Can you trust your numbers?

Much of the work we do here at Summit is helping practice owners and managers understand the financial side of their hospital. Whether we help our clients with increasing overall profitability, understanding the numbers, practice valuation or whether to buy a particular practice, we have to dig into the financial records to do our job. All too often, what we find makes it difficult to do an accurate analysis. Just as the medical records need to reflect an accurate picture of an animal's health, the financial records for the business need to reflect the practice's health. Financials need to be in good order to be useful and meaningful.

Here are some common problems we see.

> **Payroll recorded as net wages instead of gross wages** – This means that the payroll checks were entered as the net amount that cleared the bank account, rather than the gross wages, which is the amount paid to employees before the taxes and other withholdings. If net payroll is recorded, the financial statements will reflect lower compensation totals, which will artificially reduce payroll costs. This mistake has several consequences, one being that you could pay more in income taxes since you didn't record the full deduction of the gross wages.
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> **Employee-paid portion of benefits** - If a practice offers health insurance to employees, and the practice pays a portion, and the employee pays a portion, the amount that the employee pays is not a practice expense. Many times we see the entire premium paid to the insurance company recorded as a company expense. Recording the employee portions as practice expense erroneously decreases profits and, in the event of an audit, could cause the IRS to assess additional taxes, penalties, and interest. To prevent this, record employee withholdings in an account such as Employee Withholding Payable.
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> **Sales tax recorded as an expense** – Sales tax that a practice collects from its clients is not income to the practice and the remittance made to the governing body is not a practice expense. The practice merely acts as a collection agent on behalf of the state or local government. Therefore, sales tax that is collected and paid should be recorded in a liability account, such as Sales & Use Tax Payable. When sales tax is recorded as income or expense, it skews analytics and effects profitability.
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> **Online pharmacy income** – Staying on the subject of sales tax, another common mistake we see is when the total amount of the deposit from an online pharmacy is recorded as income. The majority of online pharmacies collect sales tax on behalf of the practice, and then deposit that tax into the practice's bank account together with the practice's commission on the items sold. If the total amount of the deposit is recorded to income, the practice will then pay income tax on the sales tax that doesn't belong to them.
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> **Recording loan payments as expenses** – Many times loan payments are confused with expenses since monthly payments are made and money leaves the bank account. However, the IRS allows deductions only for the interest paid on loans, not the principal portion of the payment. If the principal portion of the loan is mistakenly recorded as an expense, it artificially decreases your profit and again, could cause problems in the event of an audit by taking deductions that are not allowed.
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> **Recording capital equipment as expenses** – Very similar to the loan payments, large equipment purchases are often mistakenly recorded as expenses. The IRS states that anything over $2,500 must be capitalized and depreciated. When large items are incorrectly recorded as expenses, it artificially decreases profits and can lead to audit issues, similar to the other examples.

These are just a few of the many situations we encounter when we review financial statements. The consequences from these errors can be small at first, but could eventually end up being catastrophic for a practice. As mentioned previously, in the event of an audit, these errors have the potential to create large liabilities and hardships for the practice with the IRS assessing hefty fines or worse. This leads to another pitfall: cash flow problems. If you can't trust the numbers in the books, you can't manage the operations of the practice. The inability to measure the numbers will have a negative effect on any analysis, which could include valuations as well as bank underwriter's decisions on approving loans. Poor record keeping could also be a way to disguise fraud.

How can you prevent this? It's simple, really, don't entrust an inexperienced person with the important task of managing the financial records. It is very common for veterinary practices to give bookkeeping responsibilities to a good receptionist, head technician, or practice manager, regardless of whether that person has prior bookkeeping experience. A lack of experience is the primary cause of poor bookkeeping. Even though it may seem like you are saving money by using an inexperienced bookkeeper, you will end up paying more in the future when you need to hire a professional accounting team to sort through transactions and generate accurate books. If you must use someone without much experience, invest heavily in training for that person so they can successfully fulfill the role. If you are trying to do your books yourself, don't! Your focus should be on what you are trained to do, practicing medicine and generating fees for the practice, or managing the staff, practice operations and daily grind. Time is money! A close second is having insufficient time to pay attention to the books. Keep an eye on the financials as well as the bank account.

Having accurate books will benefit the practice in many ways. With a good set of books, you can make intelligent business decisions on a regular basis. In the event of an audit, accurate books will help you get through it with less stress and cost. Another benefit is that you will save money on tax return preparation. CPAs are expensive, so the last thing you want to do is use their time to organize your records in order to prepare the tax return. Although you may not plan to sell your practice any time soon, a good set of books will also allow for the practice to receive the most accurate value possible and help you understand the profitability of your practice at any given stage in its life cycle. Help us help you. Don't run the risk of devaluing the practice simply because of bookkeeping errors!

Something as simple as good bookkeeping could be the difference between a successful practice and an unsuccessful practice. If you're unsure of your books or feel things aren't "right", feel free to reach out to us or your CPA to talk through your questions. This is a critical area of your practice and you need to be able to trust the numbers. It's never too late to get things in order.