect receivables and how likely it is that a company will meet its financial obligations over time.

For small businesses, it may not be practical for a CPA to compile monthly accrual based statements. It may make sense to have a bookkeeper trained by

an industry specific financial consultant to enter the information in an accrual format. Accountants can also convert statements to a “modified accrual” format at the end of each year but this approach is much less desirable since it will not give you the information you need each period to better manage your company.

Accrual based financial statements are superior to cash basis statements for the management and valuation of your company. CMS even requires Medicare agencies to utilize accrual accounting in the cost report filing. Accrual statements not only give a true picture of how the business is performing, but also provide accurate data for budgeting purposes and to predict future cash flows and trends. Accrual Based financials statements are an accurate, consistent and reliable method of measuring your company’s performance.

New Opportunities May 2009

Kentucky Private Duty, Non-medical Homecare Agency. Approximately \$1.2 Million all private pay revenue with over 15% falling to the bottom line. Well run with consistent year over year growth. Diverse referral base. Good books and records. Owners will remain involved to assist with transition. Refer to PD10-0331

Texas Valley Area Medicare Home Health Agency. Fast growing agency with approx. \$2.7 Million in Medicare Revenue and 20% Profit. Great area in Texas with growing retirement population. Good financial records. Recently surveyed with NO deficiencies. Very well run agency. Refer to HH10-0113

Houston Area Medicare Home Health Agency. Established agency with approx. \$3 Million in Medicare Revenue. Very profitable with great reputation. Management will stay in place. Owner is relocating but will assist in transition to new ownership. Refer to HH09-0401

Detroit Area Medicare Home Health Agency. Small but growing agency with stable workforce and marketer in place. Young agency with consistent growth in revenues and admissions. Agency is admitting approx. 25 Medicare patients per month. Diverse referral base. Refer to HH10-0501

To learn more about these companies, please call Beth DaSilva at (888) 220-2270. Visit www.Fleetridge.com/opportunities to view all available opportunities.

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Fleetridge Pacific
3725 Talbot St.
Suite A
San Diego, CA 92106

Phone: (888) 220-2270
Fax: 619-523-1313
info@fleetridge.com