Interpreting Profit and Loss Statements

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Profit and loss statements are often the last thing practices look at when managing their business; in fact, owners usually save it for year-end tax purposes only. But I challenge you to answer the following question: how can you make business related decisions and changes based on year end results only? If you wanted to spot trends and implement a correction, shouldn't you do that when the trend starts instead waiting until it has damaged the business?

What are Profit and Loss Statements?
P&L can also be referred to as income and expenses statements, as they do simply that: track where your money comes from and where it goes for a specified time. A few simple rules:

- You can view P&Ls in either Cash Base or Accrual base accounting
- P&Ls do not match your bank statement
- The CPAs job is to have as low of profit as possible at the end of the year – but nor yours as a manager
- Start simple then add specific details when the comfort zone increases

Cash base accounting is defined as recording payments at the time of receiving (the payment) and recording expenses at the time of payment. Accrual base accounting records payments and at the time of invoice and expenses at the time the product is received. Often, it depends how the practice reports taxes to the IRS as to how statements will be produced. Either way, the point is to be able to track trends and make a difference in managing the business.

Because P&Ls record the daily income coming in and the expenses as they go out, they do not match the bank statements (that is the job of the cash flow statements). You may receive a payment from a client on the 31st of the month, but it is not actually deposited in the bank account until the next business day. You may send checks out to pay bills, but the money was not actually extracted from your bank account yet. Therefore, don't expect these to match.

The goal of the CPA is to reduce the tax burden on the practice- which is what we want them to do! They also need to categorize items for tax purposes. Allow them to do their job; but you also need to manage the business to the best of your ability. If you are managing a zero percent profit, then you have some work to do! However, the reality is, is that you may have a higher profit then 0% when looking at a managing P&L. Creating an accurate chart of accounts will help you to do this.

Chart of Accounts
The American Animal Hospital Association (AAHA) has a fabulous Chart of Account (CoA) that enables the practice to benchmark. It is very important to utilize the CoA, so comparisons can be made, questions can be asked, and solutions can be implemented. Work with your accountant to be able to follow a standard CoA.

Accurate entry in the chart of accounts is key or your entries/dollars/percentages will be off, preventing you from identifying issues in the practice. The CoA has 3 important portions: income, expense and profit. Income records where your money is coming from (yes, you need to identify this)! Expense entry identifies where you spend the money, and the profit will indicate what is left over.

Income categories to consider include any profit centers the practice has:

- Exams
- Vaccines
- Paraciticide Prevention
- Surgical

- Dental
- Rehab
- Diets
- Pharmacy
- OTC

Expense categories should be:

- Administrative
- Facilities
- Cost of Goods
- Staff
- Veterinarians

Each of the expense categories can then be further classified. The following are examples, however, not an exhaustive list.

Administrative Expenses	Facility Expenses	Cost of Good Expenses
Business Licensees/permits	Equipment	Vaccines
Advertising/Marketing	Building	Paraciticide
Copies/printing	Property	Surgical
Office supplies/postage	Utilities	Dental
Professional fee’s	Rent	Diets
Merchant credit card fees	Biomedical waste	Pharmacy
Payroll fee’s	Contract Labor	Lab

Interpreting P & Ls

P&Ls can be scary to look at. Have no fear, let’s break them down and decipher what they mean! Remember, there are 3 parts: Income, expense and profit. That's it. Simple. Print your P&L in both dollar amounts and percentages of Gross Revenue. This allows you to benchmark against industry standards and start asking questions.

> **STEP 1:** Ask WHAT? Evaluate your percentages and compare to either AAHA[1] or Well Managed Practices (WMP)[2]. Are your percent’s higher or lower?
>
> **STEP 2**: Ask WHY? Evaluate why your numbers might be out of line.
>
> **STEP 3**: Ask HOW? This is when we correct it.

There are two forms of benchmarks: those listed above (AAHA and WMP) are considered external benchmarks. They are great to look at to help evaluate your numbers and get your books moving in the right direction. However, internal benchmarks (derived from practice history) are also important. Many times, your practice numbers are different then industry standards; be sure you can evaluate and explain your numbers and know why striving to reach the external benchmarks won’t improve your business.

Key Performance Indicators (KPIs) are also important when interpreting P&L’s, as they may be able to help decipher issues or throw some red flags. Red flags are issues you need to identify and deal with immediately, or your practice could sink. There are plenty of KPIs to track monthly, pick the ones that resonate with you and help you manage the practice better. Some KPIs to consider:

- Active clients
- Active patients
- New clients
- New patients
- Average Client Transaction
- Average Doctor Transaction
- Revenue per Income Center
- Expense per Expense Center
- AR
- Discounts

Looking for Red Flags

- Are your percentages in each category consistent with benchmarks (internal and external)?
- Compare income centers to expense centers.
- Are you spending more money in one center then what it is producing in revenue?
- Has one particular category changed significantly? Why?

Managing Profit

It is important to produce a profit, and manage it – similar to income and expenses. Profit can be invested back into the practice, invested into the staff, and / or provide owner compensation. Consider future building maintenance needs, equipment, and raises. Ideally, at least 10% of the profit should be reinvested into the practice itself (verses owner compensation).

Managing Cost

Another important reason to interpret P&L's is so that you can see what the practice overhead expenses are, and ensure your services are priced appropriately with what it costs to run the business. Do you know how much it costs for each minute the business is open to produce services for clients? Depending on the practice, this can range from $8.00 to $15.00 per minute.

The following is the equation to determine the costs per minute to keep the building open:

- Fixed costs/minute (administrative and facility costs) **+**
- Staff costs/minute (include all taxes and benefits**) +**
- DVM costs/minute (include all taxes and benefits)

Divide the total annual costs of each of these categories (extracted from the P&L) by the total number of minutes the business is open to produce a service.[3]

It is also important to trend all discounts provided to clients. Industry standards show that the average veterinary practice loses 15-25% of gross revenue every year in missed charges and discounts. Imagine how this can affect your bottom line! If the practice grosses $1 Million dollars per year, $150-$300k is walking out the door.

Learn how to scrutinize you P&L on a monthly basis to secure the future of your practice.

1. AAHA Financial Productivity and PulsePoints, 8th ed; AAHA Press; Lakewood, CO
2. Well Managed Practices 2015; Tumblin and Associates
3. Front Office Management for the Veterinary Team 2nd ed; H. Prendergast; Elsevier; 2015