

INTRODUCTION TO FINANCIAL STATEMENTS

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- Summary of four financial statements
- General example of each statement
- Pharmacy P&L discussion
- Helpful equations quick reference

HLC Business Acumen 101

Great pharmacy leaders begin here! If you are looking to increase your understanding of fundamental finance and accounting principles including how those pieces factor into operating your pharmacy, then this resource is for you! This guide shares essential, concise material to swiftly enhance your business confidence. The goal of The Healthcare Leadership Certificate is to coach pharmacists into their best leadership careers through actionable, evidence-based techniques with effective tools and resources. Let's dive right in!

The Income Statement

Of the four main financial statements that encompass a firm's overall financial position, the most relevant statement for day-to-day operation managers is the income statement. The income statement is also known as the profit and loss statement or P&L.

In the most basic sense, this statement shows if your business is profitable or not. The simple equation for the statement is sales minus expenses equals profit.

Within the business realm, the terms top-line and bottom-line are intuitively used to refer to the P&L referencing nothing more than sales and profit. The first line of the P&L lists sales, and the bottom line is net income or profit.

Example Company	
Income Statement	
Year ended December 31, 2020	
Net Sales	1,000
COGS	500
Gross Profit	500
SG&A	250
Operating Profit	250
Interest Expense	25
Income Taxes	50
Net Income	175

Now let's take it one step further and break down the major lines contained within the P&L.

Net sales is the amount of revenue generated from the sale of products and services. Cost of goods sold or COGS is how much the product cost to produce. Net sales minus COGS equals gross profit. Gross profit is the profit margin before factoring in additional operational expenses.

The SG&A line item is listed after gross profit and stands for selling, general, and administrative expenses. These are the additional outlays that encompass the costs of operating the business. Among other items, wages are included in this expense line. Subtracting SG&A from the gross profit provides operating profit or operating income. This is the earnings that remain after accounting for operating expenses.

To arrive at net income or the bottom line, interest expenses and income taxes must be accounted for and deducted.

When evaluating the P&L, there will be more than the five lines discussed here but additional lines generally roll-up into these larger buckets. From a simplicity standpoint, understanding these five lines will provide sufficient awareness for what is going on in your business.



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Pharmacy P&L

Let's consider the P&L in more detail from a pharmacy perspective. Net sales include revenue from products and services sold. In pharmacy, this includes prescriptions sold, immunizations delivered, service fees for vaccine administration, and MTM fees collected.

The largest driver of COGS within the pharmacy is drug inventory. Recall, sales less COGS or the costs of drugs equal gross profit.

SG&A expenses are not product specific (like COGS) but are part of day-to-day business operations. SG&A items include supplies, like prescription labels, bottles, bags, counting trays, utilities, and the largest expense: wages.

As we think about how to impact the P&L to operate a profitable business, tactics are to either grow sales or minimize expenses.



What steps can you take to grow sales? These can range from simple actions like making corrections based on feedback from calls to transferred patients to understand why they left to proactively completing ready reminder programs so patients remember to come pick-up their medications and boosting medication adherence. More grandiose plans may include expanding to offer a specialty service or entering a new market segment like hospice or mail-order.

On the flip side, balancing and controlling expenses is an equally important consideration from a profitability standpoint. As mentioned, there are two general areas for expenses within the income statement.

The first is COGS. How can we impact the cost of goods sold? Within a pharmacy, solid inventory control and maximizing preferred generic in-stock are effective ways to control costs. Comparatively, larger scale efforts might include strategic company partnerships and leveraging buying power. After COGS, other expenses to consider are held within SG&A.

Prescription drugs margins have diminished in recent years causing pressure the largest portion of SG&A—wages. Pharmacy staff wages are the largest controllable expense in the industry, which for some seem to be the easiest lever to pull in reducing expenses.

However, be cautious here because saving your way to a strong operating profit is often not the best tactic. Consider strategic ways to increase efficiency that can methodically reduce wasted wages. Ultimately the sales growth or expense reductions will increase the business's operating profit. Evaluate wages judiciously balancing adequate support for meeting customer expectations without over scheduling hindering long-term company solvency.

While use of the remaining statements in daily operations is unlikely, a general grasp is useful.

Statements of Cash Flows

Example Company	
Statement of Cash Flows	
Year ended December 31, 2020	
Cash flows from operating activities	175
Cash flows from investing activities	0
Cash flows from financing activities	1,000
Net increase (decrease) in cash	1,175
Cash at the beginning of the year	0
Cash at the end of the year	1,175

The Statement of Cash Flows follows the money reflecting the cash inflows and outflows from the company. Going back to the Income Statement, it records revenue and expense transactions as they are incurred which may not involve immediate receipt or payment of cash. Comparatively, the Statement of Cash Flows presents the *actual* movement of dollars spent or received whenever cash is exchanged.

Cash is king so evaluating the cash flows of the business is important to ensure sufficient liquidity or readily available cash on hand for the firm to continue ongoing operations.

Statement of Shareholder's Equity

The Statement of Shareholder's Equity essentially shows the shareholder's interests over time. The statement begins with the balance from the previous period then adds in the amount of common and preferred stock issued to provide funding plus any net income (from the P&L) for the current period. Dividends paid out are subtracted leaving the remaining amount of equity available to shareholder's.

Example Company	
Statement of Shareholder's Equity	
Year ended December 31, 2020	
Balance on January 1	5,000
Issued shares for cash	1,000
Net Income	175
Dividends	(175)
Balance on December 31	6,000

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Balance Sheet

Finally, the balance sheet is summary of the firm's assets and liabilities. The basic equation that drives the balance sheet is:

$$\text{Assets} = \text{Liabilities} + \text{Shareholder's Equity}$$

Assets include both physical items like cash, pending payments for goods or services provided (accounts receivable), inventory, property, plant, and equipment and intangible elements like the ownership of trademarks, patents, and goodwill that are valuable for the company.

Liabilities are expenses that firms owe including payments due for goods or services received called accounts payable, short- and long-term loans as well as stockholder's equity. This equity is what remains if the company sold all the assets it owns paying off all liabilities.

It is also worth noting that a balance sheet must in fact balance with total assets equaling total liabilities and stockholder's equity.

Example Company	
Balance Sheet	
December 31, 2020	
Assets	
Current Assets	
Cash/cash equivalents	4,000
Inventory	1,000
Total Current Assets	5,000
Property, plant, equipment (PPE)	10,000
Other Assets	1,000
Total Assets	16,000
Liabilities and Shareholder's Equity	
Current Liabilities	
Accounts payable	1,000
Notes payable	4,000
Total Current Liabilities	5,000
Long-term Debt	5,000
Total Liabilities	10,000
Shareholder's Equity	
Common stock	1,000
Retained earnings	5,000
Total Liabilities and Shareholder's Equity	16,000

Research on this resource was done with the help of Investopedia.com.

FINANCIAL EQUATIONS QUICK REFERENCE

Easy reference guide for seven common financial equations!

by SJ Holdings Group, Inc.

1 GROSS PROFIT

$$\text{Gross Profit} = \text{Sales} - \text{COGS}$$

2 GROSS PROFIT MARGIN

$$\text{Gross Profit Margin} = \frac{\text{Sales} - \text{COGS}}{\text{Sales}}$$

3 OPERATING PROFIT

$$\text{Operating Profit} = \text{Gross Profit} - \text{SG\&A}$$

-or-

$$\text{Operating Profit} = \text{Sales} - \text{COGS} - \text{SG\&A}$$

4 OPERATING PROFIT MARGIN

$$\text{Operating Profit Margin} = \frac{\text{Operating Profit}}{\text{Sales}}$$

5 NET INCOME

$$\text{Net Income} = \text{Operating Profit} - \text{Interest Expense} - \text{Income Taxes}$$

-or-

$$\text{Net Income} = \text{Sales} - \text{COGS} - \text{SG\&A} - \text{Interest Expense} - \text{Income Taxes}$$

6 NET PROFIT MARGIN

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Sales}}$$

7 ACCOUNTING EQUATION

$$\text{Total Assets} = \text{Total Liabilities} + \text{Shareholder's Equity}$$

where

$$\text{Total Assets} = \text{Current Assets} + \text{Fixed Assets}$$

$$\text{Total Liabilities} = \text{Current Liabilities} + \text{Long-term Debt}$$

