

# **The first few steps to improve financial management at your practice!**

## **Budgeting and budgetary control**

### **Introduction**

In this series of articles on “first few steps to improve financial performance at your practice” I will be discussing how simple, yet effective, measures of financial management could improve your practice’s overall financial management and its profitability.

In my last article, I discussed how a bookkeeping package could help you to record all your business transactions in one place, how such a system could help you to obtain various financial information including reports on practice profitability, how such a system could simplify the preparation of your annual accounts and possibly save tax too!

In this article, I will discuss how you could implement a budgeting and budgetary control system at your practice.

In my experience, most dentists are aware of their annual gross income and annual profitability. However, most dentists haven’t got access to adequate information pertaining to monthly profitability, detailed breakdown of practice expenses, whether a particular expenditure is too high or not etc.

Implementation of a bookkeeping package is therefore your first step towards improving financial management and awareness at your practice.

However, measuring actual performance on a monthly basis is not enough. What is needed is the measurement of actual practice performance in comparison to a pre-set budget.

### **What is budgeting and budgetary control?**

Every business should have long term objectives. These objectives should include both financial and non financial objectives. Usually objectives stem from your business plan.

Once the long term objectives are set, it is necessary to devise an action plan to achieve these objectives. Long term objectives could only be achieved by setting more detailed short term objectives, in other words, breaking down long term objectives into more manageable short term objectives.

The short term objectives are usually set over a period of one year and when it comes to short term financial objectives your annual budget is the best form of measuring your success in reaching these objectives. A short term financial objective usually needs to be achieved on a year on year basis to ensure your grand business (financial) objectives are met.

Therefore, the process of budgeting involves setting up a realistic financial forecast for the forthcoming financial year.

In setting the annual budget, it is essential to consider the practice owner's long term financial objectives and current business position. Usually a financial budget or a forecast would involve a budgeted profit and loss account, a balance sheet and a cash flow statement for the period concerned.

Usually when a budget is set, it is important to prepare the forecasted financial statements for each month of the financial period concerned. In other words, the annual budget should be broken down into monthly forecasts.

By preparing monthly forecasts, we are in a better position to monitor actual performance of the practice in comparison to the budget. This will enable you to identify monthly favourable and adverse variances.

For example, if the actual monthly revenue is lower than what was budgeted for, then we have an adverse variance which needs to be investigated further to find out the likely reasons.

Once you have identified the likely reasons for the adverse variance, then you need to take the necessary management actions to ensure that these adverse variances are reversed so that annual targets are achieved.

The above process is known as budgeting and budgetary control.

### **How to implement a budget and a budgetary control system at your practice?**

The first step is to set up a budget.

For a typical dental practice a budgeted profit and loss statement and a cash flow statement would be more than adequate. A budgeted balance sheet is most welcome but not essential in my opinion, in order to keep things simpler.

In setting up a budget it is essential to consider the practice owner's financial objectives, seasonal variances in demand, current price list of the practice, number of dentists working, daily revenue targets, operational requirements, headcount, pay rates etc. These will help you to forecast the revenue and expenses accurately.

When setting expenditure targets you need to set expenditure ceilings. Usually you should use industry averages for this. If you are with a NASDA accountant, your accountant could help you with setting up a budget or providing industry averages (%) for various expenses at your practice.

For example, material costs should represent only 6 % of the revenue; lab fees should represent only 8% of the revenue and so on. However, please note that it is not possible set all expenditure targets based on industry averages or benchmarks. In certain cases, for example in the case of setting the employee cost budget, you need to take in to account the operational requirements and work out a detailed employee cost budget, then incorporate that into your main budget.

When preparing a budget is it important to set a realistic budget – neither a slack budget nor an unrealistic budget.

If your budget is slack or unrealistic, it will act as a de-motivator and it'll result in non implementation of the budgetary control process.

This is because you know that your actual performance will always be better than your budget or the budget can not be achieved, no matter how hard you work!

The following is an example of a budgeted profit and loss account. Please note that seasonal variations in demand have not been considered in this budget to keep it simple.

(Arun/Sarah: We can send them a PDF version of the following if necessary)

**Dr Tooth - Budget 2006-07**

**Profit and Loss Statement**

	%	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Total
<b>Income</b>														
Principal		8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	107,322
	92%	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	8,943	107,322
Associate - 1	40%	12,786	12,786	12,786	12,786	12,786	12,786	12,786	12,786	12,786	12,786	12,786	12,786	153,433
Associate - 2	23%	6,386	6,386	6,386	6,386	6,386	6,386	6,386	6,386	6,386	6,386	6,386	6,386	76,635
Associate - 3	0%	0	0	0	0	0	0	0	0	0	0	0	0	0
	68%	19,172	19,172	19,172	19,172	19,172	19,172	19,172	19,172	19,172	19,172	19,172	19,172	230,068
	100%	28,116	28,116	28,116	28,116	28,116	28,116	28,116	28,116	28,116	28,116	28,116	28,116	337,389
<b>Direct Costs</b>														
Materials	6%	1,687	1,687	1,687	1,687	1,687	1,687	1,687	1,687	1,687	1,687	1,687	1,687	20,243
Lab	8%	2,249	2,249	2,249	2,249	2,249	2,249	2,249	2,249	2,249	2,249	2,249	2,249	26,991
Associate	29%	8,052	8,052	8,052	8,052	8,052	8,052	8,052	8,052	8,052	8,052	8,052	8,052	96,628
Other														0
	43%	11,989	11,989	11,989	11,989	11,989	11,989	11,989	11,989	11,989	11,989	11,989	11,989	143,863
<b>Gross Profit</b>	57%	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>16,127</b>	<b>193,526</b>
<b>Other Expenses</b>														
Employee cost	14%	3,914	3,914	3,914	3,914	3,914	3,914	3,914	3,914	3,914	3,914	3,914	3,914	46,969
Premises cost	6%	1,667	1,667	1,667	1,667	1,667	1,667	1,667	1,667	1,667	1,667	1,667	1,667	20,000
Repairs and renewals	1%	200	200	200	200	200	200	200	200	200	200	200	200	2,400
Finance/Lease charges	6%	1,565	1,565	1,565	1,565	1,565	1,565	1,565	1,565	1,565	1,565	1,565	1,565	18,780
Depreciation	5%	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	16,800
Patient financing charges	2%	478	478	478	478	478	478	478	478	478	478	478	478	5,736
Interest and bank charges	2%	500	500	500	500	500	500	500	500	500	500	500	500	6,000
Marketing and advertising	2%	425	425	425	425	425	425	425	425	425	425	425	425	5,100
Administration expenses	2%	500	500	500	500	500	500	500	500	500	500	500	500	6,000
Professional fees	1%	250	250	250	250	250	250	250	250	250	250	250	250	3,000
	39%	10,899	10,899	10,899	10,899	10,899	10,899	10,899	10,899	10,899	10,899	10,899	10,899	130,785
<b>Net Profit</b>	19%	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>5,228</b>	<b>62,742</b>

- Figures based on a detailed working
- Figures based on industry wide benchmark %
- Figures based on last year's actuals + upward revision
- Figures based on approximations

Once you have set a budget for the forthcoming financial year, then you are ready to undertake budgetary control. As explained before, it is a process of comparing your actual performance with your budget (ideally on a monthly basis) with a view of identifying both adverse and favourable variances so that you could take the necessary management action to ensure that your yearly budgeted targets are met.

If you use a computerised bookkeeping package, then you can input the details of your budget into your bookkeeping package and carry out budgetary control on a monthly

basis with a click of a button, without the need to manually calculate the variances or juggle with too many Excel spreadsheets.

### **Conclusion**

In today's context, dental practices need to be operated as any other business. In doing so, it essential to take the necessary steps to introduce better financial management procedures and increase your financial awareness.

Implementation of a bookkeeping system and a budgetary control system has endless advantages which can lead to much better control over your practice's finances and increased practice profitability.