

Unlocking Insights: How to Read Between the Lines of Your Financial Statements

Camala C. Bailey, CPA, CVA

Camala C. Bailey, CPA, PC – CPA 4 Vets – Tempe, Arizona

INTRODUCTION

For veterinary practice's it is essential to use the AAHA/VMG chart of accounts in your accounting system to track performance and metrics accurately. Using this standard industry chart gives you the ability to utilize your financial statements to track key performance indicators (KPIs), metrics and benchmark. We will review and discuss the three financial statements; balance sheet, income statement and statement of cash flows, along with interpreting the common and not-so-common KPIs, metrics and benchmarks that will lead you to financial success.

THE FINANCIAL STATEMENTS

The balance sheet shows a practice's assets, liabilities, and equity at a specific point in time. It provides valuable information on a practice's liquidity, solvency, and financial flexibility, which are all important metrics to track. For example, the current ratio and debt-to-equity ratio are commonly used metrics to assess a practice's liquidity and leverage, respectively.

The income statement, also known as the profit and loss statement, shows a practice's revenue and expenses over a specific period. It provides valuable information on a practice's profitability, which is a key performance indicator. By tracking metrics such as gross profit margin, operating profit margin, and net profit margin, a practice can assess its financial health and make informed decisions about improving profitability.

The cash flow statement shows the inflows and outflows of cash during a specific period, providing valuable information on a practice's cash flow management. Metrics such as operating cash flow, free cash flow, and cash conversion cycle are commonly used to track a practice's cash flow performance.

These financial statements are important because they provide a comprehensive view of a practice's financial performance, which is critical to making informed business decisions. By tracking key performance indicators and metrics, practices can identify areas of strength and weakness and adjust as needed to improve their financial health and overall performance.

BALANCE SHEET METRICS AND RATIOS

While balance sheets don't typically include performance indicators in the traditional sense, they do include several metrics that can provide insight into a practice's performance. Here are a few examples:

Current ratio: This is calculated by dividing a practice's current assets by its current liabilities. It shows a practice's ability to pay its short-term debts with its

short-term assets. A high current ratio indicates that a practice is in good financial health and has enough liquidity to meet its short-term obligations.

Debt-to-equity ratio: This is calculated by dividing a practice's total liabilities by its total equity. It shows the proportion of a practice's financing that comes from debt as opposed to equity. A high debt-to-equity ratio can indicate that a practice is heavily reliant on debt financing, which can be risky if the practice is unable to meet its debt obligations.

Return on equity (ROE): This is calculated by dividing a practice's net income by its total equity. It shows how much profit a practice generates for each dollar of equity. A high ROE can indicate that a practice is generating a healthy return on investment for its owner(s).

Inventory is a critical component of a practice's financial statements, and it is typically tracked on both the balance sheet and the income statement.

On the balance sheet, inventory is reported as a current asset, reflecting the value of the goods that a practice has on hand and available for sale. The value of inventory on the balance sheet of a veterinary practice is typically determined using the cost method, which means that the inventory is valued at its cost.

On the income statement, the cost of goods sold (COGS) is the expense incurred by a practice to acquire the goods that it sells during a given period. COGS is calculated by subtracting the value of ending inventory from the sum of the cost of goods purchased during the period and the beginning inventory value.

Accurate tracking of inventory is crucial for financial statement purposes for several reasons. First, it helps to ensure that a practice's financial statements accurately reflect its financial position and performance. An incorrect inventory valuation on the balance sheet can affect a practice's reported assets, liabilities, and equity, while an incorrect COGS calculation can affect a practice's reported gross profit and net income.

Additionally, accurate inventory tracking can help a practice to make better business decisions. By understanding how much inventory is on hand, a practice can more effectively manage its supply chain process, which can lead to cost savings and improved profitability.

Accurate inventory tracking is critical for financial statement purposes because it ensures that a practice's financial statements are reliable and that management has the information it needs to make sound business decisions.

An important financial metric that measures the efficiency of a practice's inventory management is the inventory turn rate. It calculates the number of

times a practice sells and replaces its inventory within a given period, typically a year.

The inventory turn rate is calculated by dividing the cost of goods sold by the average inventory level during a specific time period. A higher inventory turn rate indicates that a practice is selling its inventory quickly and efficiently, while a lower rate suggests that a practice is struggling to sell its inventory or is carrying too much inventory.

A high inventory turn rate is generally considered favorable because it indicates that a practice is generating revenue from its inventory and is able to minimize inventory carrying costs. Conversely, a low inventory turn rate may suggest inefficiencies in a practice's inventory management, such as overstocking, poor sales performance, or ineffective supply chain management.

Another key to managing inventory is understanding the re-order point. The reorder point is a term used in inventory management to refer to the specific point at which a practice needs to reorder a particular item in order to avoid stockouts or inventory shortages. It is typically calculated by considering the lead time (time taken for the item to be replenished after placing an order), the average demand for the item during that lead time, and the desired level of safety stock (extra stock held to mitigate unexpected fluctuations in demand).

The reorder point is important because it ensures that a practice maintains an adequate level of inventory to meet client demand while avoiding the costs associated with overstocking. If a practice orders too late, it may result in stockouts, which can lead to lost sales and dissatisfied clients. On the other hand, if a practice orders too early, it may result in excess inventory, which ties up capital and incurs additional holding costs. By setting an appropriate reorder point, a practice can achieve a balance between these two extremes and optimize its inventory management.

INCOME STATEMENT METRICS

The income statement, also known as the profit and loss statement, provides a summary of a veterinary practice's revenue, expenses, and net income over a specific period of time. The following are some of the common metrics that may be found on a veterinary income statement:

1. Gross revenue: This is the total amount of revenue generated by the veterinary practice from all sources, including veterinary services, product sales, and other revenue streams. We will discuss the latest metrics related to revenues during the presentation.
2. Cost of goods sold: This refers to the direct costs associated with providing veterinary services and selling products, such as the cost of medications,

diagnostic tests, and supplies. We will discuss, in detail, the latest metrics related to cost of goods sold during the presentation.

3. Gross profit: This is the difference between the gross revenue and the cost of goods sold, and represents the amount of revenue that remains after accounting for the direct costs of providing services and selling products.

4. Payroll expenses: These are the indirect costs associated with labor including wages, payroll taxes and employee benefits. We will discuss, in detail, the latest metrics related to labor during the presentation.

5. Net income: This is the final metric on the income statement, and represents the veterinary practice's total profit after accounting for all expenses and revenue streams.

It's important to note that using the AAHA/VMG chart of accounts in the practice's accounting and practice software will ensure the practice financial information is comparable with industry benchmarks enabling practice management to make smart decisions and improve profitability and practice value.

CASH FLOW STATEMENT METRICS

The cash flow statement, also known as the statement of cash flows, provides information about a practice's cash inflows and outflows for a particular period. The net change in cash is the result of the cash flow activity and the most important metric found on the statement. This is the difference between the cash inflows and outflows for the period, and represents the net increase or decrease in the practice's cash balance.

NON-FINANCIAL METRICS

Veterinarians can track a variety of metrics utilizing practice information management systems (PIMS) to help manage and improve their practice. Some of the metrics that may be available in a PIMS for veterinarians include:

1. Patient information: PIMS can track information about each patient, including their medical history, current medications, vaccination status, and more.

2. Appointment scheduling: PIMS can help manage scheduling of appointments, cancellations, and no-shows. This can help veterinarians optimize their schedule and manage their time more effectively.

3. Inventory management: PIMS can help veterinarians track inventory levels of medications, supplies, and equipment. This can help prevent stockouts, reduce waste, and ensure that necessary items are always on hand.

4. Patient outcomes: PIMS can help track patient outcomes, such as survival rates, recovery times, and readmission rates. This can help veterinarians evaluate the effectiveness of their treatments and improve patient care.

In order to effectively utilize key performance indicators and metrics, veterinarians should track those that are relevant to their specific practice goals and objectives. By regularly tracking and analyzing specific metrics related to their goals, veterinarians can identify areas for improvement and make data-driven decisions to optimize their practice.