

UNIVERSITY OF PENNSYLVANIA
VBMA Management Certificate Program

Understanding Financial Statements

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Important Accounting Terms

- **Asset**
- **Liability**
- **Equity**
 - Retained Earnings
- **Return on investment (ROI)**
- **Revenue**



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Important Accounting Terms

- **Expenses**
 - Fixed
 - Variable
- **Profit (Net Income)**
- **Debit**
- **Credit**



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Important Accounting Terms

- Sales Invoice
- Cash Receipt
- Cash Disbursement
- Chart of Accounts
- Journal
 - Sales
 - Purchases
 - Cash receipt
 - Cash Disbursement



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Important Accounting Terms

- General Ledger
- Financial Statement
- Cash Flow
- EBITDA
- Accounts receivable
- Accounts payable



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Important Accounting Concepts

- Measurement of Information –Define the period of time
- Developing proper cuts offs for information
- Recognition of income and expense
 - Cash basis
 - Accrual basis
- Depreciation



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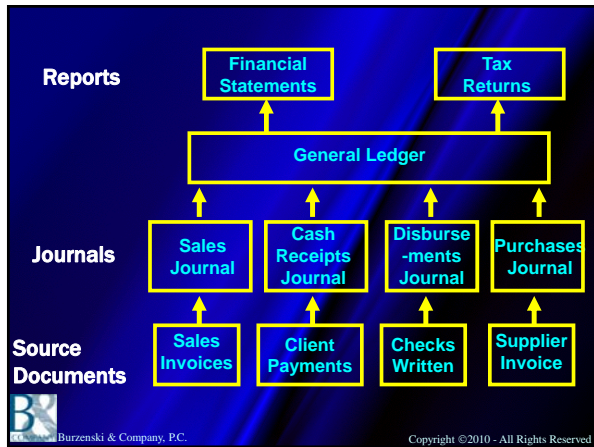
Flow of Information

- How does it start?
- Where does it end?



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Financial Controls

- Cash
- Invoicing & Accounts Receivable
- Inventory



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What Are Good Financial Controls?



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Financial Controls a/k/a Internal Controls

- Procedures put in place to protect assets and assure the correct reporting of financial activity



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Protecting assets means they are safeguarded



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Good Internal Controls Invest In:

- Formal procedures and
- A Segregation of duties



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Practices should not create an environment of disorganization and inefficiency. Practices start by...

- Hiring good people
- Conduct a proper employment screening process
- Check references



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Cash Objectives

- Record receipts accurately
 - Account-type of service
 - Doctor production
 - Amount
 - Period



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Record-Disbursements Accuracy

- Account - type of expense
- Amount
- Period



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Are all checks made for authorized goods and services

Save packing slips and match with invoices



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“DO NOT EXPECT WHAT YOU DO NOT INSPECT”



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Internal Controls
Major Areas to Address

- Non financial (Medical Records)
- Computer system
- Client record
 - Is it complete?



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Have all clients been set up with...



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Client set up

- Address
- Telephone number
- E-mail address
- Animal's name
- Animal's birth date
- Weight
- Sex
- Breed



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Vaccination Reminders



Are they Complete?



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Run search and sort criteria reports within veterinary software to determine missing items.



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What is the first step in the process?



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“Understand the existing process”

**Use my checklists
to determine
strengths and
weaknesses**



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**Are checks
presented with
invoices or
statements and
signed by the
practice owner?**



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**Are the use of
signature stamps
restricted or
prohibited?**



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**Are checks not returned
to preparer after
signing?**



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**Is mail opened by
someone other than the
bookkeeper and is the
daily collection of
accounts receivable
independent of accounts
receivable posting
activity?**



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**Is adequate employee
fidelity bond
insurance
maintained?**



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Are checks to cash prohibited?



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Is access to the computerized accounting program limited?



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Is a daily/shift cash out performed which agrees to the computerized veterinary software?



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**Are cash out sheets printed,
signed off on and approved by
management?**



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**Are daily deposit
tickets done which
agree to the
computerized
veterinary
software?**



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**Are restricted
endorsements (e.g. for
deposit only) placed on
check remittances upon
receipt?**



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**Are deposits
made daily to
the bank?**



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**Are credit card
machines used
which can batch
process daily
transactions and
which have
printers?**



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Invoicing and Accounts Receivable Objectives

- **Sales transactions:**
 - Valid
 - Recorded timely & accurately
 - Properly applied to client accounts
 - Credits or allowances are approved
 - Credit risk is assessed



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Are pre-numbered receipts or cash registers effectively used and controlled?



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Is the veterinary software password protected for limited access to change a client invoice, issue a credit, charge off a bad debt, or change any other part of a client record?



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Is the veterinary software password protected for limited access to print an entire client list?



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**Are monthly statements sent
and an aged accounts
receivable listing prepared and
reviewed?**



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**Are collection procedures
established for accounts at 30
days, 60 days, 90 days and to
collection agency?**



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**Are write offs
limited and
approved by
owner/ manager?**



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Are exam room and hospital travel sheets utilized to determine accurate billing?



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Are estimates utilized and signed by clients for services rendered?



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Are payment agreement forms utilized for charging?



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Do authorizations for surgeries and other procedures indicate payment is expected at time services are rendered?



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Are daily fee exception reports run for fee overrides?



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Are manual discounts prohibited or limited with proper approval?



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Have daily, monthly and year end close out procedures been established for cut offs at the end of each accounting period?



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Monitor Accounts Receivable

Created by Provider

- Run accounts receivable aging report from veterinary software
- Share the information with associates
- Hold associate accountable for what they create



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Bad Debts

- 50% of over 90 days amounts will turn to bad debts
- Industry average
 - Small animal - .5% of gross revenue
 - Large animal - 1% of gross revenue

Small animal

\$500,000 gross = \$2,500 bad debts



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Have procedures been established to determine what reports to run for each reporting period and how they will be stored?



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Inventory Objectives

Inventory transactions:

- **Authorized**
- **Properly valued**
- **Physical loss prevented**



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Are inventories adequately safeguarded (limited access) and insured?




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Are computerized inventory records maintained?




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Is access to computerized inventory records limited?



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Are reconciliations done between physical counts and computerized records?



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Are physical counts of inventory performed at least yearly?




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Are packing slips matched with inventory received?



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Are packing slips matched with invoices before payment? Are discrepancies resolved?



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Are pricing changes made when vendors indicate price increases?




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Has a system for determining optimum inventory re-order quantities been established and/or maintained?



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Are inventory turns in times and days calculated?



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Does the owner/manager periodically assess whether excess, slow moving, obsolete inventory items are accounted for appropriately?

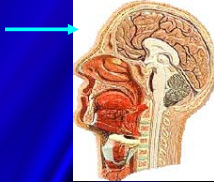


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The Anatomy of a Financial Statement

Income



Expense



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What Are Financial Statements?



Books that tell the Financial Story


- **Health – Long & Short-term**
- **Operating efficiencies**
- **Profitability**
 - overall
 - by location
 - by department




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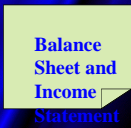
What Do Financial Statements Consist Of?



**Financial
Statement**



**Accountant's
Report**




**Balance
Sheet and
Income
Statement**

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What Do Financial Statements Consist Of?

Accountant's report

- **Audit**
- **Review**
- **Compilation**



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What Do Financial Statements Consist Of?

Balance Sheet

- **Assets**
- **Liabilities**
- **Equity**



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What Do Financial Statements Consist Of?

- Supporting Income Statement Schedules
 - Must meet the practice objectives
 - By location
 - By hospital department
 - By type of service rendered
 - Veterinary
 - Grooming
 - Kennel
 - Retail



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Uses of Financial Statements

- Management Decision Analysis
 - Lease vs. buy decisions
 - Benefit plan consideration
 - Expansion plans
 - Business Plans
 - Budgets



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Uses of Financial Statements

- Management Profitability/ Efficiency Analysis
- Practice Valuations
 - Estate tax purposes
 - New partner/shareholder buy-ins/buy-outs
 - Divorce settlements





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Uses of Financial Statements

- Credit grantors
 - Banks
 - Leasing companies

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Basic Considerations in Developing Financial Statements

- Tailor to your specific needs & objectives
- Define those needs
 - Meet AAHA comparative information requirement

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Basic Considerations in Developing Financial Statements

- Determine profitability
 - By activity
 - Veterinary services
 - Grooming
 - Kennel & boarding
 - Retail
 - By location (in a multi-office practice)

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Basic Considerations in Developing Financial Statements

- Match income & expenses to archive valid results



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Developing Information to Prepare Financial Statements

- Income Information
 - Categorize revenue by type of service provided
 - Manual
 - Computer
- Expense Information
 - Developed through chart of accounts
 - AAHA chart



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Methods of Presentations to Use Financial Statements

- Cash Basis vs. Accrual Basis
 - Cash basis – tax reporting
 - Accrual basis – meaningful results for management decisions



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Considerations in Developing Financial Statements



Always Comparative
(A Must)



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Considerations in Developing Financial Statements

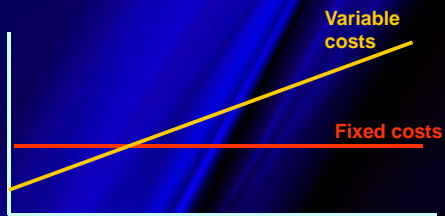
- Always presented with percentages to Gross Revenue
- Fixed vs. variable expense
- Measures efficiency of practice management
- Comparison of industry standards



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What Are Variable & Fixed Costs?



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Fixed Expenses

- Fixed expenses are those that do not directly fluctuate with changes in sales

Fixed costs

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What are fixed expenses?

Examples

- Rent
- Utilities
- Repairs & maintenance
- Telephone
- Insurance
- Salaries & wages
- Payroll taxes

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Variable Expenses

- Variable expenses are those that directly fluctuate with changes in sales

Variable costs

Fixed costs

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What are variable expenses?

Examples

- Drugs & supplies
- Food Costs
- Laboratory expense



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**Veterinary practice is a
fixed cost business
Most expenses are not
controllable**



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**To improve the profitability of a
veterinary hospital you must:**

- Look to new ways for
increasing revenue
- Control Expenses



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FACT




You cannot improve the overall profitability of a veterinary hospital by cutting expenses

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Fixed to variable expense cost ratio

Fixed Expenses 75%



Variable Expenses 25%

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Run Internal Prepared Financial Statements Monthly

Quickbooks

- Go to Reports
 - Profits & loss
 - Balance Sheet

Peachtree

- Reports
 - Financial Statement



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Financial Records for Internal Reporting

- Have your accountant provide a monthly depreciation entry
- Get accountant prepared general ledger adjustments when done
- Have your accounting records match those of the accountants



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Chart of Accounts Considerations

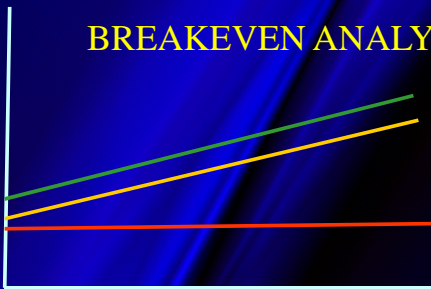
- ♦ Provide more detail rather than less
- ♦ Consider detailed revenue analysis
 - Income categories per veterinary software
- ♦ Consider detailed wage analysis
 - Set up departmentalized payroll through payroll service



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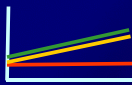
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BREAKEVEN ANALYSIS



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BREAKEVEN COMPUTATION

$$\text{Break-even point in sales} = \frac{\text{Fixed costs}}{\text{Contribution Margin}}$$

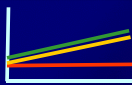
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What Is The Contribution Margin?

$$\text{Contribution Margin} = 1 - \text{Variable Costs}$$

$$76.29\% = 1 - 23.71\%$$

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BREAKEVEN ANALYSIS

Breakeven Point in Daily Sales


$$\text{Break-even point in daily sales} = \frac{\text{Breakeven Point in Sales}}{\text{Number of Days Open}}$$

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BREAKEVEN ANALYSIS EXAMPLE

Fixed Costs	\$616,655
Contribution Margin	76.29%
Breakeven Point in Sales	\$808,304
Breakeven In Dally Sales	
Breakeven in Daily Sales	\$808,304
Number of Days Practice Open	286 days
Breakeven per Day	\$2,826.00




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What Does It Cost To Open The Hospital Door Each Day?




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FORMULA


$$\text{Daily Cost To Open The Door} = \frac{\text{Yearly Fixed Costs}}{\text{Number of Days Open}}$$


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DAILY COST TO OPEN THE DOOR

Daily Cost To Open The Door = $\frac{\text{Yearly Fixed Costs}}{\text{Number of Days Open}}$

\$2,156.13 = $\frac{\$616,655}{286}$



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Inventory Efficiency




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Calculation of Inventory Turns

Average Inventory = $\frac{\text{Inventory at the beginning of year} + \text{Inventory at the end of year}}{2}$



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Calculation of Inventory Turns

$$\text{Inventory Turns} = \frac{\text{Yearly Drug \& Supply Costs}}{\text{Average Inventory}}$$

$$\text{Inventory turns in days} = \frac{365 \text{ Days}}{\text{Inventory Turns}}$$



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Calculation of Inventory Turns

Industry Average 4 to 5 times

Or

Once Every 89 Days



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Inventory Turns

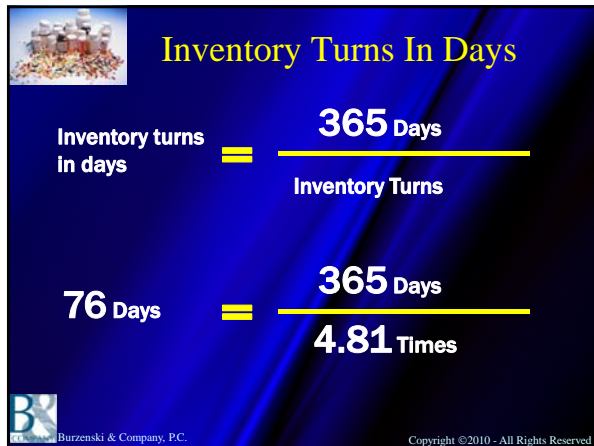
$$\text{Inventory Turns} = \frac{\text{Yearly Drug \& Supply Costs}}{\text{Average Inventory}}$$

$$4.81 \text{ Times} = \frac{130,000}{27,000}$$



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Inventory Turns In Days

Inventory turns in days = $\frac{365 \text{ Days}}{\text{Inventory Turns}}$

76 Days = $\frac{365 \text{ Days}}{4.81 \text{ Times}}$

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Inventory Issues

Duplicate Stocking of Drugs because of the Doctor Preference

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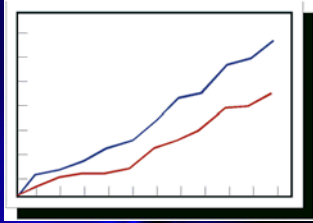
Inventory Issues

Every \$100 of Inefficient Inventory Adds \$8.00 in carrying cost

COST!

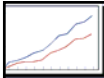
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Economic Order Point Analysis



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Economic Order Point for Optimum Inventory Quantities

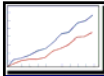
Every item of inventory can be quantified for optimum quantity on hand

- ✓ Source of Data - Computer System
- ✓ Information Needed
 - Vendor
 - How many sold per day
 - Shipping time
 - Minimum quantity to be maintained on hand
- Order frequency



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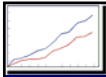
Economic Order Point Analysis Example

Inventory Item	
Vendor	Henry Schein
Price	\$3.99
Shipping Time	5 Days
Order Frequency	bi-weekly
Minimum Quantity On Hand (Sold per day x shipping time)	10
Average Quantity Sold Per Day	2



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Formula

Minimum Quantity Maintained (Sold Per Day x Shipping Time)		10
Average Sold Per Day	2	
Days Between Orders	x 14 Days	28
Total Required		38
Quantity on Hand at Date Of Order Placement		(10)
Total To Order		28



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BUDGETING



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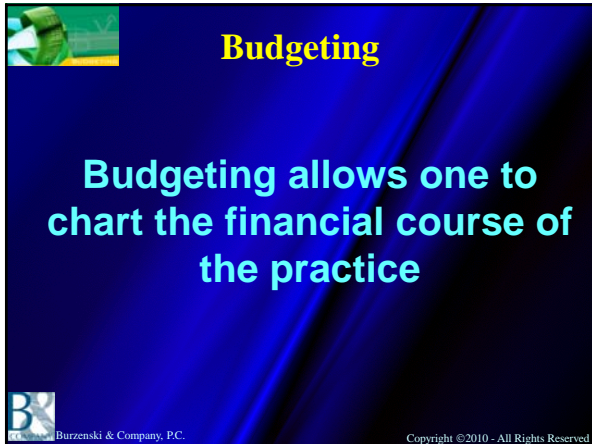
Budgeting

Why do you need to prepare one?




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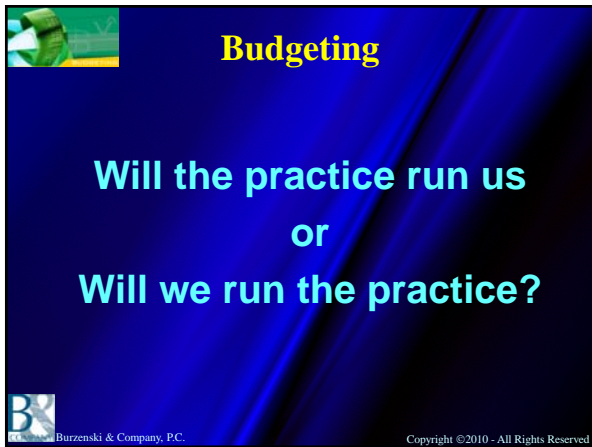
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Budgeting


Budgeting allows one to chart the financial course of the practice

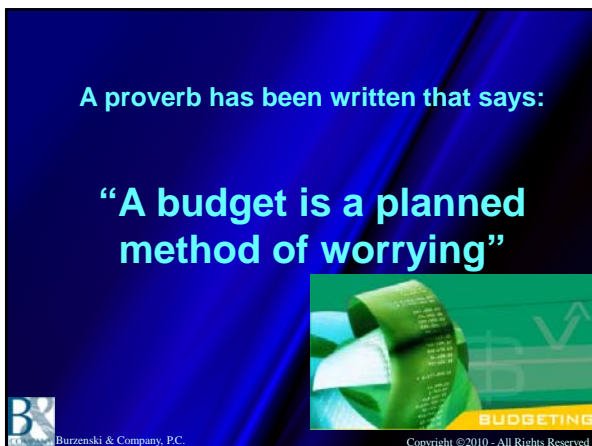
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Budgeting

**Will the practice run us
or
Will we run the practice?**


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A proverb has been written that says:

“A budget is a planned method of worrying”



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BUT others have said:

**“If you are failing to plan ,
then you are planning to fail”**

Tariq Siddique



BUDGETING




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Others have also said:

**“Define your business goals
so that others can see them
as you do”**


George F. Burns



BUDGETING




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Rules of Budgeting

- Budget by the month
- Use historical information as your guide
- Budget revenue first (use statistical analysis reports)
- Budget variable expenses as a percent of basis revenue
- Budget fixed expenses based upon best information available (use historical general ledger)



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Make budgeting an ongoing process. As things change in the hospital, so should your budget



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YOUR QUESTIONS

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