STARTING A PRIVATE PRACTICE

The financial figures to take into account

Understanding your accounts and evaluating your performance is crucial in private practice – yet they remain a mystery even to many 'old hands'. **Ian Tongue** (right) talks you through the key areas

THE ACCOUNTS produced by your accountant each year are not just for the taxman. They contain a wealth of useful information to help you evaluate your financial performance that ultimately can help you improve your profitability and to react to changes in your circumstances.

Private practice accounts

The income and expenditure account (or profit and loss account) is the main statement in the accounts that gives you an indication of your performance and is a precis of your trading results.

This statement presents a summary of your trading results by deducting your expenditure from your income to arrive at your accounting profit. It should be noted that this is usually a different figure to your taxable profit (see below).

As your private practice grows, your accountant is likely to produce a summary of assets and liabilities for your practice, which is known as the balance sheet. This is a useful statement and also an indication that more work has been carried out by the accountant, as your fees and bank account will need to have been reconciled to the underlying records.

Trading results

Within the trading results, you should be able to make a comparison against the prior year – if applicable. In the early years of your practice, rapid growth is common, which can easily distract you from the expenses.

Review your income figure and consider whether this is in line with expectations given the level of work performed. You should review you fees annually, as many are aware, there is significant price pressure being applied by the insurers at present.

You should also review your mix of work performed, particularly if you are performing medico-legal work, as it is important to separately classify this income due to its VAT status. Your accountant will be able to discuss the VAT implications of this type of work.

Again, when reviewing expenses, contrasting against expectations and the prior year is always the first start.

Then focus attention on costs that generate income and see if they have been value for money. Depending on specialty, advertising costs may be a significant expense and it is vital that you have some form of system to assess its success.

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With the electronic world we live in, online advertising costs for internet searches can add up to a significant amount. Set a budget for these types of expenditures as a percentage of income and try and stay within that amount.

Review your other expenses and focus on those that are controllable, otherwise you will not be able to do much about them. In recent years, there have been more entrants into the market to provide indemnity insurance and therefore many consultants are reviewing their position.

The key message when considering switching is to ensure that you are getting like-for-like cover and support, otherwise it could prove to be a false economy.

Focus on the smaller expenditures as well; modest savings across a number of expense types can add up into more significant ones.

Balance sheet

The balance sheet provides a summary of your assets and liabilities to give you a 'net asset' position for your business. Producing this statement ensures that assets and liabilities are reconciled to the underlying data and acts as an excellent control in relation to the completeness and accuracy of the accounts.

This makes life much easier should you be subject to a HM Revenue and Customs' inquiry and may actually reduce your chances of having one, as the tax return asks for a balance sheet. If you are trading as a limited company, a balance sheet is compulsory, as the accounts are in a prescribed format.

The balance sheet starts with 'fixed assets', which is a summary of the expenditure on capital assets. It can be useful to compare the impact of purchasing new assets. Did they generate income?

This can be particularly useful for future purchasing of capital equipment, as frequently technology becomes out of date sooner than expected and you might not have earned as much as expected.

The current assets comprise of assets such as stock, debtors and bank balances. Depending on your specialty, it may be necessary to hold stocks of drugs and medical supplies. Ensure that they are controlled to avoid wastage.

The debtors figure indicates how much is owed to you at the date the accounts are drawn up. The income figure includes everything earned (not received) and therefore the debtors figure is necessary otherwise the accounts would only record cash movements, which is not acceptable.

For most specialists, a debtors figure representing around one or two months' income would be reasonable. Compare your debtors as a percentage of your total income each year to see if your proportion of debtors are rising.

If it is rising, this could indicate a problem with your collection of debts or could point towards bad debts. It is vital that your accounting systems adequately record outstanding fees and these are chased on a regular basis.

The mix of fees can also have an impact on the debtors, in particular if you are starting or increasing the amount of medico-legal work, where it is not uncommon for it to take 6-12 months to be paid for work performed.

The current liabilities section will record the amounts owed by you at the date the accounts are drawn up but not paid. A prime example of this would be your accountancy fees. They are paid after the accounts are drawn up but relate to that period and are brought into the accounts.

There are other items that can appear on a balance sheet, but the above represents the main ones for a typical consultant.

Taxable profit

It is worth noting that your taxable profit could be materially different from your accounting profit shown in your private practice accounts. Each year, it is likely that certain expenditures are incurred that are not allowable expenses for tax purposes, such as entertaining and depreciation.

In relation to the latter example, depreciation is added back but a tax allowance is given known as 'capital allowances'. Depending on the age of your assets, these adjustments can make a material difference to the amount of tax you pay.

In recent years, there have been significant incentives to buy certain business assets that give you a 100% allowance in year one, but nothing thereafter. Therefore, if you bought an expensive machine in your prior year's accounts and received the tax relief in one go, you could be in for a shock the following year if you have not continued buying qualifying assets.

Benchmarking

Benchmarking yourself against others can be useful, but care must be exercised to ensure that a fair comparison is made. There is no point in comparing apples with oranges, so ask your accountant how you are doing compared to similar consultants.

Understanding your accounts and evaluating your performance should ensure that you are maximising your profitability and are able to react quickly to changes in your circumstances. Speak with your accountant about your performance and ask for suggestions on how you can improve. ■

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