A SOAP Approach to Diagnosing Practice Financial Health

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INTRODUCTION

You think like a veterinarian, not like an accountant. How can you excel at managing the finances of your practice without having to go to business school? Despite preconceived notions, understanding practice finances is not that dissimilar from understanding medical diagnostics. Much like we use diagnostic tests to assess an animal's health, it is important to know how to assess the financial health of your practice. Let's work through a SOAP together.

Subjective

In a medical case, the subjective content includes the reason for the visit and the medical history of the patient. It also includes the non-quantifiable observations of the patient's clinical status such as mentation and attitude.

In assessing a practice's financial health, consider the non-quantifiable merits and drawbacks of the business. Merits may include such factors as location of the practice, number of years in business, reputation of the doctor(s) in the practice, and quality of the facility and the equipment. Non-quantifiable drawbacks would include direct competition and those pesky Yelp reviews.

Think about and list your practice's Strengths, Weaknesses, Opportunities and Threats. Strengths and weaknesses are the internal attributes that differentiate your business from the competition. These are within your control. Opportunities and threats, on the other hand speak to the external factors that impact your business. These factors cannot be controlled; your business needs to adapt to these changes in the marketplace. This is referred to as a 'SWOT' analysis and it is much like performing an initial assessment of a patient that is brought into your practice to determine if it is in critical or stable condition.

As an example, let's consider a few factors that would fall into each of these categories:

Strengths: 1) Your practice has been operating for several decades and has a great reputation in the community. 2) You have state-of-the-art equipment including therapeutic laser, digital x-ray and ultrasound. 3) Your team is well trained and highly qualified. 4) You just completed a renovation to update your facility. These are all factors that are within your control and afford your business a competitive advantage in the marketplace.

Weaknesses: 1) You just lost your long-time associate because she went to work for your competitor. 2) Your dental unit broke and you have not been able to replace it due to budgeting constraints. 3) Your team morale is low and employee turnover is high. 4) There are a number of negative on-line reviews about your practice. Employee retention, practice culture, client satisfaction and equipment maintenance are all factors that are within your control.

Now, let's examine the external or uncontrollable factors. **Opportunities** would include factors such as population growth in your area, increasing pet ownership or household income in your target market, or a write-up about your practice in the local newspaper. **Threats** would include increased direct competition, changes to State and local regulations that impact your practice and increased availability of pet products through on-line marketplaces.

Objective

After performing a physical exam of a patient, you would proceed by collecting all the quantifiable data available including vitals, blood pressure and, when indicated, performing diagnostics such as blood work, urinalysis and imaging. Through analysis of this quantifiable data, you are able to piece together a picture of the patient's health and diagnose any illness or disease. In the same manner, collecting and analyzing key metrics for your practice will allow you to determine your practice's financial health.

To do this, you need to examine each line item on your profit and loss statement as a percentage of gross revenues. This will allow you to understand how much of your revenues you are spending on the different expenses in a practice. Most accounting platforms e.g. Quickbooks or Xero will do this for you. Alternatively, you can use a simple Excel spreadsheet to prepare this data.

Revenues

Gross Revenues: Let's start with the profit and loss statement, also called the income statement. The first step in analyzing your income is to calculate your growth from period to period. This could be monthly, quarterly, or annual growth. As a veterinarian you would examine a comparison table of the patient's vitals and weight over a period of time to look for trends that could give you clues to the patient's health and well-being. By the same token, the trends in revenue and profit growth can help you better understand if your practice is growing at a reasonable pace or if your expenses are not adequately controlled. It can also help you identify trends such as seasonality in your business or the impact of economic changes.

In a mature general practice annual revenue growth of around 8-9% is expected. If your practice is growing at a faster pace than this, then kudos to you—keep up the good work! If you are seeing more sluggish revenue growth, then "advanced diagnostics" may be warranted to determine the underlying cause and to reverse the trend.

> " In a mature general practice **annual revenue growth** of around 8-9% is expected. "

Income by Category: Next, you need to examine the contribution of each revenue or income category to total gross revenues. This will allow you to understand how you are generating your revenues. To do this, you will need to calculate each income category as a percentage of your total revenues. An example is as follows:

Table 1
Revenue by Category as a % of Total Revenues

Revenue Category	% of Total Revenues
Professional Services	*63.4%*
Dentistry	3.8%
Surgery	2.7%
Anesthesia	3.7%
Hospitalization	3.2%
Treatment	13.5%
Euthanasia	2.0%
Vaccinations	9.8%
Laboratory	14.0%
Imaging	3.3%
Boarding and Grooming	7.4%
Product Revenues	*36.6%*
Pharmacy	19.0%
Flea, Tick & Heartworm	10.9%
Prescription Food	3.5%
Over-the-Counter	3.2%

Source: AAHA, Financial and Productivity Pulsepoints, Tenth Edition.

Just like with a complete blood count or a chemistry panel for a patient, the percentage of revenue data is meaningless without a range of "normals" to compare it to. It is important to understand how your practice is operating compared to other comparable practices in the industry. As consultants, we typically refer to published industry data including the American Animal Hospital Association, Financial and Productivity Pulsepoints or the WTA Veterinary Consultants, Well-Managed Practices Benchmarks Study. If you have access to other relevant financial data, e.g. a sister practice, or State association data, or if you are part of a Veterinary Management Group, then this data could also be used to assess your financial performance compared to "normal."

In general, most general practices should strive to generate approximately two-thirds of revenue from professional services and one-third of revenue from product sales. This will help your business in three important ways. First, it will differentiate you from your competitors as a service-focused business; you will be the practice that pet owners come to for great care and advice on their pets' well-being as opposed to the practice where they pick up their pets' food. Second, in today's increasingly competitive market place, it is becoming more and more difficult for veterinary practices to compete with large on-line retailers such as Chewy and Amazon. Focusing your efforts on professional service sales rather than low-margin product sales will boost your bottom line by improving your costs of goods sold ratios. Finally, this strategy will not only save you and your support team time spent on ordering, receiving and stocking products, but it will also save you money on holding costs, shrinkage and product expiration.

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Discounts: Calculate your discounts as a percentage of total revenues. On average, these should not be more than about 2-5% of your total revenues. If your discounts as a percentage of total revenues is significantly higher than this, then you may be losing revenues through promotions or other practice discounts. In a multi-doctor practice, it could also mean that one of your associates is giving away services on a more consistent basis than other doctors. If your discount percentage is higher than the industry standards, it may be worthwhile taking a closer look at your marketing and promotions strategy and determining the average number of discounts as well as the dollar amount of discounts by provider.

Revenue per FTE Veterinarian: Even if you don't pay your doctors on production it is still important to track production by provider in order to assess each doctor's productivity. Start by calculating the revenue per full-time-equivalent (FTE) veterinarian since the amount of revenues generated by the doctors in a practice is a good indicator of practice profitability. According to AAHA, the average annual revenue per full-time-equivalent (FTE) veterinarian is $565,196. This does not mean that each veterinarian needs to produce this amount. Rather, it is the total revenue of the practice divided by the number of FTE veterinarians. Divide your total annual revenue by this amount to determine the number of FTE veterinarians that can be supported by the practice income. If this number is significantly lower than the number of veterinarians in your practice, then you should consider the productivity and efficiency of your veterinarians and your veterinary team, as well as the possibility that you may be underpricing your services. If this number is significantly greater than the number of FTE veterinarians in your practice, then you may be understaffed and your doctors (and your team) may be overworked.

Average Transaction Charge: Calculate the Average Transaction Charge (ATC) for the practice as a whole. This is the total revenues for the practice divided by the total number of invoices. This number takes into account invoices for both patient visits and for non-patient visits i.e. product sales. Compare your practice's ATC from period to period to identify any patterns or trends. According to AAHA (The American Animal Hospital Association), the ATC for most practices is approximately $127, although this number varies substantially from practice to practice depending on location, type of practice and services offered. Smaller, solo-practitioner practices can see an ATC as low as $90, while emergency clinics will often generate an ATC in excess of $500.

Productivity: In addition to tracking average transaction charge for the entire practice, it is important to track this number for each doctor in the practice, sometimes referred to as Average Client Transaction (ACT). This is a very important performance indicator because you are able to easily evaluate if a doctor is making appropriate recommendations for diagnostic tests and surgeries, rather than treating patients empirically with medications. It also helps to track doctors' performance as compared to one another and as compared to the practice average.

Calculate each doctor's production as a percentage of total doctor production. There are no "normals" for these numbers since each practice is unique in how doctors are scheduled. In examining these ratios, take into consideration management duties of each of the doctors, the doctors' schedules including number of hours worked and if they are scheduled during the busier days of the week or hours of the day. Also take into consideration their individual expertise, such as surgery versus internal medicine.

Finally, track the number of new clients and active clients as well as new patients and active patients over a given time period. Compare this to the same time period in the prior year. These data can help you assess if your marketing and promotions are attracting new clients to the practice. Also calculate the percentage of new clients to active clients. If this ratio is increasing then this would suggest that there may be some attrition of your existing clients. While some levels of attrition would be expected in any practice since clients will sometimes move out of the area or lose a pet, it may be worthwhile to determine the reasons why existing clients might be leaving your practice.

> "...data can help you assess if your **marketing and promotions** are attracting new clients to the practice."

Costs of Goods Sold

Costs of Goods Sold (COGS), sometimes referred to as Costs of Professional Services, constitutes the second largest expense line item in a veterinary practice after staff salaries and wages. The ability to effectively manage inventory and to ensure that revenue is captured for all inventory items that leave the practice is a good indication of practice profitability and success.

In general, AAHA-accredited and other well-managed practices are able to achieve

COGS between 22% and 25% of total revenues. However, practices that closely and carefully manage their COGS on a just-in-time basis are sometimes able to reduce COGS to as low as 8-12%, depending on their practice type.

While it is always important to look at the overall diagnostic picture of a patient, it is equally important to hone in on each individual metric. For example, if we see that all the liver enzymes including ALT, ALP and AST are elevated, this could suggest a hepatopathy. However, if only ALP is elevated, this could be a normal puppy or it could suggest liver pathology. By the same token, we need to examine COGS on an overall basis, but it is also useful to look at each category of COGS as a percentage of total revenues. The following table lists a range of "normals" for some of the COGS categories.

Table 2
COGS Compared to Industry

COGS Category	% of Total Revenues		
	Min	Max	Avg.
Laboratory	3.0%	6.3%	5.3%
Imaging	0.1%	1.4%	1.2%
Pharmacy	5.4%	18.7%	13.0%
Flea, Tick and Heartworm	2.4%	7.3%	5.4%
Prescription Food	1.7%	3.1%	2.5%
Over-the-Counter	0.5%	1.6%	1.2%

Source: AAHA, Financial and Productivity Pulsepoints, Tenth Edition.

Where appropriate, it is also worthwhile to compare the category COGS to the revenue for that category. This is sometimes referred to as the category revenue-to-expense ratio. The following table outlines industry standard expense-to-revenue ratios for certain categories of income.

Table 3
Revenue to Expense Ratios by Category

Revenue Category	Revenue to Expense Ratio		
	Min	Max	Avg.
Laboratory	1.7	3.8	2.9
Imaging	2.0	16.4	13.5
Pharmacy	1.0	2.5	2.0
Flea, Tick and Heartworm	1.3	2.3	1.9
Prescription Food	1.2	1.5	1.3
Over-the-Counter	1.0	2.4	2.3

Source: AAHA, Financial and Productivity Pulsepoints, TenthEdition.

As you consider these ratios for your practice it is important to compare them from period to period. This will help you assess if your pricing in each category is keeping up with increases in your vendor costs.

Expenses

Salaries and Wages: Consider compensation for associate doctors both as a percentage of total revenues and as a percentage of their production. On average most AAHA-accredited and other well-managed practices pay their associate doctors approximately 10.6% of total revenues. When we consider associate doctor compensation as a percentage of production, a good rule of thumb is that each doctor should be compensated at approximately 22-25% of their production, including benefits. This is true regardless of whether or not you pay your doctors on production or if you pay them a base salary.

Support staff compensation as a percentage of revenues typically represents between 19% and 22% of total revenues for most AAHA-accredited and other well-managed practices. When we assess our patients, we need to keep in mind factors that are specific to that patient like diet, environment,

> "Consider compensation for associate doctors both as a percentage of **total revenues** and as a percentage of their **production.**"

lifestyle and even geographic location. Similarly, when you compare your practice to industry standards, it is important to think about market specific factors such as minimum wage, availability of qualified staff, and costs of living.

Facilities Expenses: Facilities expenses include rent, repairs and maintenance, utilities, and other costs spent on the building such as security, landscaping etc. It does not include capital expenditures for renovations or remodels to the facilities.

On average, AAHA-accredited and other well-managed practices spend between 5% and 8% of gross revenues on rent expense. For practices that have outgrown their space, this percentage may be low. On the other hand, start-up practices will likely see a high revenue percentage ratio until their revenues stabilize.

Most practices spend between 0.5% and 1% of their total revenues on building repairs and maintenance each year. However, just like when our patient's age, older facilities need more attention and this ratio can sometimes be as high as 4-5%.

Utilities expenses vary widely from practice to practice depending on the geographic location, the state of the facilities, and the type of practice (think 24/7 ER practice versus solo-practitioner day practice). However, in general, utilities comprise approximately 0.5% to 0.8% of total revenues.

Other Expenses: This includes all other overhead costs required to operate your business. In some cases, these expenses will be stable from year to year i.e. they do not fluctuate with revenues. Examples include insurance costs, continuing education costs, membership dues and, if applicable, legal and professional services. Other overhead expenses that do tend to fluctuate with revenues include advertising and business promotion, and credit card fees. The following table lists a few of the more common overhead expenses together with the industry standard percentage of total revenues:

Table 4
Overhead Expenses as a Percentage of Total Revenues

Revenue Category	Revenue to Expense Ratio		
	Min	Max	Avg.
Professional Fees	0.3%	1.1%	1.4%
Advertising & Promotion	0.3%	1.0%	1.0%
Communications	0.3%	0.7%	0.6%

Source: AAHA, Financial and Productivity Pulsepoints, Tenth Edition.

Balance Sheet Ratios: Many practice owners focus all their time and energy on the profit and loss statement and overlook the balance sheet. However, this financial report gives a very important "snap shot" of your practice's financial health at a given point in time.

While the "value" of a business is determined by the future stream of cash flows that can be expected to be generated from its operations rather than on the assets and liabilities it owns, it is still important to understand what the assets and liabilities of the business are, especially if you are planning to sell your practice or if you are looking to raise funds for a renovation or expansion of your facility. It is also important to understand the key financial metrics of the business as compared to industry expectations.

The current ratio (current assets/current liabilities) represents the liquidity of the business i.e. its ability to meet its short-term obligations. It is expected that any business should have a current ratio of at least 1.5 times. The quick ratio (current assets excluding inventory/current liabilities) is another measure of liquidity. This ratio is more relevant in a retail or manufacturing environment where the business carries a large amount of inventory. However, even for a veterinary practice, this ratio should never be less than 1:1.

Finally, the debt to equity ratio (total debt/ total equity) is an idea of how the business is financed, sometimes referred to as leveraging. In general, industry expectations are that for every dollar of equity that you have invested in the business, there should be no more than $1 of debt funding. In other words, your debt to equity ratio should not exceed 1.0.

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Assessment

Now that you have completed your subjective analysis of your practice and performed all the diagnostics of crunching numbers, it is time to make an assessment or diagnosis of your practice's financial health. When we assess or diagnose a patient, we have to take into careful consideration the history of the patient and the presenting complaint as well as all the factors pertinent to this patient including breed disposition, lifestyle, diet etc. By the same token, when assessing your practice's financial health, it is important to consider the following questions:

What is the practice (and your) history? How long have you owned the practice? Are you a sole owner or do you have partners? How long has the practice been in business?

How has the practice performed historically? Have revenues increased or decreased over the past three to five years? What about net income? What are the trends in new clients, average client transaction and doctor production?

What are your goals? Do you want to grow your practice, increase your service offerings and take on additional associates? Are you looking to maximize profitability and value so that you can sell your practice and retire? Do you want to continue working at your current pace and not take on additional clients or patients?

What makes your practice unique? Is yours a customer-service centric practice seeing a large number of geriatric internal medicine cases that require long histories and extensive work-ups? Or do you see mainly healthy puppies and kittens? Do you offer emergency or urgent care services? And are you open on weekends?

Taking all of these factors into consideration, carefully compare your practice's financial performance to industry standards. Assess where you have excelled, such as by attracting new clients to the practice or keeping your COGS low and identify those areas where you could improve, such as reducing staffing costs.

> "...compare your practice's financial performance to **industry standards.**"

Plan

Now that you have made an assessment of your practice's financial health, you are ready to develop an action plan! Whenever we create a treatment plan for a patient, we need to consider client adherence. For your practice, you need to be realistic about what you can and cannot accomplish as you develop a plan to improve your financial position. Planning to decrease your staff costs by 10% may not be realistic if you need the support staff to manage the workload. Resolving to create a detailed budget and to update it every month may be difficult if you do not have a practice manager to help you accomplish these tasks.

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Internal Accounting

Begin by closely examining your internal accounting function. If you have not done so already, adopt the AAHA Chart of Accounts in your accounting records. This will give you better information for managing your practice and will put the most important (and largest) expenses at the top of the Profit & Loss Statement. It will also allow you to more easily compare and benchmark yourself against other veterinary practices. AAHA/VMG Companion Animal Chart of Accounts.

Ensure that all costs are being coded to the correct category. For example, contract labor costs should be coded to compensation and not included in COGS. Correct tracking of expenses will allow you to better understand your costs and enable you to compare your profit margins to industry standards.

Increase Revenues

This does not necessarily mean you should increase your prices! Rather, it means that you should take steps to ensure that you are capturing all charges for all services provided to the patient. According to a survey conducted by Veterinary Economics, veterinary practices miss $64,000 in fees per full-time veterinarian each year. Think about that! For a two-doctor practice, that's another full-time veterinarian that could be hired! According to AAHA, the average hospital is missing 17% of its diagnostic charges, while others claim that 80% of practices are missing 10% to 15% of revenues through uncaptured charges.

To be clear, we are not talking about clients or even employees walking out of your hospital with products that have not been purchased. We are not even talking about clients declining your recommendations or staff not offering additional services to a client that could benefit their pet. We are not talking about discounting services or giving services or products away. Rather, we are talking about unintentional neglect in charging clients for services actually performed.

Many Practice Management Systems (PiMS) have a complete disconnect between the medical record and the client invoice. While veterinarians and technical staff are trained to ensure that all treatments administered to a patient are appropriately documented in the medical record, this is not always true for the invoice. This system of dual information entry inevitably results in treatments being administered and services being performed that ultimately do not find their way onto the client invoice. Using a software platform where information recorded on the medical record is automatically charged to the invoice will reduce errors, increase revenues and save you time.

If you have charges that are routinely missed, find a way to bundle these services. For example, when a pet is hospitalized for care, do you use a flat rate for fluid therapy, or does the price vary based on the amount of fluids used? How would a 100# dog be charged differently than a 10# dog? How do you charge for hospitalization? If the patient needs frequent evaluation, is there a higher charge than if they do not? What about re-examinations in the hospital? Is there an assessment examination charged each day?

" Using a software platform where information recorded on the medical record is **automatically** charged to the invoice will **reduce errors, increase revenues and save you time.** "

How is the doctor and staff time devoted to that animal captured in the fee schedule and the patient's record?

For laboratory services, review invoices from the reference laboratory and check to make sure that your clients were charged for those services. If in-house laboratory services are being performed, ensure that the clients are being charged for both supplies and doctor/technician time to not only run diagnostic tests, but to review test results.

Review discount programs to ensure that they do not exceed 2-5% of total revenues. Perform an analysis of each discount program and determine how much they are contributing to revenues and if they are worthwhile.

Decrease COGS

Inventory management is a critical part of hospital operations. To make sure that you understand your inventory usage (and by extension your COGS), determine the answers to the following questions: 1) What are the most commonly used products in your practice? 2) What are the products that you absolutely cannot run out of (e.g. emergency drugs?) 3) How much do you use of each product? 4) What is the minimum amount of each product that you need to keep on the shelf? 5) How long does it typically take for your orders to be delivered?

Next, categorize your products into the following "buckets": AA: Must never run out! A: Important but you have a back-up plan. B: Rarely used but you must have this in the practice, and C: On the chopping block!

Finally, manage your inventory using a just-in-time philosophy to minimize the quantity of inventory you have on hand. Define minimum and maximum stock on hand and re-order points. Understand how frequently each product is used or turned and know the lead time it takes from order to delivery of any particular product.

"Inventory management is a **critical** part of hospital operations."

Periodic inventory counts should be performed and reconciled against purchasing and inventory records to ensure that products are not leaving the hospital without being invoiced. If shrinkage is a concern, establish or reinforce inventory control procedures and ensure that the person placing the order is not the person checking in and stocking the order.

Budgeting

Creating a budget every year and then comparing your monthly profit and loss statement to budget will help you keep control of your expenses and assist you with managing your cash flows.

Refer to a Specialist

For some patients, the complexity of the case requires a specialist referral. The same is true for your practice. If you are concerned about your practice's financial health and are in need of an attorney, accountant or valuation analyst, or if you need help turning around your practice culture, improving employee morale or training your staff, do not delay in reaching out to an experienced industry professional. You can find a list of industry specific consultants and professionals across all specialties on https://www.vetpartners.org.

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Keeping your practice healthy takes as much dedication as keeping your patients healthy. Understanding how to apply the critical thinking skills that you use every day as a doctor to assess, diagnose and then "treat" your practice finances will help you keep your practice healthy for many years to come.

"Keeping your **practice healthy** takes as much dedication as keeping your **patients healthy.**"

ABOUT THE AUTHOR

Originally from South Africa, Dr. Fuhrman has extensive experience in financial consulting and corporate accounting. As a CPA and a graduate of Colorado State University's combined MBA/DVM program, she offers a combination of veterinary practice ownership, financial, and management skills.

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