

# Show Me the Money

## Using Financial Reporting to Improve Your Bottom Line

By Charles R. Felder, PT, SCS, ATC, MBA

As small business owners, it is critical that we make wise decisions about how we handle our money. This article might help you understand what's happening on the financial side of your practice and enable you to make better decisions. Few of us received business training, but knowing how to read and use financial statements is critical to our success.

Most practices operate on the cash basis for tax reporting. Far too many also operate on the "checkbook basis": If there's money left in the checkbook, I'm doing okay. Anyone who wants to develop a healthy, long-term practice should focus on building a solid financial base with consistent cash flow and an adequate reserve.

According to PT Benchmark studies, most practices are using QuickBooks financial software. This powerful software package is frequently underutilized. Most people set up their chart of accounts in alphabetical order, using the standard format provided by the software. This puts the focus on tax reporting,

which, while important, is not the best tool for managing the financial aspects of your practice.

In our practice, and with our clients, we encourage the use of a managerial accounting format. This format groups common expenses together to highlight the areas that are most volatile and have the greatest impact on the bottom line. For a service business such as physical therapy, it makes sense to group expenses into labor, variable, and fixed costs. These categories are somewhat arbitrary, but they have been quite helpful over the years. I believe they are critical, given the current economic pressures.

Labor costs include base wages, incentives, and employer payroll taxes. Variable costs are those that tend to change with volume and those that can be relatively easily modified. Fixed costs are typically those that are required and tend not to change much with volume. Some costs could fit into more than one category,

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- You should be collecting about \$218 per square foot per year.
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- Your labor costs should be no higher than 60% of collections.
- Your profit should be at least 9% of collections.

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but our goal is to improve our ability to manage the financial side of the practice, not to worry too much about which category we use for which item. A common error is to have so many line items that it is difficult to read or use the profit and loss statement (P&L). (See the sample P&L).

In the PT Benchmark studies over the past five years, labor cost has been about 58 percent of income. Not surprisingly, this is the largest category and the most variable. The connection between the amount spent on labor and the productivity resulting from that labor is crucial to the financial health of the practice. Many practices lump all wages together in one line item. This common error hurts your ability to manage the most volatile part of your business. Splitting labor costs into manageable categories (e.g., professional, clinical support, and office staff) allows you to closely watch this area. This monitoring can make a significant change in the practice.

Variable costs include advertising, education, postage, outside services, medical, and office supplies. Fixed costs include dues, licenses, equipment, facility expenses, insurance, professional services, and telephone.

Net ordinary (or operating) income (NOI) reflects the profit from operations. This is the key to knowing how well you are managing the financial side of the business.

We review the P&L every month and typically look at the most recent three months compared with the same three months the previous year. This approach helps smooth out month-to-month and seasonal variances, providing a better picture of the trends and overall health of the practice. Combine this with a comparison of the new patients, visits, charges, and accounts receivable (A/R) status and you have a critical review of the practice.

If you review your P&L statement on a consistent basis and compare it with historical trends and outside benchmarks, you can get a better understanding of your business. Use this information to make evidence-based decisions on the financial aspects of your practice. I'm confident that you'll see an upward trend in the profit and value of your practice. ■

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**Reference**

Charles R. Felder. (2007). *PT Benchmark 2007*, Corona, CA: HCS Consulting, Inc.

Sample P&L	Jan–Dec 07	% of Income
<b>Ordinary Income/Expense</b>		
<b>Income</b>		
4000 • Therapy Services		
4010 • Physical Therapy (PT)	\$1,000,000.00	98.0%
4040 • Refunds for Therapy Services	\$(10,000.00)	(1.0%)
Total 4000 • Therapy Services	\$990,000.00	97.1%
4100 • Misc Services	\$30,000.00	2.9%
<b>Total Income</b>	<b>\$1,020,000.00</b>	<b>100.0%</b>
<b>Expense</b>		
6000 • Labor		
6010 • PTs	\$205,000.00	20.1%
6020 • PTAs	\$51,000.00	5.0%
6040 • Aides/Techs	\$50,000.00	4.9%
6050 • Office	\$86,000.00	8.4%
6060 • Payroll Taxes	\$54,000.00	5.3%
6110 • Incentive	\$19,000.00	1.9%
6200 • Registry / Per Diem Labor	\$8,000.00	0.8%
6210 • Officers	\$97,500.00	9.6%
Total 6000 • Labor	\$570,500.00	55.9%
6400 • Variable		
6410 • Advert/Bus Promo/Mrktg	\$8,500.00	0.8%
6420 • Education/Travel	\$8,200.00	0.8%
6430 • Postage/Shipping	\$1,000.00	0.1%
6450 • Services—Billing & Collection	\$80,000.00	7.8%
6460 • Services—Consult/Pr Mgmt	\$18,000.00	1.8%
6480 • Supplies & Expense—Clinical	\$15,000.00	1.5%
6490 • Supplies & Expense—Office	\$14,000.00	1.4%
Total 6400 • Variable	\$144,700.00	14.2%
6600 • Fixed		
6620 • Dues/Subs/Licenses/Permits	\$7,000.00	0.7%
6630 • Equip Rental & Purchase	\$8,000.00	0.8%
6640 • Facility Expense	\$104,400.00	10.2%
6650 • Insurance	\$48,200.00	4.7%
6710 • Services—Acctng/Legal	\$3,110.00	0.3%
6730 • Telephone	\$7,000.00	0.7%
Total 6600 • Fixed	\$177,710.00	17.4%
<b>Total Expense</b>	<b>\$892,910.00</b>	<b>87.5%</b>
<b>Net Ordinary Income</b>	<b>\$127,090.00</b>	<b>12.5%</b>
<b>Other Income/Expense</b>		
<b>Other Income</b>		
7020 • Interest Income	\$1,000.00	0.1%
<b>Total Other Income</b>	<b>\$1,000.00</b>	<b>0.1%</b>
<b>Other Expense</b>		
8020 • Interest Expense	\$5,000.00	0.5%
8030 • Taxes	\$800.00	0.1%
<b>Total Other Expense</b>	<b>\$5,800.00</b>	<b>0.6%</b>
<b>Net Other Income</b>	<b>\$(4,800.00)</b>	<b>(0.5%)</b>
<b>Net Income</b>	<b>\$122,290.00</b>	<b>12.0%</b>