

UNDERSTANDING YEAR-END ACCOUNTS

Familiarity with basic accounting procedures and terminology can help GPs no end. In the second of six articles on financial management, accountant Ian Tongue gives advice on interpreting the year-end accounts

Understanding year-end accounts can be difficult, especially as many doctors have not received any form of financial training. Too often, complex year-end accounts are produced that overload doctors with information, so it is not absorbed.

The role of an accountant should be to present the information in a clear and concise manner that is understandable to all – a skill that can perhaps be compared to a doctor explaining a diagnosis to a patient.

Obtaining knowledge of the accounts is easier than you think once you have mastered the basic accounting concepts and are able to follow the flow of information.

Accounting basics

One of the fundamental principles in preparing accounts is that they must be on an 'earnings basis', or 'accruals concept' in accounting speak. This ensures that all income earned and expenditure incurred up to the date the accounts are prepared is included within the figures presented. This is irrespective of whether the money has physically been received or paid. This principle is applied from the smallest sole trader right up to listed companies.

This can result in misunderstandings in relation to the level of drawings that can be taken. This is because the cash may not be physically available, but the profit has been earned from an accounting perspective. When making decisions on drawings, the timing of physical cash receipts and payments is very important to ensure that the practice has sufficient cash for its day-to-day needs.

Income

For GPs, the timing of income receipts can lead to large amounts of income being brought into the accounts that have not physically been received at the date the accounts are produced. This is known as 'accrued income'. Obvious examples are:

- QOF achievement
- enhanced services
- drugs.

The accounting entries are to add the income to that already received and create a 'debtor' for the balance. A 'debtor' represents money owing to the practice at the year end.

This concept can work in reverse where income has been received in advance – for example, receiving notional rent during the year for a period after the year-end accounts. This

income would not be included as income in the accounts. Instead, it would be deferred until the following accounting period. This is known as 'deferred income' and would be recorded in the creditors section of the balance sheet.

It should be noted that the income figures in the accounts are before any deductions for superannuation. These deductions are taken directly to the current accounts, with tax relief being obtained on personal tax returns. This is because superannuation is a personal expense.

This treatment is required by HM Revenue and Customs and unfortunately has resulted in the distortion of published GP earnings. The large amounts of superannuation that are paid out of the headline GP earnings rarely get mentioned.

Expenses

The same principles apply to expenses. Bringing expenses into the accounts is known as 'accruing' for the costs, and these items are shown as liabilities in the creditors section of the balance sheet. Examples of accruals are:

- invoices for drugs and medical supplies not paid for at the financial year
- tax and National Insurance for employees (PAYE) as these are usually paid one month in arrears
- deferred income (see above).

It is important to understand that superannuation payments for partners are not a business expense of the surgery and therefore should not be included in the profit and loss account. Instead, they are treated as additional drawings. But superannuation paid in relation to salaried doctors and ancillary staff is a business expense and is included with the profit and loss account.

Balance sheet

The balance sheet is a snapshot of the assets and liabilities of the surgery at the financial year-end.

The balance sheet can often be overlooked. But it is an important tool in assessing how much funding the surgery requires. This is known as the 'working capital' requirement. When partners are deciding how much each partner should retain in their current accounts, current and future working capital requirements are a very important factor.

Frequently provisions are included in the balance sheet, the most common one being for

superannuation. A provision is very similar to an accrual in that you are making provision for a future cost. It is an estimate of expenses incurred that have not yet been paid.

Profit allocation

Usually, the allocation of profit between each partner is presented in the accounts. The first adjustment is usually in relation to seniority, which is almost always different between each partner. Further adjustments can be made in relation to notional/cost rent or some other retained profit. The balance of profits would be divided in accordance with the agreed profit shares.

Capital accounts

The capital accounts are usually equal to the surgery value recorded within fixed assets minus any outstanding partnership loan. The capital accounts only increase or decrease if there is a change in property ownership or a revaluation of the property.

Current accounts

This is often the area that causes the most confusion with doctors. Almost all accounting transactions are recorded in the current accounts in one way or another. The closing balance represents the undrawn profit in the surgery, and is after taking account of all monies drawn from the practice. The amount drawn from the practice would include:

- monthly or one-off drawings
- superannuation paid in the year
- income tax (if paid by the surgery)
- movements in superannuation provision.

As each doctor will have differing superannuation payments or tax (if this is saved for internally), despite having taken the same monthly drawings, they will have a different closing balance on their current accounts. To address this, many surgeries have an annual balancing or equalisation exercise or decide to take differential drawings between partners to compensate.

This guide aims to provide answers to the more basic accounting questions. Taking the time to understand the basis on which accounts are drawn up will inevitably lead to them being more meaningful and a more productive year-end meeting with your accountant.

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