



USING YOUR THREE FINANCIAL STATEMENTS TO UNDERSTAND

How Money Flows Through Your Business

► FINANCIAL REPORTS 101

Analyzing your practice's financial health goes way beyond looking at your production, collections and overhead %. If you ever asked yourself or your accountant, "**Where did all my money go?**", read on.

► KEY IDEA #1:

Production is a useless number unless you know what % of that production you collect. Further, the collection amount isn't all that helpful unless you know how much of that is going out the door before you can call it profit. That is your overhead. It is essential for a dental practice to understand what their overhead is, monitor it monthly, and put in practices to minimize overhead expenses. This understanding will lead to recognizing how to increase the net profit amount at the bottom of your Profit and Loss (P&L) Statement.

► KEY IDEA #2:

The net profit at the bottom of your P&L statement is not what you get to take home. Huh? What? We know! It doesn't make sense. This is why this **Profitability Tool** is important for you to embrace. This net profit is only the start to following the windy path of how cash flows in and out of your practice. To fully follow the money in your practice, you will need 3 financial statements.

Print the following financial reports and have them in front of you as you work through the following steps:

- Profit and Loss Statement (P&L)
- Cash Flow Statement
- Balance Sheet

Together, these three reports paint a clear (or at least less blurry) picture of the financial health of your dental business.

▶ PROFIT AND LOSS (P&L) STATEMENT

The Profit and Loss Statement is the most used and favorite financial statement among most small businesses. The P&L statement shows your practice's revenues and expenses for a selected period of time: a month, a quarter, or a year. The bottom line of the P&L statement, called the net income/loss, is the difference between the revenues and expenses over a period of time. If the difference is positive, it is profit. If the difference is negative, it is a loss. Some of your

income will be stated on the P&L. How much will depend on how you and your accountant structure your income? Dentists are often paid in two ways: salary and cash distributions. Both are income to you, but how much of each depends on your corporate structure, and we'll leave that to you and your accountant. Salary and benefits to you are listed on the P&L and cash distributions on the balance sheet and cash flow statement.

Let us take a look at an example P&L statement of XYZ Dental for one month.

INCOME

XYZ DENTAL - PROFIT AND LOSS STATEMENT		MARCH 1 - MARCH 31, 2022
COLLECTIONS	▶	100,000
PATIENT REFUNDS	▶	-2,000
NET COLLECTIONS	▶	98,000

EXPENSE

ADVERTISING	▶	3,000 (3%)
DENTAL SUPPLIES	▶	6,000 (6%)
FACILITY EXPENSES	▶	9,000 (9.2%)

***Note:** This category includes \$900 in Depreciation. We will deal with this non-cash expense later in the process.

OPERATING EXPENSES	▶	9,000 (9.2%)
LAB COSTS	▶	7,000 (7.1%)
TEAM COMPENSATION	▶	25,000 (25.5%)
DR. SALARY AND BENEFITS	▶	20,000 (20.4%)
DISCRETIONARY	▶	2,000 (2.0%)
TOTAL EXPENSE	▶	81,000
NET INCOME	▶	17,000

What you should learn from your P&L:

1 Is your top line big enough to produce a profit?

Track the top line income and compare against prior months and prior years to determine what your production and collections goals need to be in order to result in profit. Meaning, what is the break even point in terms of revenue where your practice will have a net profit on the P&L.

2 Are your expenses low enough to produce a profit?

Track your expenses as instructed in Step Two in an effort to minimize them. Profit is a balancing act between increasing top line and limiting expenses.

So in our example, \$100,000 was collected, the practice has a 60% overhead, Dr. was paid 20,000 in income and there was still \$17,000 left over. That's good. Does that mean Dr. can pay themselves another 17K? Not necessarily. We have to now look at two other reports to get the full picture of the business health.



BALANCE SHEET

A balance sheet is the current snapshot of your business finances. It tells you about the assets you own and liabilities (i.e. debts) you owe at a particular point in time. Balance sheets are broken up into three general categories: assets, liabilities, and equity.

Here's an example of what a balance sheet looks like:

EXPENSE

XYZ DENTAL - BALANCE SHEET

MARCH 1 - MARCH 31, 2022

CURRENT ASSETS

CASH IN BANK	20,000
ACCOUNTS RECEIVABLE	30,000
INVENTORY	5,000

FIXED ASSETS

EQUIPMENT/FIXED ASSETS	150,000	*Accumulated Depreciation is simply the cumulative total amount that the fixed assets have been depreciated during their lifetime.
LESS ACCUMULATED DEPRECIATION	-40,000	
TOTAL ASSETS	165,000	Total Assets = Current Assets + Fixed Assets - Depreciation.

LIABILITIES

ACCOUNTS PAYABLE	12,000
CREDIT CARD PAYABLE	8,000
LINE OF CREDIT	15,000
CBCT LOAN BALANCE	52,000
CAD/CAM LOAN	25,000
TOTAL LIABILITIES	\$112,000

EQUITY

COMMON STOCK	15,000
RETAINED EARNINGS	38,000
TOTAL OWNERS EQUITY	\$53,000

▶ ASSETS

Assets are anything valuable that your practice owns. This may include:

- 1 Money in the bank
- 2 AR
- 3 Dental equipment
- 4 Furniture

▶ LIABILITIES

Liabilities are debts you owe to other people. These include:

- 1 Bank loans
- 2 Line of credits
- 3 Credit card balances
- 4 Practice loans
- 5 Taxes owed

▶ EQUITY

Equity is the remaining value of the company after subtracting liabilities from assets, less any distributions. This might be retained revenue—money the company has earned to date—as in the example above.

To put it simply:

Whatever value (equity) your business actually has consists of what it owns (assets) minus what it owes (liabilities).

▶ THE BALANCE SHEET FORMULA

To grasp how the three categories on the balance sheet work together, remember this formula:

$$\text{Equity} = \text{Assets} - \text{Liabilities}$$

This is useful information, but it's not the full picture. While the balance sheet is used by many industries to determine the value of a business, this is not true of a private dental practice.

We advise you use your balance sheet not to constantly estimate the selling value of your business, but rather to do the following:

1

Understand your cash position or what you have in the bank.

A healthy business should be paying the team, paying the bills, paying the doctor their base salary, AND be putting money in the bank every month. We want our dentists to be paying themselves a good salary and watching the bank account grow throughout the year.

2

Track your existing loan balances and other liabilities over time.

The doctor must be rewarded for owning the business at some point in the form of additional profit. That will never happen if the debts keep up with the production. Use your balance sheet to monitor your debts. Your debts are an investment in your practice. As mentioned above, when your debts go to 0, you can start investing that money for you!

► CASH FLOW STATEMENT

Your practice cash flow statement tracks how much money came into the practice during a period of time and how much money was paid out during the same period. As a result, the cash flow statement shows **how much cash is available** to the company at the end of each period.

Many dentists are frustrated because their P&L statement consistently shows nice profits, yet they still end up having no cash to pay taxes at the end of the year.

Even if your P&L statement consistently shows nice profits, you still can end up in a situation when you do not have enough cash. P&L and cash flow include different items and serve different purposes: P&L shows the business performance from its day to day activities and cash flow reflects the financial performance of the practice. They aren't necessarily the same and that is why it is important to pay attention to both.



Here are the main things to keep in mind when evaluating your Cash Flow statement:



In a cash flow statement, all revenues and expenses are registered when they are actually paid, i.e. when money came into the practice account or left it. So if you signed for the purchase of some equipment in January but don't make the first payment till February, it won't show on the cash flow statement until February.



You likely have some expenses that incur cash leaving your practice that are NOT shown on your P&L. This is frustrating and confusing for most dentists. It is also imperative to grasp if you want to have a handle on your business' financial health. For example, all your loans and the principle payments on those loans are not seen on the P&L at all. They are recorded on the cash flow statement. Only the interest paid on your loans are recorded on the P&L.



Everytime you finance any purchase of new equipment, you will see the depreciation of that asset on the P&L along with the interest but the payment will be on the cash flow statment.

Let us look at our example dental practice again:

XYZ DENTAL - CASH FLOW STATEMENT

MARCH 1 - MARCH 31, 2022

NET INCOME (FROM BOTTOM OF P&L) > 17,000

FINANCING ACTIVITIES

LINE OF CREDIT > -\$3,000

CBCT LOAN PAYMENT > -\$2,000

CAD/CAM UNIT PAYMENT > -\$2,000

PRACTICE PURCHASE LOAN PAYMENT (DISTRIBUTION) > -\$5,000

TOTAL FINANCING ACTIVITIES > \$12,000

DR. MONTHLY TAX SAVINGS DEPOSIT (DISTRIBUTION) > -\$15,000

NET CASH INCREASE FOR PERIOD > -\$10,000

PRACTICE CASH POSITION AT START OF PERIOD > \$20,000

PRACTICE CASH POSITION AT END OF PERIOD > \$10,000

WHAT DID WE LEARN HERE?

This practice has the potential to produce profit. Its net profit was \$17,000. Its overhead is 60%. Looks pretty healthy, right? However, this practice's cash flow is not healthy. This practice lost money this month and only has only \$10,000 in the bank, not enough to survive any unforeseen challenges.

Where is all my money going? We produce \$100,000 per month? I thought there would be way more money left over!

Why? If you see that your cash flow balance is often negative while the P&L statement indicates profits, your practice likely has too much debt to service. Remember, those of you who are a "pass through tax entity" (S corp, LLC, Sole Proprietor) pay taxes on the net profit at the bottom of the P&L, NOT the bottom cash position of the cash flow statement. It is very easy for a dental practice to be profitable according to the IRS and accounting principles and yet have no money.

Keep working on this and we'll show you how to calculate your True Profit.

Your goal should be to plan wisely, invest in things that directly add to the income of your practice, and watch the last line of your cash flow statement increase each month. This is probably the most important line in all of your practice or financial reports. *When your cash position increases each month, you now have lots of options to invest in the practice, reward your team with bonuses, and reward yourself as a return on your investment.*