Understanding Medical Practice Finance

Presented by:
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Blake King is the Director of the Accounting Department and a partner with DoctorsManagement. He joined DoctorsManagement in 2003.

Blake and his team work exclusively with medical practices. They deliver accounting and tax services to DoctorsManagement clients with an unmatched commitment to quality of service.

Clients appreciate the availability of Blake and his team as well as the clear and detailed communications they provide. While many firms leave clients quietly wondering how to read and interpret their financial reports, Blake and his team provide a unique report format that even non-accountants can understand. The cash flow based reports are tailored for medical practices and allow clients to fully understand the movement of funds in and out of their practice.

Blake earned a Bachelor of Science degree in Accounting and Business Administration and a Master of Accountancy (MAcc) degree from the University of Tennessee. He is a Member of the National Association of Certified Valuation Analysts (NACVA) and the American Institute of Certified Public Accountants (AICPA). He has been awarded a Certificate of Specialized Educational Achievement in Healthcare Consulting by the National Association of Certified Valuation Analysts.

Blake lives in Knoxville, Tennessee with his wife, Lauren, and two daughters, Emma and Blake.

Agenda
• Financial Statements
• Profit Centers
• Taxes
**Financial Statements**

Records that outline the financial activities of a business, an individual or any other entity. Financial statements are meant to present the financial information of the entity in question as clearly and concisely as possible for both the entity and for readers. *

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**Financial Statements**

- Internal
- External

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**Financial Statements**

- Internal
  - Compensation Calculations
  - Current Performance
  - Budget to Actual
  - Comparison to Peers
  - Comparison to Past Performance
Financial Statements

External
- Bank Financing
- Sale
- New Partner
- Hospital
- Outside Investor
- Surgery Center
- Imaging Center

Financial Statements
- Income Statement
  - Also called the P&L or Profit & Loss
  - A financial statement that measures a company’s financial performance over a specific accounting period.
  - Think of it as a movie i.e. covers a period of time.

Financial Statements
- Balance Sheet
  - Also called Statement of Assets, Liabilities & Equity
  - A financial statement that summarizes a company’s assets, liabilities and shareholders’ equity at a specific point in time.
  - Think of it as a picture i.e. covers a moment in time
Financial Statements

- Cash Flow Statement
  - The document provides aggregate data regarding all cash inflows a company receives from both its ongoing operations and external investment sources, as well as all cash outflows that pay for business activities and investments during a given quarter.
  - Rarely used in small business

Income Statement

- Revenue
  - Money coming in to the practice
    - Insurance
    - Private Pay
- Expenses
  - Money going out of the practice
    - Salaries
    - Rent
- Net Income
  - Revenue less expenses
  - Profit if positive
  - Loss if negative

Example Income Statement

<table>
<thead>
<tr>
<th>Revenue</th>
<th>$1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses</td>
<td>-500,000</td>
</tr>
<tr>
<td>Net Income/(Profit)</td>
<td>$500,000</td>
</tr>
</tbody>
</table>
Detailed Income Statement

Revenue
- Collections 1,050,000.00
- Refunds (50,000.00)
  Net Collections 1,000,000.00

Expenses
- Accounting Fees 15,000.00
- Bank & Credit Card Fees 9,500.00
- Contract Labor 2,500.00
- Dues And Subscriptions 1,000.00
- Equipment Rental 15,000.00
- Insurance - Health 18,000.00
- Insurance – Malpractice 25,000.00
- Insurance – Other 4,000.00
- Lab Fees & Supplies 25,000.00
- Laundry & Uniform Expense 2,000.00
- Licenses & Permits 1,000.00
- Office Expense 10,000.00
- Postage 3,000.00
- Rent 100,000.00
- Repairs & Maintenance 10,000.00
- Salaries - Non Provider 91,000.00
- Salaries – NP 52,000.00
- Retirement Plan - Match 6,000.00
- Statement Processing & Postage 9,000.00
- Supplies - Injectables 12,500.00
- Supplies - Medical 52,500.00
- Supplies - X-Ray 2,000.00
- Taxes - Other 2,000.00
- Taxes - Payroll 22,000.00
- Utilities 10,000.00
  Total Expenses 500,000.00
  Net Income 500,000.00

Balance Sheet

- Assets
- Items of value that the practice owns
  - Cash, furniture, equipment
- Liabilities
- Value owed to someone else
  - Bank loans, accounts payable, credit cards
- Equity
- Assets less liabilities
- The combined earnings of the practice since inception
- Likely very small or negative

Example Balance Sheet

<table>
<thead>
<tr>
<th></th>
<th>Liabilities &amp; Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities</td>
<td>$360,000</td>
</tr>
<tr>
<td>Equity</td>
<td>$45,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Assets</th>
<th>Total Liabilities &amp; Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$405,000</td>
<td>$405,000</td>
</tr>
</tbody>
</table>
Balance Sheet

- Assets
  - Current Assets – cash, accounts receivable
  - Fixed Assets – furniture, equipment
    - Depreciation
      - A method of allocating the cost of a tangible asset over its useful life *
    - Methods
      - Tax
      - Book
    - Shown net of depreciation

- Liabilities
  - Short – Term (<1yr)
  - Long - Term (>1yr)
  - Components
    - Interest (P&L)
    - Principal (Bal. Sheet)

Example Balance Sheet

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities &amp; Equity</th>
</tr>
</thead>
</table>
| Current Assets | Short-Term Liabilities | 37,000
| Cash           | Payroll Taxes         | 10,000 |
|                | Total Current        | 47,000 |
|                | Assets               | 25,000 |
| Fixed Assets   | Total Short-Term     | 62,000 |
| Furniture &    | Liabilities          | 20,000 |
| Equipment      | Long-Term Liabilities| 165,000|
| Depreciation   |                      |       |
| Total Fixed    | Total Long-Term      | 185,000|
| Assets         | Liabilities          | 110,000|
|                | Equity               | 5,000  |
| Total Assets   |                      | 205,000|
|                |                      | 405,000|
Balance Sheet

- Equity
  - Assets less liabilities
  - Accumulated earnings of a business
    - Usually small or zero

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Income</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>1,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Year 3</td>
<td>1,500</td>
<td>3,500</td>
</tr>
</tbody>
</table>

- Equity = Assets - Liabilities

Basis / Accounting Method

The method by which income and expenses are reported — The two primary accounting methods in North America are cash and accrual accounting*

- All financial statements are based on a method of accounting
- I/S & BS will be on same method

* Investopedia.com
Basis / Accounting Method

- **Cash**
  - A major accounting method that recognizes revenues and expenses at the time physical cash is actually received or paid out. *
  - Small business
  - Revenue = cash in
  - Expenses = cash out
  - Personal checkbook

Basis / Accounting Method

- **Accrual**
  - An accounting method which requires income to be recognized in a company's books at the time it is earned (but not necessarily received) and records expenses when liabilities are incurred (but not necessarily paid for). *
  - Uncommon in small business
  - Will have Accounts Payable and Accounts Receivable

Basis / Accounting Method

- **Tax**
  - Books same as tax return
  - Slightly less common
  - Revenue = cash in
  - Expenses = cash out with exceptions
    - Fixed assets
## Income Statement
Comparison of Methods

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Annual</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>100</td>
<td>200</td>
<td>100</td>
</tr>
<tr>
<td>Expense</td>
<td>50</td>
<td>125</td>
<td>35</td>
</tr>
<tr>
<td>Net</td>
<td>50</td>
<td>75</td>
<td>65</td>
</tr>
</tbody>
</table>

## Balance Sheet – Assets
Comparison of Methods

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Annual</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>A/R</td>
<td>0</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Depreciation</td>
<td>50</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Net Fixed Assets</td>
<td>0</td>
<td>40</td>
<td>30</td>
</tr>
<tr>
<td>Total Assets</td>
<td>100</td>
<td>240</td>
<td>130</td>
</tr>
</tbody>
</table>

## Balance Sheet – Liabilities
Comparison of Methods

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Annual</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>A/P</td>
<td>0</td>
<td>75</td>
<td>0</td>
</tr>
<tr>
<td>Loans</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
Financial Statement Uses
- Performance
- Budget
- Comparison to Peers
- Comparison to Self
- Bank Financing
- Sale
- Compensation

Financial Statement Uses
- Performance (Are we making money?)
  - Profit
  - Cash in Bank
  - Compensation
  - Liabilities

Financial Statement Uses
- What is a Budget?
- Did we plan well?
- How should we plan for the future?
- How do we prepare?
  - Historical Data
  - Projections
  - Peer comparisons (Benchmarking discussed later)
Financial Statement Uses

• What is the goal?
• Planning
• Pitfalls
  • Spending to the budget
• E.g. — we had $1,000 left in the budget so we bought a computer we didn’t need.
• More art than science

Budget Calculations

<table>
<thead>
<tr>
<th></th>
<th>Last Year</th>
<th>% of Inc</th>
<th>Peers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Fees</td>
<td>15,000</td>
<td>1.15%</td>
<td>1.00%</td>
</tr>
<tr>
<td>Equipment Rent</td>
<td>35,000</td>
<td>2.67%</td>
<td>1.10%</td>
</tr>
<tr>
<td>Lab Fees</td>
<td>32,500</td>
<td>2.48%</td>
<td>1.60%</td>
</tr>
<tr>
<td>Office Expense</td>
<td>15,200</td>
<td>1.16%</td>
<td>1.10%</td>
</tr>
<tr>
<td>Salaries Non-Provider</td>
<td>278,200</td>
<td>21.24%</td>
<td>21.40%</td>
</tr>
</tbody>
</table>

Financial Statement Uses

• Comparison to Peers (Benchmarking)
• Best for Income Statement
• Use studies to see if 3 components (Revenue, Expense, Profit) are in line
• MGMA, NSCHBC, Specialty Society
Financial Statement Uses

- Comparison to yourself (Benchmarking)
- Compare 3-5 years
- Trends in income and expenses
- Compensation Trends
### Accounting Fees
- **2011**: 1.15%
- **2010**: 0.73%
- **2009**: 1.01%

### Bank & Credit Card Fees
- **2011**: 0.73%
- **2010**: 0.64%

### Biohazard Disposal
- **2011**: 0.11%
- **2010**: 0.09%

### Building Cleaning Services
- **2011**: 0.48%
- **2010**: 0.76%

### Common Area Maintenance
- **2011**: 1.41%
- **2010**: 1.60%

### Consulting Fees
- **2011**: 0.11%
- **2010**: 0.12%

### Contract Labor
- **2011**: 0.19%
- **2010**: 0.17%

### Dues And Subscriptions
- **2011**: 0.09%
- **2010**: 0.08%

### Equipment Rental
- **2011**: 2.67%
- **2010**: 1.36%

### Insurance - Health
- **2011**: 3.46%
- **2010**: 1.82%

### Insurance - Malpractice
- **2011**: 2.05%
- **2010**: 2.05%

### Insurance - Other
- **2011**: 0.35%
- **2010**: 0.35%

### Lab Fees & Supplies
- **2011**: 2.50%
- **2010**: 2.49%

### Laundry & Uniform Expense
- **2011**: 0.18%
- **2010**: 0.17%

### Licenses & Permits
- **2011**: 0.12%
- **2010**: 0.12%

### Management Fees
- **2011**: 0.23%
- **2010**: 0.23%

### Office Expense
- **2011**: 1.16%
- **2010**: 1.27%

### Postage
- **2011**: 0.28%
- **2010**: 0.27%

### Rent
- **2011**: 8.12%
- **2010**: 9.55%

### Repairs & Maintenance
- **2011**: 2.12%
- **2010**: 0.91%

### Salaries - Non Provider
- **2011**: 21.40%
- **2010**: 23.18%

### Salaries - NP
- **2011**: 4.00%
- **2010**: 3.98%

### Simple Ira Plan - Match
- **2011**: 0.45%
- **2010**: 0.45%

### Sonogram
- **2011**: 0.53%
- **2010**: 0.53%

### Statement Processing & Postage
- **2011**: 0.75%
- **2010**: 0.75%

### Supplies - Injectables
- **2011**: 0.99%
- **2010**: 0.99%

### Supplies - Medical
- **2011**: 4.04%
- **2010**: 4.02%

### Supplies - X-Ray
- **2011**: 0.14%
- **2010**: 0.14%

### Taxes - Franchise/Excise
- **2011**: 0.45%
- **2010**: 0.45%

### Taxes - Other
- **2011**: 0.20%
- **2010**: 0.20%

### Taxes - Payroll
- **2011**: 3.44%
- **2010**: 3.42%

### Taxes - Property Equipment
- **2011**: 0.05%
- **2010**: 0.05%

### Utilities
- **2011**: 0.78%
- **2010**: 0.77%

### X-Ray Expense
- **2011**: 0.04%
- **2010**: 0.04%

### Total Expenses
- **2011**: 61.07%
- **2010**: 64.06%
- **2009**: 63.24%
Financial Statement Uses

- Bank Financing
- Loan Review
- Clean Books
- Explainable

Financial Statement Uses

- Sale
  - Fixed Assets
  - Listing
  - Profit trends and projections

Financial Statement Uses

- Compensation
  - “Eat what you treat”
  - How do you calculate physician compensation
Profit

• What is it?
  • In a small medical practice, profit is what the owners take home.
  • No profit = No pay

• Profit Centers
  • Ancillaries
  • Midlevel Providers
  • Employed Physicians

Example MR with Ancillaries

<p>| | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
<td>C</td>
<td>A</td>
<td>C</td>
<td>F</td>
</tr>
<tr>
<td>Charges - Gross</td>
<td>575,000</td>
<td>515,000</td>
<td>500,000</td>
<td>425,000</td>
<td>63,000</td>
<td>335,000</td>
</tr>
<tr>
<td>Less: Medical Services Adjustments</td>
<td>(245,000)</td>
<td>(200,000)</td>
<td>(204,000)</td>
<td>(170,000)</td>
<td>(20,000)</td>
<td>(135,000)</td>
</tr>
<tr>
<td>Charges - Net</td>
<td>330,000</td>
<td>315,000</td>
<td>296,000</td>
<td>255,000</td>
<td>43,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Collection Percentage - Gross</td>
<td>56.00%</td>
<td>60.00%</td>
<td>52.00%</td>
<td>58.35%</td>
<td>50.79%</td>
<td>41.49%</td>
</tr>
<tr>
<td>Collection Percentage - Net</td>
<td>97.58%</td>
<td>98.10%</td>
<td>87.84%</td>
<td>97.25%</td>
<td>74.42%</td>
<td>69.50%</td>
</tr>
<tr>
<td>Posted Collections</td>
<td>322,000</td>
<td>309,000</td>
<td>260,000</td>
<td>248,000</td>
<td>32,000</td>
<td>139,000</td>
</tr>
<tr>
<td>Total Collections Deposited</td>
<td>322,000</td>
<td>309,000</td>
<td>260,000</td>
<td>248,000</td>
<td>32,000</td>
<td>139,000</td>
</tr>
<tr>
<td>Refunds</td>
<td>(3,000)</td>
<td>(2,900)</td>
<td>(3,000)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Returned Checks</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Interest Income</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Income</td>
<td>318,900</td>
<td>306,000</td>
<td>256,900</td>
<td>248,000</td>
<td>32,000</td>
<td>139,000</td>
</tr>
<tr>
<td>Less: Overhead Expenses Shared Equally</td>
<td>(94,333)</td>
<td>(94,333)</td>
<td>(94,333)</td>
<td>(52,000)</td>
<td>(5,000)</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Less: Overhead Expenses Based on Collections</td>
<td>(144,659)</td>
<td>(138,807)</td>
<td>(116,534)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Overhead</td>
<td>(238,992)</td>
<td>(233,140)</td>
<td>(210,868)</td>
<td>(52,000)</td>
<td>(5,000)</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Professional Profit / (Loss)</td>
<td>79,908</td>
<td>72,860</td>
<td>46,032</td>
<td>196,000</td>
<td>27,000</td>
<td>79,000</td>
</tr>
</tbody>
</table>

Available for Provider Compensation 180,575 173,526 146,699 0 0 0
### Available for Provider Compensation

<table>
<thead>
<tr>
<th>Doctor</th>
<th>B</th>
<th>C</th>
<th>Total Collections Deposited</th>
<th>Less: Medical Services Adjustments</th>
<th>Charges - Gross</th>
<th>Charges - Net</th>
<th>Professional Profit / (Loss)</th>
<th>Less: Overhead Expenses Based on Collections</th>
<th>Professional Profit / (Loss) Based on Collections</th>
<th>Total Overhead</th>
<th>Total Income</th>
<th>Total Overhead</th>
<th>Total Income</th>
<th>Charges - Gross</th>
<th>Professional Profit / (Loss)</th>
<th>Less: Overhead Expenses Based on Collections</th>
<th>Professional Profit / (Loss) Based on Collections</th>
<th>Total Overhead</th>
<th>Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>322,000.00</td>
<td>309,000.00</td>
<td>260,000.00</td>
<td>48,750.00</td>
<td>248,000.00</td>
<td>32,000.00</td>
<td>135,000.00</td>
<td>939,750.00</td>
<td>1,178,550.00</td>
<td>930,550.00</td>
<td>130,550.00</td>
<td>153,824.68</td>
<td>146,776.35</td>
<td>119,948.97</td>
<td>93,960.00</td>
<td>939,750.00</td>
<td>1,178,550.00</td>
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<td></td>
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<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

**Total Collections Deposited**: 322,000.00

**Less: Medical Services Adjustments**: 48,750.00

**Charges - Gross**: 375,000.00

**Charges - Net**: 330,000.00

**Professional Profit / (Loss)**: 40,908.01

**Less: Overhead Expenses Based on Collections**: 133,333.33

**Less: Overhead Expenses Shared Equally**: 133,333.33

**Interest Income**: 0.00

**Returned Checks**: 100.00

**Refunds**: 3,000.00

**Posted Collections**: 322,000.00

**Collection Percentage - Net**: 97.58%

**Collection Percentage - Gross**: 56.00%

**Charges - Gross**: 575,000.00

**Charges - Net**: 330,000.00

**Professional Profit / (Loss)**: 40,908.01

**Less: Overhead Expenses Based on Collections**: 133,333.33

**Less: Overhead Expenses Shared Equally**: 133,333.33

**Interest Income**: 0.00

**Returned Checks**: 100.00

**Refunds**: 3,000.00

**Posted Collections**: 939,750.00

**Collection Percentage - Net**: 99.87%

**Collection Percentage - Gross**: 59.10%

**Charges - Gross**: 1,590,000.00

**Charges - Net**: 1,178,550.00

**Professional Profit / (Loss)**: 253,550.00

**Less: Overhead Expenses Based on Collections**: 525,000.00

**Less: Overhead Expenses Shared Equally**: 525,000.00

**Interest Income**: 0.00

**Returned Checks**: 0.00

**Refunds**: 0.00

**Posted Collections**: 2,413,000.00

**Collection Percentage - Net**: 93.45%

**Collection Percentage - Gross**: 66.90%

**Charges - Gross**: 4,200,000.00

**Charges - Net**: 3,092,354.00

**Professional Profit / (Loss)**: 420,550.00

**Less: Overhead Expenses Based on Collections**: 1,000,000.00

**Less: Overhead Expenses Shared Equally**: 1,000,000.00

**Interest Income**: 0.00

**Returned Checks**: 0.00

**Refunds**: 0.00

**Posted Collections**: 9,702,354.00

**Collection Percentage - Net**: 92.84%

**Collection Percentage - Gross**: 56.00%

**Charges - Gross**: 11,800,000.00

**Charges - Net**: 7,702,354.00

**Professional Profit / (Loss)**: 420,550.00

**Less: Overhead Expenses Based on Collections**: 1,000,000.00

**Less: Overhead Expenses Shared Equally**: 1,000,000.00

**Interest Income**: 0.00

**Returned Checks**: 0.00

**Refunds**: 0.00

**Posted Collections**: 9,702,354.00

**Collection Percentage - Net**: 92.84%

**Collection Percentage - Gross**: 56.00%

**Charges - Gross**: 11,800,000.00

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**Collection Percentage - Net**: 92.84%

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Taxes

- Section 179
  - Immediate expensing of fixed assets
  - 2013 Limit - $500,000
  - 2014 Limit - $25,000
- Bonus Depreciation
  - Immediate expensing of 50% of fixed assets
  - 2014 – no longer available

Taxes Depreciation Comparison

<table>
<thead>
<tr>
<th>MACRS</th>
<th>Section 179</th>
<th>Bonus</th>
<th>Both</th>
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Taxes

- Automobile
  - 100% Business Use = Red Flag
  - Business Use
  - Who should own?
  - Easiest Method
Taxes

- Retirement Plans
  - Many Different Types
  - 401(k)
  - Profit Sharing
  - SEP
  - SIMPLE
  - Cash Balance
  - Qualified
  - $5,000 per year for 20 years
  - Qualified plan = $247,000
  - Taxable = $195,000

- Health Insurance
  - Credit for Small Businesses
    - 35% Tax Credit
    - Phases out after 25 employees
    - Phases out after $25,000 average wages
  - Fine for Large Businesses
  - Expensing for Owners

Questions

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