MONEY MATTERS

How to Account for Your COGS

A list of codes can be as complex or as straightforward as you want. In the end, it will help you monitor and adjust your expenses and prices.

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Imagine this scenario: A practice broker says you will get a much higher price for your veterinary hospital if you reduce your spending on the cost of goods sold (COGS) from 30% of gross fees to 25%. In a practice grossing $2 million, you would need to cut spending from $600,000 annually to $500,000. Alternatively, you could increase your gross fees by $400,000. How will you achieve the 25% goal?

The best place to start is to compare revenue by category (vaccines, surgery, pharmacy, etc.) with each area's product costs. Compare the current period, whether a month, quarter or year, to the previous period to determine where income-to-expense ratios are falling. When the ratio is lower, the business is making less gross profit in that category than before. If the ratio is higher, you are earning more on each sale.

From there, you can look at what you charge, whether better pricing is available and whether efficiencies are possible. It's not simple, but you know where to focus.

Unfortunately, many veterinary practices don't track costs in enough detail to make good comparisons. Some use just a few COGS categories, such as:

- Drugs and supplies
- Laboratory
- Dietary
- Over-the-counter products

Your accountant might not want additional breakouts, and that's fine for tax purposes. But to maintain a financially healthy practice, you can't rely on so few COGS categories. Honestly, if you track COGS using just four or five categories, how do you significantly reduce expenses if you don't know where you are spending too much? A single account, like "Drugs and Supplies," might represent 12% to 15% of gross fees, and just figuring out where and how to start can be overwhelming.

Use a Precise Chart of Accounts

If you find yourself in this situation, define your costs better by using a veterinary-specific chart of accounts. For companion animal practices, the industry standard is produced by the American Animal Hospital Association and the Veterinary Management Group. It's available for free at bit.ly/3hUPlh9.

A chart of accounts is a framework for financial statements, similar to how the skeletal system is a framework for the body. The purpose is to create a standard for recording revenue and expenses and balance sheet accounts such as equipment and loans. The results allow practice owners and managers to make apples-to-apples comparisons against industry benchmarks and other veterinary hospitals.

In the 2017 version of the AAHA/VMG Companion Animal Chart of Accounts, each income category has a paired COGS account — 35 in all. Before you stop reading, understand that I don't recommend that level of detail unless your practice is quite large and provides a broad scope of services. The detail in your practice management software can help determine the number of categories you need.

For example, suppose you want an account to measure vaccination revenue (category 5001 in the AAHA/VMG chart). In that case, you need a COGS partner account to record the cost of the vaccinations you purchased (6001). Having paired COGS accounts allows a quick review of income to expenses in every category and shows which areas generate gross profit.

How Much Is Too Much?

I suggest breaking out highly shopped items such as parasiticides when you keep track of your margins. With parasiticides, you can split prescription heartworm, flea and tick products into multiple categories or just one. The AAHA/VMG chart includes entries for prescription and over-the-counter flea and tick products (revenue account 5115 and expense account 6115 for prescription; 5803 and 6803 for non-

HISTORY REVISITED

The AAHA/VMG Companion Animal Chart of Accounts was released in June 2017. The debut of the financial tool marked the first time that several key players in the veterinary profession endorsed a single chart of accounts for companion animal practitioners. The project involved the American Animal Hospital Association, the Veterinary Management Group, the Veterinary Hospital Managers Association, VetPartners and the American Veterinary Medical Association's Economics Advisory Research Council.

prescription) and separate lines for heartworm or combination preventives (5120 and 6120). With crossover products that treat all three parasites, you might use single paired accounts depending on the sales volume and details you wish to compare.

Also, don't break out certain expenses just because you can. You don't need separate accounts for printer ink, pencils and Post-it notes because you can't do much with that level of detail. And honestly, you have more important things to fret over than what you spend on pens and paperclips.

The 1% Threshold

As a rule of thumb, I recommend breaking out anything representing more than 1% of total revenue. For example, the AAHA/VMG Chart of Accounts has six subaccounts for imaging costs:

- X-ray (6403)
- Dental X-ray (6404)
- CT (6405)
- Ultrasound (6410)
- MRI (6415)
- Specialist consultation (6420)

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Your practice might not need each account. If you don't provide CT or MRI services, you can eliminate accounts 6405 and 6415 (and the paired income accounts 5405 and 5415). Or you might decide to use only the "Imaging" parent accounts (5400 and 6400), which is perfectly fine.

How much detail is too much? It's a trade-off. Having too few accounts makes measuring your performance in detail difficult. But having too many can present a challenge of where to record the costs. Are ketamine income and expenses under "Anesthesia" (5600 and 6600), "Medication" (5105 and 6105) or "Injection" (5110 and 6110)? Ketamine could fit in any of those categories, so choose the one that makes sense. Just verify that ketamine is always recorded the same way. Consistency is the key.

The Role of Vendors

If all this sounds like a lot of work, it can be. But you can save a lot of time by sharing the chart of accounts with your vendors. Many will show your assigned account number for each invoiced product. For vendors that don't summarize their invoices using your codes, have one of your veterinary nurses jot the correct account numbers next to each item. Doing this will save your bookkeeper time and frustration.

Using the AAHA/VMG Chart of Accounts won't automatically increase your practice's value. But your ability to manage the practice by quickly identifying variances and drill into the numbers will make controlling your profitability easier. Your chart of accounts is the tool and you are the carpenter. TVB