



Top 10 Pharmacy Accounting Questions to Ask Your CPA

What your CPA wishes
you were asking

It's well into the new year and if you're like most independent community pharmacy owners, you're waiting for your CPA to tell you how your pharmacy performed last year and how much you have to pay in taxes from your already tight cash flow.

"Instead of waiting, you need to be proactive now," said Scott Sykes, CPA, of Sykes & Company, P.A., an accounting firm focused on independent community pharmacies.

While it's too late in the season for most tax planning mitigation strategies, you can still be proactive by making sure your CPA has an understanding of your pharmacy and what's vital for proper accounting, advisory and tax, Sykes said.

We talked with Sykes about what CPAs wish independent pharmacy owners knew and what questions owners need to be asking their CPAs. Here are the top questions.

1.

DO I NEED AN UPDATED INVENTORY BALANCE?

For an independent pharmacy owner, the answer to this question should be 'yes,' and you need

to ask this question often throughout the year. Without an accurate inventory figure, you may be grossly overstating or understating your margins and net bottom line. “You’re lost from a managerial perspective without a good grasp of your gross margin,” Sykes said.

2. HOW DO I COMPARE TO MY PEERS?

By understanding where you stand compared to your peers, you can have confidence in what you’re doing—and find areas in which you can improve.

For example, ask your CPA how you compare to your peers in gross margin. For a normal independent pharmacy, gross margin should be steady. This is a great starting point to see what you’re doing—or aren’t doing—compared to other pharmacies.

You might also want to know how you compare to your peers in rebates as a percent of revenues. For example, your rebates may be 3 percent (a minimum,) but your peers’ rebates with the same wholesaler may be 10 percent. What are they doing differently?

And, what’s the trend in the industry regarding revenues? Is there growth in the industry as a whole and, if so, how does your pharmacy compare? The answers to, and analysis of, these questions may give insight into areas where you can perform better.

3. WHAT KEY RATIOS SHOULD I BE FOCUSING ON?

Every independent pharmacy owner needs to understand several key ratios. “Knowing what those ratios are, where you stand compared to your peers and the average is important,” Sykes said. “It starts the conversation on what you’re doing right or wrong.”

For example, you need to know your current ratio, which is current assets divided by current liabilities. This ratio tells you how many dollars of current assets you have for every dollar of current liabilities. A ratio at or above three to one is ideal for a pharmacy. “Without good balance sheet reconciliations and integrity, this ratio has no value,” Sykes said. “Getting your accounting fundamentals in order is key to utilizing this analysis tool.”

4. SHOULD I BE REPORTING ACCOUNTS RECEIVABLES FROM THIRD PARTIES ON MY TAXES?

In most cases with independent pharmacies, the answer to this question is, ‘yes.’ There may be a very small

percentage of owners who are excluded, but 99 percent should be reporting receivables from third parties on their taxes (and books.) It’s required!

5. IF I HAVE MORE THAN \$10 MILLION IN REVENUE, SHOULD I BE CONCERNED ABOUT SECTION 263A RULES?

If you’re an independent pharmacy owner with revenues of more than \$10 million, compliance within IRS Code Section 263A may be required. Section 263A requires resellers, or pharmacies, including controlled groups, with average gross receipts for the prior three years of more than \$10 million to capitalize costs into inventory. “It’s like a hidden tax hike on those larger businesses,” Sykes said.

6. WHAT ARE AVERAGE GROSS WAGES FOR A PHARMACY?

Depending on the type of pharmacy you operate, there are averages for payroll that you need to be aware of—and strive to obtain. “Payroll is one of your largest expenses and it has a material effect on cash flow, so you should first focus on managing your payroll costs,” Sykes said.

7. HOW CAN I IMPROVE MY BACK OFFICE ACCOUNTING PROCESSES?

The accounting industry is changing, just like the pharmacy industry. Your accounting should include technology enhancements to streamline your efforts and to make your accounting more efficient, timely, accurate and transparent. Also, the CPA industry is moving toward a more niche-based service model, which will make it easier—and prudent—to find CPAs who specialize in pharmacy accounting.

8. WOULD YOU LIKE TO SEE MY SCRIPT DISPENSING LOGS?

The information gleaned from these audit logs serves many purposes to an experienced pharmacy CPA. Sykes said key areas he reviews using audit logs include revenue trends compared to what the accounting is showing; new scripts versus refills, which give an indication on whether the pharmacy is growing or dying; and gross margins and how they compare to the pharmacy’s books. Any differences between these logs and what’s reflected on the books can add insight that you may otherwise have overlooked.

9. WHAT TAX STRATEGIES CAN I IMPLEMENT?

It's a good idea to ask your CPA this question far in advance. Unfortunately, it's too late for tax planning for 2016, as most meaningful strategies require advanced planning. Instead, focus on 2017 and putting a system in place, so you can avoid this scenario next year.

This plan should include updating your accounting, implementing key fundamentals and putting an experienced pharmacy team in place, including lawyers, bankers and CPAs. "It's no secret that pharmacy is an extremely complex industry," Sykes said. "Having a team of professionals who understand your business can save you time, money and headaches."

For example, most bankers don't understand how a pharmacy operates with slim margins. And, most won't lend to pharmacies as a result of this lack of understanding, among other reasons. Find bankers who understand the cash flow models of pharmacy. As well, it's best to heed the expert advice of lawyers who specialize in pharmacy law to avoid issues from inexperienced lawyers.

CPA firms are another area where you need expertise. "A lot of CPAs only work with a couple pharmacy clients. And, most owners have to 'teach' their CPA the ins and outs of the business," Sykes said. "Find a CPA who can speak the language, understand the rules with regard to pharmacy reporting and add value with industry insight."

10. WHY ARE ACCOUNTING FUNDAMENTALS SO IMPORTANT FOR MY PHARMACY?

With margins as tight as ever, below-cost reimbursements and an inherently complex industry, you must have accounting fundamentals in place to manage, track and understand your pharmacy. "Waiting each year for information that's not reliable doesn't work. Those pharmacy owners who fail to understand this are having serious trouble," Sykes said. "Use accounting as an asset for success."

"These questions should help you get a good feeling of your CPA's experience and comfort in being your trusted advisor," Sykes said. "With the pharmacy industry ever-changing, you must change with it and think outside small town America. Seek the experienced industry professionals

you need to grow and succeed before you find yourself scrambling to mitigate taxes for the next year."

For more than 35 years, Sykes & Company has helped independent pharmacies with every aspect of pharmacy accounting, including tax and business advisory needs. Learn more at sykes-cpa.com.

Financial Resources

Get your questions about the financial side of your independent community pharmacy answered with these helpful websites.

Federal Tax Forms

Quickly find and download current tax forms, instructions and publications.
irs.gov/uac/Forms,-Publications,-and-Other-Tax-Products

Pharmacy Accounting Video Blogs

From corporate tax return deadlines to top questions about pharmacy taxes, these video blogs clarify accounting issues for independent community pharmacies.
sykes-cpa.com/news-blog

Pharmacy Information Request List

A listing of the documentation independent pharmacies should compile when meeting with their CPA for the first time.
sykes-cpa.com

State Tax Forms

An online directory of state tax forms. Search by state.
50states.com/tax

Where's My Refund?

Easily check the status of your tax refund. You'll need your social security number or ITIN, filing status and exact refund amount.
irs.gov/Refunds