



# 9 Accounting Secrets That Actually Work

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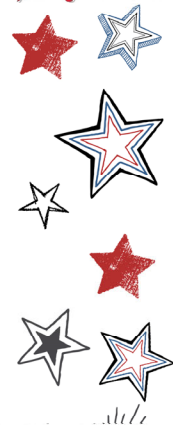


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## Disclosures

Ollin Sykes is the President of Sykes & Company, P.A. The conflict of interest was resolved by peer review of the slide content.

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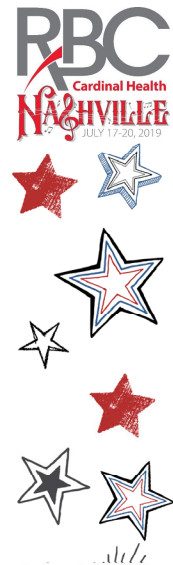


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## Learning Objectives

- List nine best practices for managing community pharmacy operations.
- Discuss strategies for managing inventory effectively.
- Describe key financial indicators and benchmarks for your own business.



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## #1 – Set up the Fundamentals

- No question...this is the #1 “secret”
- Provide the basics for financial analysis and tax planning
- Pharmacy owner lost without the fundamentals in place
- Impossible to be proactive and effectively manage without these fundamentals
- Pharmacy industry inherently requires strong fundamentals



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## #1 – Set up the Fundamentals



- Fundamentals include:
  - Daily/Weekly processes
  - Monthly processes
- Utilize technology
- Back office should be streamlined and efficient
- Allows for pharmacy owner to focus on growth and patient care



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## #1 – Set up the Fundamentals



- Balance Sheet
  - Snap shot in time; must start here when analyzing financial performance
- Profit and Loss
  - Displays net income/loss for the period
- Cash Flow Statement
  - Helps describe link between net income and cash



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## #2 – Know Your Third Party Receivables



- The biggest unreconciled bank account in a pharmacy
- Fill and hope is not a fundamental business strategy
- Technology is a must
- Managing the technology is a must
- Quickly identify errors and issues with payors

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## #2 – Know Your Third Party Receivables



- Provides additional data you can analyze to maximize your cash flow and margin
- DIR/GER fee reporting
- Provides for actual real time accounting
- Enhances financial analysis
- Is linked directly with total sales
- Average AR days outstanding – 19

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## #3 – Inventory Management



- Management of inventory is vital
- You think you know, but you have no idea
- \$100 bills on the shelf
- Excess inventory will kill cash flow
- Typically, next day shipping, why keep excess inventory?
- Average turns 12

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## #3 – Inventory Management



- Med sync/Adherence to maximize
- Utilize technology
- Perpetual inventory systems a must
- Accurate cost downloads very important, not just for perpetual system, but for script audit log analysis

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## #3 – Inventory Management


- Financial analysis requires accurate inventory balances; suggest actual count at least once a year
- Inventory directly associated with cost of goods sold and gross margin
- Inaccurate inventory on balance sheet = inaccurate margin and net income
- Inventory overstated by \$50,000 means net income overstated by \$50,000 = \$17,500 excess tax @ 35%

## #4 – Accounts Payable Processing

- Directly associated with cost of goods sold, inventory and margin
- Keep in real time using technology
- No need to hand write checks
- Should take minutes a day
- Enhanced controls is key

## #5 – Cost of Goods Sold/Margin


- Biggest expense in a pharmacy
- Accurate inventory adjustments are vital
- Any inaccuracies will impact margin and net income
- Average retail 2019 gross margin around 23%



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## #5 – Cost of Goods Sold/Margin

- Revenue diversification and specialization to enhance margin
- DIR fee impacts to gross margin and profit and loss statement
- Are you maximizing behind the bench adjudication



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## #6 – Payroll



- Payroll inherently complex
- Look to technology and outsourcing
- Second biggest expense for a pharmacy
- Average is 10.5% of total revenue
- Under 10% of total revenues ideal

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## #6 – Payroll



- Simple analysis of your operating hours may provide opportunity to cut costs dramatically
- Should owners adjust their salaries for tax purposes?
- How do owner salaries impact retirement planning?

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## #7 – Key Performance Indicators



- Current Ratio
  - Current Ratio = Current Assets / Current Liabilities
  - 2.5/1 – Average
  - < 2.0/1 – Red Flag
  - > 2.5/1 – Good, higher the better

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## #7 – Key Performance Indicators



- Equity to Assets
  - Equity Ratio = Total Equity / Total Assets
  - 10-20% for newer pharmacies
  - 50% + for mature pharmacies
  - Great indicator of balance sheet strength

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## #7 – Key Performance Indicators



- Inventory Turnover
  - Inventory Turnover =  $\text{COGS} / \text{Average Inventory}$
  - Typical industry average is 12 turns a year
  - 12 turns is not ideal
  - Higher the better; explains how well you manage inventory



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## #7 – Key Performance Indicators



- Others
  - Gross Margin – 23%
  - AR Days – 19
  - Payroll % of Rev. – 10.5%
  - Overhead % – 6-8%
  - Net Income – 4-7%



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## #8 – Accrual and Cash Accounting



- Major planning area with Tax Cuts & Jobs Act of 2017
- Fundamental change in tax reporting for pharmacies
- Taxpayer friendly
- Will impact financial reporting
- Moving from accrual to cash accounting likely to increase expenses and reduce taxable income
- **Optional** for pharmacies

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## #8 – Accrual and Cash Accounting



- Generally, pharmacies were required to report on the accrual basis of accounting for tax purposes
- TCJA expanded the use of the cash method of accounting for tax reporting
- Many pharmacies incorrectly reported cash basis for tax and therefore not eligible to take advantage

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## #8 – Accrual and Cash Accounting



- Eligible pharmacies include those with average gross receipts for prior three years less than \$25 million
- Controlled groups of pharmacies must be taken into consideration for gross receipts test
- Treatment of inventory has not been clarified by the IRS as there are conflicting opinions on how inventory should be handled

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## #8 – Accrual and Cash Accounting



- Form 3115, Change in Accounting Method required
- 481(a) adjustment can be taken in year of change if negative (expense)
- If positive (income), 481(a) adjustment can be taken in year 1 if under \$50,000 or over a four-year period

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## #8 – Accrual and Cash Accounting



- Know the limitations before making a change!
  - Expiration of the TCJA in 2025 and potentially converting back to accrual
  - Basis limitations for pass-through entities (S Corp, Partnerships, LLC)
  - Financial reporting limitations
  - Already cash basis = no benefits



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## #9 – Tax Planning



- Utilize fundamental accounting system to plan for taxes
- Proactive not reactive
- No surprises
- Adds control to your financial future and allows pharmacy owner to plan for cash flow requirements



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## #10 – Bonus Secrets



- Expanded use of depreciation write-offs
- Cost segregation studies for pharmacy buildings
- Charity planning
- Section 199A – Qualified business income planning
- Retirement planning options



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