Private Practice Common Financial Terminology

While many physicians would like to practice medicine without handling the financial aspects this entails, a physician in private practice needs to understand at least the basics of financial management for the viability of their business. A lack of attention to the details of the financial side of your practice could lead to disaster and could prevent you from practicing in the way you would prefer.[1]

Table 1. Common Accounting Acronyms[2]

TERM	ACRONYM	DEFINITION
Accounts receivable	**AR**	Funds owed to your practice for services invoiced
Accounts payable	**AP**	Funds owed to a vendor for services performed and invoiced
Current Asset	**CA**	A practice's cash and its other assets that will be converted to cash within one year of appearing in the practice's balance sheet heading
Fixed Asset	**FA**	Long-term assets that a practice has purchased and is using for services
Balance Sheet	**BS**	A financial statement that reports a practice's assets, liabilities, and shareholder equity
Cash flow	**CF**	The net amount of cash and cash equivalents being transferred into and out of a business
Cost of goods sold	**COGS**	The total amount your practice paid as a cost directly related to the sale of products
Credit	**CR**	A record of the money flowing out of an account
Debit	**DR**	A record of the money flowing into an account
Depreciation	**DEPR**	The amount of expense allocated during a specific period for certain types of assets that lose their value over time—for example, building and equipment
Earnings before interest, taxes, depreciation, and amortization	**EBITDA**	Used when assessing the performance of a company; helpful to determine how much profit the business generates by providing services in a given period
Equity	**EQ**	The amount of your practice's total assets that you own outright (ie, not financed with debt)
Accrued Expenses	**AE**	An expense that is recognized on the books before it has been paid
Fixed Expenses	**FE**	An expense that does not change from period to period
Operating Expenses	**OPEX**	A cost that a company incurs to perform its operational activities
Variable Expenses	**VE**	A cost that can change over time depending on the usage of products or services
Equity and owners' equity	**OE**	The amount of money that would be returned to owners if all assets were liquidated and all debt paid off

TERM	ACRONYM	DEFINITION
General ledger	**GL**	The record-keeping system for a practice's financial data, with debit and credit account records validated by a trial balance
Current liabilities	**CL**	A practice's debts or obligations that are due to be paid to creditors within 1 year
Long-term liabilities	**LTL**	A practice's debts or obligations that are payable beyond 12 months
Marketable securities	**MS**	Stocks, bonds, and other investments with enough demand to be converted to cash or sold quickly
Net income	**NI**	A practice's gross profit minus all other expenses and costs as well as any other income and revenue not included in gross income
Operating revenue	**OR**	Revenue generated from the day-to-day operations of the practice
Present value	**PV**	The concept that states an amount of money today is worth more than that same amount in the future
Profit and loss statement	**P&L**	A financial statement that summarizes the revenues, costs, and expenses incurred during a specific period
Return on investment	**ROI**	A widely used financial metric for measuring the profitability of gaining a return from an investment
Total revenue	**TR**	Sum of operating and non-operating revenue
Uncollectibles	**UN**	An account that cannot be collected because the client or payer is not able or willing to pay

The Basics of Accounting and Budgeting

Two primary accounting methods are accrual basis and cash basis.

- **Accrual accounting** recognizes revenues and expenses when services are rendered, not when funds have exchanged hands. This method is more accurate and harder to manipulate.
- **Cash accounting** recognizes revenues and expenses as they are added or subtracted from your bank account. Small-to-medium-sized practices often use this method because it is simpler to administer.

Understanding Financial Statements

Every business should monitor 2 key financial reports: **the balance sheet and the income statement.**

The **balance sheet** summarizes all the practice assets, liabilities, and equity values. In a balance sheet, the sum of the assets must always equal the sum of the liabilities plus the equity. Three key indicators of practice health on a balance sheet:

1. If current liabilities exceed current assets, the practice may be in danger of defaulting on accounts payable.
2. If liabilities unexpectedly grow, the practice is taking on more debt.
3. Shrinking equity without depreciation of assets and retained earnings.

The **income statement**, also called a profit and loss statement, details your practice's revenues and expenses. This financial statement lists the collections in your practice and basic categories for practice expenses for a specific period. Several ratios can be calculated from the income statement, giving insight into where the practice is spending its income. One of the most important uses for the income statement is comparing any current year's financial results to previous years. Watching your expense levels and ratios year after year or quarter by quarter will alert you to dangerous increases in expenses, reductions in collections, and sometimes even theft from the practice.

Understanding the Chart of Accounts

The **chart of accounts** lists numbers that identify each expense category in your practice by the department. Your accountant will help establish a chart of accounts that allocate expenditures for tax purposes and cost accounting. Correctly distributing fees is essential to efficient practice operations.

Managing Accounts Payable

Here are some tips for managing accounts payable for your practice:

- **Pay bills close to their due date rather than in advance.** The accounts payment process works best if bills are paid only once each month. Unless a substantial discount is offered for early payment, pay bills closer to 30 days from purchase. By paying bills closer to the due date, you keep the money in the bank working for you if possible and not in the vendor's bank earning interest.
- **Pay invoices, not vendor statements.** If payment is made from a statement, an invoice may mistakenly be paid twice.
- **Establish a workable accounts payable system early on.** Accurate tracking of supply costs reduces overspending and panic buying. It also provides information needed for budgeting and forecasting and gives the accountant the information necessary to prepare financial statements and tax returns.

Managing and Tracking Cash Flow

Imagine this:

You receive a large overpayment request from Medicare. Now you must decide if you will pay the request in a lump sum to avoid interest or opt to enroll in a high-interest repayment plan. By regularly managing and tracking your cash flow, you will be able to make an informed financial decision if a situation like this occurs.

It is crucial to have enough cash on hand to pay your bills and obligations to ensure your practice operates smoothly. Highly profitable practices with healthy cash flow may feel less pressure to project and manage cash flow. The high profits enable the practice owners to work within the shifting flow of collections and expenses. On the other hand, even healthy practices can have a cash flow crisis if circumstances conspire to limit collections or dramatically increase expenses.

Budgeting

Budgets help instill fiscal discipline, so you are able to plan for major expenses and purchases rather than incurring those costs on whims. **However, it is essential to remember budgets are guidelines, not laws.** Budgets will fluctuate depending on the volume of patients seen in your practice, administrative workload, and new or revised regulations.

Benefits of budgeting include:

- Aiding group practices in holding all partners accountable for expenses or purchases.
- Delegating responsibilities and accountability to managers and supervisors by incentivizing maximum productivity of their departments.

Financial Ratios

Understanding your practice's financial ratios gives a complete picture of your practice's financial performance. You can calculate these simple ratios on your own, or you can ask your accountant to calculate them for you.

Figure 1. Key Financial Ratios

Profit Margin

$$\text{Profit Margin} = \text{Net Income} \div \text{Total Revenue}$$

Debt Ratio

$$\text{Debt Ratio} = \text{Total Liabilities} \div \text{Total Assets}$$

Days Cash on Hand

$$\text{Days Cash on Hand} = \left[\text{Cash} + \text{Marketable Securities}\right] \div \left[\left(\text{Expenses} - \text{Depreciation} - \text{Provision for Uncollectibles}\right) \div 365\right]$$

References

1. Financial management and business performance. In: Parke DW II, Durfee DA, Zacks CM, Orloff PN, eds. *The Profession of Ophthalmology, Practice Management, Ethics, and Advocacy*. 1st ed. American Academy of Ophthalmology; 2005:51-65.
2. Investopedia. Dictionary. Accessed May 19, 2022. https://www.investopedia.com/financial-term-dictionary-4769738.

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