Business Strategies To Help Your Medical Practice Thrive

MEDICAL PRACTICE

Budgeting

SIMPLE, PRACTICAL, STEP BY STEP GUIDE TO CREATE A BUDGET FOR YOUR MEDICAL PRACTICE

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In Partnership With

Medical Practice Budgeting

by Brandon Betancourt, MBA

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Introduction

William Feather knew what he was talking about when he said, "A budget tells us what we can't afford, but it doesn't keep us from buying it."

For many people, budgets are reasonable. In fact, necessary. Most would agree that they are vital to an organization's financial well-being. However, the reality is very few independent health care providers invest the time and energy necessary to prepare anything more than a cursory operating budget. I have learned this the hard way from my own painful experience.

I suspect the cause is that office managers, practice administrators and managing physicians have a hard time admitting they do not know where to begin.

Others, perhaps, find the task overwhelming. I know that was true for me as a practice administrator.

Practice administrators and physician managers' core skill sets generally reside with other important tasks.

Personally, the work of evaluating different aspects of the practice's financials, coupled with anticipating the practice's future performance, all while trying to imagine potential shortcomings and pitfalls was too burdensome.

So I would abandon the budgeting process altogether and rely on other, less scientific methods to maintain oversight over our practice's expenses.

As a result, I could have avoided many of the difficult challenges had I moved forward with creating and sticking to a budget.

The good thing about mistakes is that when you make enough of them, they lead you to the proper path. Thus, over the years, I have learned how to set up a reliable system so that the annual task of creating a budget is not overwhelming or burdensome.

I've also grown to better appreciate this value-adding process. The budgeting exercise has not only taught me, as a business owner and manager, what is our practice's financial potential and limitations, but it also helps us gain invaluable insight that allows for better, wiser and more cost-effective business decision making.

With this workbook, my intent is to remove all the obstacles keeping you from maintaining an impactful budget by breaking down the process in a practical, relevant way and laying out a step-by-step guide for you to follow, or customize for your unique requirements.

What To Expect?

If you happen to flip through the material, you may find this resource at first glance to be yet another complicated, MBA-driven, jargon-laden workbook.

If you dive deeper though, you will notice that this book breaks away from theoretical academia and focuses on real world examples and hard -learned lessons to put your organization on a path of sustainable growth.

A path that will eventually lead us to our primary objective—creating a budget for your practice that adds value, and isn't just an administrative chore to complete.

Of course, it would be foolish to begin such a project without taking the time to plan and prepare for the journey. Just like planning a route for an extended trip, timetables, set milestones, estimate supplies and other necessities, we also need to consider, study and learn some fundamental accounting and financial principles.

Let's begin.

Now What Am I Supposed To Do With This Vaccine?

It is Friday afternoon, and your practice has been seeing patients all day. The doc just has three more patients left for the day. The clinical staff picks up the pace so that they can finish up quickly and go home for a well-earned weekend's rest.

Everything is running smoothly. The last two remaining patients are checked in, roomed and the clinical staff has completed each patient's intake. With all the tasks for the end of the day nearly finished, the team waits for the pediatrician's final instructions.

Then the door in exam room seven swings open. The doctor has just completed seeing the child that came in for a well-check. As she steps out of room seven and swiftly moves to exam room eight, where the last child is waiting to be evaluated for his sore throat, your pediatrician announces to the RN that the patient in room seven needs the MMR vaccine.

"Well, I just talked to my husband, and we've decided to skip the MMR for this visit," says the mom in exam-room seven, as the harried nurse enters with the MMR vaccine drawn up in hand.

Returning to her station, the nurse asks, "*Now what am I supposed to do with this vaccine?*"

I'm sure you've encountered this exact or at least similar scenario a hundred time. So, what do you do with the MMR that has been drawn up? You cannot save it. You can't just give it to another child.

Essentially, the vaccine is lost. The practice has no other choice but to "eat" the loss of the vaccine.

What A Small Grocery Store Can Teach Us About Budgeting?

For our budgeting discussion, we have to ask ourselves a couple of questions. First is, how much is the loss? Second, and just as important as the first question is what needs to be done to recover the loss?

For help in answering these questions, let's take a look at the retail world.

A few miles outside of Baton Rouge, Louisiana, there's a town called Melville. It is an old town with a population of barely 700 people.

Like other small towns, Melville has a single, independent grocery store. One of the store's favorite items with customers is Coke in a bottle.

The store owner prices them at $1 each, even though every bottle costs him .98 cents. The owner says he is OK with only making .02 cents on each bottle because the lower price helps drive foot traffic to the store; which nets him more sells.

From time to time, a bottle of Coke falls off the shelf because somebody drops it or runs into the display. The loss should not be a big deal for the owner. He only loses two cents, right?

Not quite. There's more to it than that. The .02 cents is the owner's margin on each Coke bottle. Since he sells them at $1 apiece, he makes 2% off each bottle.

With a 2% margin, how many Coke bottles does the store owner have to sell to recover the .98 cents lost?

The answer is 50 Coke bottles (.02 x 50 = $1.00). And that's not including the additional costs of managing the store, for example, utilities, salary, rent, and other

expenses.

Now, let's return to our practice that drew up the MMR vaccine, where the parent decided not to give her child the shot, and ask the same question the store owner asked when a Coke bottle broke.

How many vaccines does the practice in the story above have to give

> The highest use of capital is not to make more money. But to make money do more for the betterment of life.
>
> -Henry Ford

The Correct Mindset

I am sure we can all agree that patient care is the top priority for any medical practice. However, providing high-quality care does not mean we can be careless with the practice's finances and resources.

Thus, to understand the fundamentals of budgeting, it is vital that practice managers and physician owners comprehend how measuring cost, margin and revenue have a direct effect on a practice's financial health.

So, as part of your preparation, it's critical to adopt an accountant's mindset and ask these type of questions regarding the practice's finances.

Adopting the correct mindset will enable you to embrace basic business principles, which will drastically increase your insights when analyzing the cost of managing a practice.

Most importantly, this frame of mind allows you to anticipate various scenarios that will help you build a stronger and more efficient budget.

Two Parts To Every Budget

Not long ago, I was coaching a practice on the topic of budgeting. The physician manager was trying to get a better handle on his practice's expenses. Specifically, he was having a hard time managing the details of his office's costs and revenues.

The managing physician explained that, for several years, his practice experienced tremendous patient demand. This led the shareholders to hire a couple of new doctors to meet demand. In the subsequent years though, patient demand did not grow at the same clip as anticipated.

I could tell he was frustrated. He had accounted for the increased expenses of adding the two physicians, but his anticipated revenue did not meet expectations. As a result, they've had a few "tight years," as he described it.

This story provides a perfect example to illustrate the fact that the budgeting process has two important, yet distinct parts to it. The first part is the cost side; which is, in essence, a process to anticipate your practice's expenses for the upcoming year.

Equally important is the revenue part. This side of the coin forecasts the amount of income you anticipate the practice (or each provider in the practice) will generate in the coming year.

We will be unpacking both the cost and the revenue side of budgeting later on.

Before we get to that, we need to check an important item off our preparation list: understanding the fundamental accounting principle called cost accounting.

Cost Accounting

Cost accounting is an important concept that practice managers have to master to even begin the budgeting process. But what is cost accounting exactly?

Cost accounting is a type of accounting process that aims to capture a company's costs of production by assessing the input costs of each step of production, as well as fixed costs such as depreciation of capital equipment.

"Assessing the input cost of each step of production?" Good Lord is that complicated! An accountant wrote that, obviously. Let us try to define cost accounting again using a non-accounting tone:

Cost Accounting is the recording of all the expenses incurred in your practice in a way that can be used to improve its management.

Better? I think so!

In the context of a medical practice, cost accounting separates each area of the practice (sometimes referred to as cost centers or even revenue centers) to determine the profitability of each sector.

Cost Accounting Methods

There are many different ways medical practices (or any business for that matter) can apply cost accounting.

If your practice has multiple locations, cost accounting can be implemented considering each

site as a cost/revenue center.

Another standard approach is the Percent of Revenue Allocation method. With this cost accounting method, the practice's overhead is allocated in correlation to a provider's revenue.

For example, Physician A generated 60% of the practice's revenue; therefore, 60% of the cost is allocated to Physician A. Doctor B brought in 40% of the revenue, thus, her cost allocation is 40%.

Another way cost accounting is applied is by separating the different areas of the practice into cost or revenue centers.

For example, let's say your practice has a laboratory or offers radiology services or perhaps behavioral health service. Under cost accounting methodology, the laboratory or the imaging services are each separated into their revenue or cost centers.

We will explore this concept in further detail in the Income Statement 101 chapter, as well as the benefits that breaking-out cost centers can bring to the budgeting process.

What Do You Know About This Business?

The man leaned back in his chair, looking over my resume. His facial expression hinted at unimpressed. After a few moments of silence, he asked me his first interview question. "What do you know about my business?"

The truth was, I knew little about this particular company. I had sent out hundreds of resumes, desperate to find anything that would pay me a salary. So when the call came in, I didn't ask but just two questions: When and where would you like to meet (Is that one or two questions?)?

Fortunately, the night before the interview, I went online to verify the company's address. While looking for their physical address, I perused the site and learned a few basic facts about the company.

"I know that your company distributes software, mainly to the education sector," I answered with confidence, but nervous as can be on the inside. And that was it. That was all I knew about the company.

The gentlemen interviewing me said, "Yeah, that's information you can find on our website. But what do you know about our company and the business?"

"Gulp!"

Without any further information about the company or the industry of even software distribution, I dug deep to find a suitable answer.

As confident as I could be, I shot back. "I don't know much about the industry, such as who's your major competitor or who are your main customers, but I do know one vital thing about your business..." I added

a pause for a little dramatic affect.

"At the end of the day," I said, "the company's revenue has to outpace your expenses. That is what is most important about your business. And as it pertains to this job, that means selling as many software licenses as humanly possible.

And selling is what I know. All the other stuff about your industry and company, well, I'm sure you can bring me up to speed with that information."

I wasn't trying to be a smart alec with my response. Although I am sure it came across as arrogant and cocky.

But the point I was trying to make was that while I didn't know the intricacies of their industry or their company, I was well acquainted with the fundamentals of business.

And to me, that was more important than knowing the company's main supplier.

Apparently the interviewer agreed, since I started immediately.

Income Statements (aka Profit & Loss Statements)

The tool used to determine if more money is coming in than going out is the income statement. The income statement is an invaluable business tool that accountants and business managers use.

If you own your medical practice or you are a shareholder, I'm sure you've looked at an income statement before.

But do you know what is an income statement exactly? And why is it important that we review it so carefully? Let us first define it.

The income statement is a summary of the revenue and expenses of an organization in a given period. It is important to understand this document because it gives you the ability to determine how well the practice is doing in terms of generating revenue.

Generally, the income statement is organized using the following categories:

Income from professional services
Income from revenue or cost centered
Income from investments

The income statement also contains expenses, usually categorized under:

Dividend expense
Operating expense
Cost of goods sold
Taxes

If the expenses are greater than the income, then the net income will become the net loss, which subtracts from the shareholder's equity. Although basic, many great business people seem to forget this central business principle.

> "Wise are those who learn that the bottom line doesn't always have to be their top priority."
>
> -William Arthur Ward

Potential Challenges

One of the obstacles that makes budgeting difficult to manage for many is that most medical practices do not have a single repository for all the data they need. Unfortunately, data comes from multiple sources.

You have your EMR providing you with potentially valuable data. You also have your accounting software (i.e. Quickbooks) that is tracking all the money that goes out of your bank account. If you are working with an accountant, he or she is sending you monthly reports (i.e. ledgers, and income statements, to name a few) that are also valuable information.

Furthermore, you have your practice management system, which has all kinds of reporting capabilities (most of them do). **Tip & Tools Of The Trade**

To help with the challenges of managing multiple sources of data, experts recommend that at least one shareholder be assigned to maintain oversight of the data. This person needs to understand the business concepts discussed in these resources, as well as have a keen awareness of how the figures may or may not affect the practice's bottom line.

Experts also recommend assigning a person to gather the data on a monthly basis and put it into a format that can be easily read and understood by stakeholders.

This person does not have to be the designated shareholder tasked with oversight, but it can

be. The recommendation is to have the practice administrator or office manager complete the work of gathering the data and compiling it. Not the doctor.

Simply put, a doctor's time is always better spent seeing patients.

For many practices, however, the notion of having someone else perform these tasks is a dream. The reality is that many practices do not have the good fortune of finding or employing someone with the skillset to perform tasks such as budgeting and monthly reporting.

Spreadsheets Are Your Friend

Whether your practice has the human resources or not, it is highly recommended to use Excel (or similar spreadsheet programs) to manage the budgeting process.

A spreadsheet program will not only mitigate the challenge of data overload, but it will also provide you with the flexibility to look at your practice's financials dynamically, instead of a static printout.

Therefore, if you are unfamiliar with spreadsheets, it is recommended that you learn at least the basics. Investing just a few hours into studying how to use this program will yield significant dividends for years.

I can tell you by experience that not only will the budgeting process be simpler and less complicated to manage, but by knowing your way around any spreadsheet program, your chances of becoming a better manager (not to mention a better business owner) will increase significantly.

Now that we have a better understanding of cost accounting and basic cost fundamentals, we are ready to turn the corner to the next phase of our preparation and begin preparing a real budget.

In this section, we will unpack cost in detail by discussing your practice's two biggest expenditures, how to read an income statement report and what goes into one.

We will also pick up our cost allocation method discussion and illustrate, with a more hands-on approach, how costs are allocated correctly using a real practice's profit and loss report.

Lastly, in this section, we will discuss a few reports from the computer programs you already have in your practice to help you begin to get a glimpse of how the budget comes together.

Two Largest Expenses In A Medical Practice: *Labor & Vaccines*

We won't spend time discussing the business side of vaccine procurement, other than to say it is an expense you should monitor carefully.

We will spend time understanding labor costs though.

Graph 1

LABOR COST	DIRECT	EMPLOYER
Wages - Staff	●	
Wages - Physicians	●	
Wages - Overtime	●	
Bonuses - Staff	●	
Bonuses Physicians	●	
Severance Pay	●	●
Employer Fica		●
Employer Medicare		●
Workers' Compensation Insurance		●
Federal Unemployment		●
State Unnemployment		●
Vacation Pay		●
Holiday Pay		●
Sick Pay		●
Employer Provided Health Insurance		●
Employer Provided Life Insurance		●
Employer Provided 401k Contributions		●
Employer Provided Long/Short Term Disability		●
Employer Provided IRA Contributions		●
Employer Provided Pensions & Retirement		●

The graph on this page shows the costs associated with having employees.

Notice the graph has three columns.

The first one lists all the labor cost items.

The next is designated "Direct" and the other "Employer."

The Direct column has circles, which represents the expenses and/or costs associated with employing a person.

Looking over to the "Employer" column, you will see that the list is even longer. The circles designate the employer's additional costs.

The chart's purpose is to highlight that there are more costs associated with employing a person than just wages.

Also crucial is notion that these other labor costs must be accounted for as well in the budgeting process.

Labor Cost Tend to Be Overlooked

Managing physicians and practice managers often overlook these additional expenses. I know I did when I was preparing budgets.

When I first started managing our practice, I accounted for increases in labor cost by doing the most simplistic math.

Here's how I would budget for employee salaries. I would take the employees' hourly rate and multiply it by 2000 (average hours worked in a year).

So, if the employee made, say $13 an hour, I'd budget for $26,000.

In retrospect, this was a mistake. Later I realized that the hourly rate we paid an employee was not even close to the entire labor cost for the employee.

I became aware of these additional labor costs when we were in the middle of a contract negotiation with an employed physician.

We hired a practice management consultant to help us manage and guide us through the process.

In the analysis phase (similar to the process we will review later in this workbook), the consultant shared with us a breakdown of the employed physician's "real" cost.

When negotiating or budgeting for physician salary, bonuses, and benefits, the items designated by as Employer become even more important as high-income earners cost the practice more in taxes, payroll liabilities and 401(k) contributions (if based on a percentage of income, for example).

As we have established in this resource, labor cost is one of the most costly expenses to your practice. Thus, it is of utmost importance to be aware of these expenditures. Otherwise, if not properly accounted for, your budget is not going to be accurate.

Moreover, failing to understand the depth of employee related costs, both for exempt and nonexempt employees, is seriously detrimental to the financial health of your practice.

Real World Application

In the next page, you will see a comprehensive spreadsheet that consultants use to assess the financial health of practices. Specialists in practice management use the example below in many ways.

They prefer this sheet because with a quick glance at the numbers, the sheet reveals a multitude of information about any medical practice.

In the next few sections, we will dissect the spreadsheet so that you too can use one like this to obtain a clear picture of your practice's financial health.

Included in the resource packet is a template similar to the illustration below to help you get started.

Graph 2

5-FTE Pediatric Sample	Total	Professional Services	Laboratory	Radiology	Vaccines	Billing Office	Admin
Professional Fees	$ 6,450,000	$ 5,440,000	$ 300,000	$ 60,000	$ 650,000		
Contractual Adjustments	$ (1,550,000)	$ (1,383,550)	$ (76,258)	$ (15,193)	$ (75,000)		
Bad Debt	$ 16,250	$ 12,500	$ 2,000	$ 500	$ 1,250		
Net Revenue	**$ 4,916,250**	**$ 4,068,950**	**$ 225,743**	**$ 45,308**	**$ 576,250**	**$ -**	**$ -**
Other Income	$ 2,600	$ 2,600					
Total Revenues	**$ 2,600**	**$ 2,600**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Bonuses - Physicians	$ 500,000	$ 500,000					
Bonuses - Staff	$ 25,000	$ 9,200	$ 2,600	$ 1,400		$ 2,400	$ 4,600
Wages - Overtime	$ 18,500	$ 18,500					
Wages - Physicians	$ 675,000	$ 675,000					
Wages - Staff	$ 625,000	$ 200,000	$ 65,000	$ 35,000	$ 30,000	$ 60,000	$ 115,000
Total Salaries & Wages	**$ 1,845,000**	**$ 1,402,700**	**$ 67,600**	**$ 36,400**	**$ 30,000**	**$ 62,400**	**$ 121,100**
Employer FICA	$ 115,000	$ 89,301	$ 4,214	$ 2,269		$ 3,889	$ 7,548
Employer Medicare	$ 25,000	$ 19,413	$ 916	$ 493		$ 846	$ 1,641
Federal Unemployment	$ 1,500	$ 1,165	$ 55	$ 30	Could Be Allocated	$ 51	$ 98
State Unemployment	$ 6,000	$ 4,659	$ 220	$ 118		$ 203	$ 394
Workers' Compensation Insurance	$ 2,500	$ 1,941	$ 92	$ 49		$ 85	$ 164
Total Payroll Related Expenses	**$ 150,000**	**$ 116,480**	**$ 5,496**	**$ 2,959**	**$ -**	**$ 5,073**	**$ 9,845**
Employer Provided 401 K Contributions	$ 7,500	$ 5,824	$ 275	$ 148		$ 254	$ 492
Employer Provided Health Insurance	$ 100,000	$ 77,653	$ 3,664	$ 1,973		$ 3,382	$ 6,564
Employer Provided Pensions & Retirement	$ 7,500	$ 5,824	$ 275	$ 148	Could Be Allocated	$ 254	$ 492
Sick Pay	$ 5,000	$ 3,883	$ 183	$ 99		$ 169	$ 328
Vacation Pay	$ 85,000	$ 66,005	$ 3,114	$ 1,677		$ 2,875	$ 5,579
Total Benefits	**$ 230,150**	**$ 178,719**	**$ 8,433**	**$ 4,541**	**$ -**	**$ 7,784**	**$ 15,106**
Answering Service	$ 12,000	$ 12,000					
Billing Service	$ 135,000	$ 113,860	$ 6,279	$ 1,256	$ 13,605		
Building Maint & Repair	$ 1,000	$ 710	$ 39	$ 52		$ 97	$ 65
Consultants	$ 2,500						$ 2,500
Copying Machine Rental	$ 2,400	$ 1,500				$ 200	$ 200
Equipment - General	$ 150						$ 150
Janitorial	$ 2,000	$ 1,419	$ 77	$ 103	Depending on Set Up	$ 194	$ 129
Laboratory- Supplies	$ 35,000		$ 35,000				
Malpractice Insurance	$ 30,000	$ 30,000					
Marketing	$ 15,000	$ 15,000					
Office Equipment	$ 500						$ 500
Office Supplies	$ 13,500	$ 7,500	$ 500	$ 500		$ 2,500	$ 2,500
Postage Meter	$ 1,500	$ 250				$ 1,000	$ 250
Rent	$ 120,000	$ 85,161	$ 4,645	$ 6,194	Depending on Set Up	$ 11,613	$ 7,742
Society Dues	$ 600	$ 600					
Software - Maintenance	$ 12,500	$ 10,000					$ 2,500
Supplies- Medical	$ 50,000	$ 50,000					
Telephone Lines	$ 15,000	$ 12,000				$ 1,000	$ 1,000
Trash	$ 850	$ 603	$ 33	$ 44		$ 82	$ 55
Travel Expense	$ 2,500						$ 2,500
Triage Service	$ 50,000	$ 50,000					
Uniforms	$ 600	$ 120	$ 120	$ 120		$ 120	
Utilities	$ 20,000	$ 14,194	$ 774	$ 1,032	Depending on Set Up	$ 1,935	$ 1,290
Operating Expenses	**$ 1,165,700**	**$ 520,868**	**$ 56,217**	**$ 15,500**	**$ 513,605**	**$ 20,741**	**$ 30,981**
Total Expenses	**$ 3,390,850**	**$ 2,218,766**	**$ 137,746**	**$ 59,400**	**$ 543,605**	**$ 95,998**	**$ 177,032**
Physician Related Items (Sal & Bon Only)	**$ 1,175,000**	**$ 1,175,000**					
Total Non-Physician Related Expenses	**$ 2,215,850**	**$ 1,043,766**	**$ 137,746**	**$ 59,400**	**$ 543,605**	**$ 95,998**	**$ 177,032**
Earnings Before Physician Comp	**$ 2,700,400**	**$ 3,025,184**	**$ 87,997**	**$ (14,093)**	**$ 32,645**	**$ (95,998)**	**$ (177,032)**

What Are We Looking At?

The spreadsheet is a sample of a completed budget/financial statement for a pediatric group with five full-time employees (FTE).

The left column compiles the practice's yearly revenue and itemized expenses. It starts with a total of the professional fees, then breaks out physician and employee bonuses and wages, and ends with a subtotal of payroll-related expenses.

Graph 3

5-FTE Pediatric Sample		Total
Professional Fees	$	6,450,000
Contractual Adjustments	$	(1,550,000)
Bad Debt	$	16,250
Net Revenue	**$**	**4,916,250**
Other Income	$	2,600
Total Revenues	**$**	**2,600**
Bonuses - Physicians	$	500,000
Bonuses - Staff	$	25,000
Wages - Overtime	$	18,500
Wages - Physicians	$	675,000
Wages - Staff	$	625,000
Total Salaries & Wages	**$**	**1,845,000**

If we continue further down, we see totals for benefits and a breakdown of the practice's operational costs.

The top portion has the cost centers separated by each area of the practice. As you can see graph 4, this practice chose to allocate cost by revenue/cost center.

Graph 4

5-FTE Pediatric Sample		Total		Professional Services		Laboratory		Radiology		Vaccines		Billing Office		Admin
Professional Fees	$	6,450,000	$	5,440,000	$	300,000	$	60,000	$	650,000				
Contractual Adjustments	$	(1,550,000)	$	(1,383,550)	$	(76,258)	$	(15,193)	$	(75,000)				
Bad Debt	$	16,250	$	12,500	$	2,000	$	500	$	1,250				
Net Revenue	**$**	**4,916,250**	**$**	**4,068,950**	**$**	**225,743**	**$**	**45,308**	**$**	**576,250**	**$**	**-**	**$**	**-**

Charges Receivables & Adjustments

I mentioned earlier in the workbook that all budgets have two principal components: the Cost and Revenue side. In this illustration, we see both the costs and income side-by-side on the spreadsheet.

We have not yet discussed the revenue part of the budgeting process. However, the revenue numbers are included because they are an integral component of the financial assessment process that leads to a budget.

The upper part of the example highlights the revenue of a Five-FTE pediatric practice. Reading from top to bottom, starting with the **Total** column, we see the group's professional fees are $6.4 million, their contractual adjustments are $1.5 million and their net revenue is $4.9 million when we round the numbers and subtract the practice's bad debt.

Graph 5

5-FTE Pediatric Sample		Total
Professional Fees	$	6,450,000
Contractual Adjustments	$	(1,550,000)
Bad Debt	$	16,250
Net Revenue	**$**	**4,916,250**

The columns next to the total are the practice's cost/revenue center. Reading graph 6 left to right, we see that $4 million of the practice's $4.9 million net revenue came from professional fees after contractual adjustments. We also observe that $225,773 came from the laboratory revenue, $45,308 from revenue generated by their Radiology cost center and $576,250 from vaccines.

Graph 6

Professional Services		Laboratory		Radiology		Vaccines
$ 5,440,000	$	300,000	$	60,000	$	650,000
$ (1,383,550)	$	(76,258)	$	(15,193)	$	(75,000)
$ 12,500	$	2,000	$	500	$	1,250
$ 4,068,950	**$**	**225,743**	**$**	**45,308**	**$**	**576,250**

Separating The Income by Revenue/Cost Center

One of the first questions that came to mind when I was first shown a similar spreadsheet was, how does one distribute the revenue among the categories (i.e. professional services versus the revenue that is applied to laboratory and so forth?). The answer lies in your practice management reporting system.

Using Your Practice Management System

To allocate revenue by cost/revenue center, you will need to run a report from your practice management system that filters the data by CPT code.

To identify the charges and receivables for each cost/revenue center, you will need to sort data (ascending or descending order, it does not matter) so that the codes are grouped.

Once sorted, then the amounts can be applied to your spreadsheet by departments using coding nomenclature. All the codes that start with (8) are laboratory codes; the codes that start with a (7) are radiology, and so forth.

If you are not familiar with the coding nomenclature, consider running a CPT report that includes descriptions for each code.

In the next page, I've included an example of a sorted CPT report.

Graph 7

Procedure Description	Charges	Current Charges	Payments	Contractual Adjustments	Net Receivable
10060: I&D ABSCESS; SIMPLE OR SINGLE	x	$X.XX	$X.XX	$X.XX	$X.XX
17250: CHEMICAL CAUTERIZATION	x	$X.XX	$X.XX	$X.XX	$X.XX
36415: VENIPUNCTURE	x	$X.XX	$X.XX	$X.XX	$X.XX
36416: BLOOD SPECIMEN COLLECTION	x	$X.XX	$X.XX	$X.XX	$X.XX
41010: INCISION OF LINGUAL FRENUM	x	$X.XX	$X.XX	$X.XX	$X.XX
69200: REMOVAL FOREIGN BODY FROM EXTERN	x	$X.XX	$X.XX	$X.XX	$X.XX
69210: CERUMEN REMOVAL (EAR)	x	$X.XX	$X.XX	$X.XX	$X.XX
81002: URINALYSIS W/O MICROSCOPY	x	$X.XX	$X.XX	$X.XX	$X.XX
81025: URINE PREGNACY TEST	x	$X.XX	$X.XX	$X.XX	$X.XX
82270: BLD OCCLT PEROX ACT,FECES1-3 DET	x	$X.XX	$X.XX	$X.XX	$X.XX
83655: LEAD BLOOD ANALYZER	x	$X.XX	$X.XX	$X.XX	$X.XX
85018: HEMOGLOBIN, BLOOD COUNT	x	$X.XX	$X.XX	$X.XX	$X.XX
86308: HETEROPHILE ANTIBODIES, SCREENIN	x	$X.XX	$X.XX	$X.XX	$X.XX
86580: TUBERCULOSIS SKIN TEST	x	$X.XX	$X.XX	$X.XX	$X.XX
87804: INFLUENZA RAPID FLU TEST	x	$X.XX	$X.XX	$X.XX	$X.XX
87807: INFECT AGNT ANTIGEN DETECTION	x	$X.XX	$X.XX	$X.XX	$X.XX
87880: STREPT GRP A TEST	x	$X.XX	$X.XX	$X.XX	$X.XX
88738: TTL HGB, QUANTATIVE & TRANS	x	$X.XX	$X.XX	$X.XX	$X.XX
90460: IMMUN ADMIN FIRST COMPONENT	x	$X.XX	$X.XX	$X.XX	$X.XX
90461: IMMUN ADMIN ADD'L COMPONENT	x	$X.XX	$X.XX	$X.XX	$X.XX
90473: IMMUNIZATION ADMINISTRATION INTRANASAL/ORAL ROUTE	x	$X.XX	$X.XX	$X.XX	$X.XX
90633: HEP A VACCINE	x	$X.XX	$X.XX	$X.XX	$X.XX
90648: HIB VACCINE (ACTHIB)	x	$X.XX	$X.XX	$X.XX	$X.XX
90649: HPV	x	$X.XX	$X.XX	$X.XX	$X.XX
90651: HUMAN PAPILLOMAVIRUS VACCINE TYPE 9	x	$X.XX	$X.XX	$X.XX	$X.XX
92567: IMPEDANCE TESTING (TYMPANOMETRY)	x	$X.XX	$X.XX	$X.XX	$X.XX
92587: HEARING SCREEN (TEST)	x	$X.XX	$X.XX	$X.XX	$X.XX
94640: AIRWAY INHALATION TREATMENT	x	$X.XX	$X.XX	$X.XX	$X.XX
94664: DEMNSTRT/EVALUATE PT USE OF INHA	x	$X.XX	$X.XX	$X.XX	$X.XX
94760: NONINVASIVE EAR/PULSE OXYMETRY	x	$X.XX	$X.XX	$X.XX	$X.XX
94761: NONINVASIVE EAR OR ULSE OXIMETRY	x	$X.XX	$X.XX	$X.XX	$X.XX
96110: DEVELOPMENTAL TEST, LIMITED	x	$X.XX	$X.XX	$X.XX	$X.XX
96127: BRIEF EMOTIONAL/BEHAVIORAL ASSESSMENT	x	$X.XX	$X.XX	$X.XX	$X.XX
99000: HANDLING OF SPECIMEN	x	$X.XX	$X.XX	$X.XX	$X.XX
99051: SERVICES EVENING & WEEKENDS	x	$X.XX	$X.XX	$X.XX	$X.XX
99173: VISION SCREEN	x	$X.XX	$X.XX	$X.XX	$X.XX
99201: NEW OFFICE VISIT LEVEL I	x	$X.XX	$X.XX	$X.XX	$X.XX
99202: NEW OFFICE VISIT LEVEL II	x	$X.XX	$X.XX	$X.XX	$X.XX
99203: NEW OFFICE VISIT LEVEL III	x	$X.XX	$X.XX	$X.XX	$X.XX
99213: EST OFFICE VISIT LEVEL III	x	$X.XX	$X.XX	$X.XX	$X.XX
99214: EST OFFICE VISIT LEVEL IV	x	$X.XX	$X.XX	$X.XX	$X.XX
99215: EST OFFICE VISIT LEVEL V	x	$X.XX	$X.XX	$X.XX	$X.XX
99222: INITIAL HOSPITAL CARE LEVEL II	x	$X.XX	$X.XX	$X.XX	$X.XX
99223: INITIAL HOSPITAL CARE LEVEL III	x	$X.XX	$X.XX	$X.XX	$X.XX
99232: SUBSEQUENT HOSP CARE LEVEL II	x	$X.XX	$X.XX	$X.XX	$X.XX
99233: SUBSEQUENT HOSP CARE LEVEL III	x	$X.XX	$X.XX	$X.XX	$X.XX
99238: HOSPITAL DISCHARGE	x	$X.XX	$X.XX	$X.XX	$X.XX
99243: OFFICE CONSULATION LEVEL III	x	$X.XX	$X.XX	$X.XX	$X.XX
99244: OFFICE CONSULATION LEVEL IV	x	$X.XX	$X.XX	$X.XX	$X.XX
99291: CRITICAL CARE, FIRST 30-74 MIN	x	$X.XX	$X.XX	$X.XX	$X.XX
99381: NEW PREVENTIVE WELLNESS <1 YR	x	$X.XX	$X.XX	$X.XX	$X.XX
99382: NEW PREVENTIVE WELLNESS 1-4 YR	x	$X.XX	$X.XX	$X.XX	$X.XX
99383: NEW PREVENTIVE WELLNESS 5-11 YR	x	$X.XX	$X.XX	$X.XX	$X.XX
99391: EST PREVENTIVE WELLNESS <1 YR	x	$X.XX	$X.XX	$X.XX	$X.XX
99392: EST PREVENTIVE WELLNESS 1-4 YR	x	$X.XX	$X.XX	$X.XX	$X.XX
99393: EST PREVENTIVE WELLNESS 5-11 YR	x	$X.XX	$X.XX	$X.XX	$X.XX
99394: EST PREVENTIVE WELLNESS 12-17 YR	x	$X.XX	$X.XX	$X.XX	$X.XX

How Cost is Allocated

Using the same sample spreadsheet, let us move down and focus on the items included in the practice's operating expenses. Keep in mind that everything that comes after the Total Revenue line is considered an expense. In other words, we are talking about cost again.

Let's take a look at the answering service from the expenses column as an example (Graph 8). In the spreadsheet, the practice spent $12,000 on answering services. Notice that the entire $12,000 remained allocated to professional services.

Building maintenance and administration also went to professional services, but notice the costs are assigned to other areas of the practice.

Graph 8

Answering Service	$ 12,000	$ 12,000						
Billing Service	$ 135,000	$ 113,860	$ 6,279	$ 1,256	$ 13,605			
Building Maint & Repair	$ 1,000	$ 710	$ 39	$ 52		$ 97	$ 65	

Another example we can learn from is Wages-Staff (see Graph 9). We can see the practice spent $625,000 on staff wages. Because this medical practice separates their cost/revenue centers, you can see how they allocate the salary expenses accordingly, thus allowing them (or practice management consults and now you) to have a clear view

Graph 9

Wages - Overtime	$ 18,500	$ 18,500					
Wages - Physicians	$ 675,000	$ 675,000					
Wages - Staff	$ 625,000	$ 200,000	$ 65,000	$ 35,000	$ 30,000	$ 60,000	$ 115,000

of what are the costs for each area of the practice.

Cost / Revenue Allocation

Expense	
401k Employer Contributions	13,568.81
Advertising Expense	14,922.57
Bank Charges & Fees	3,886.41
Business Licenses and Fees	100.00
Computer Expenses	27,657.34
Dues & Subscriptions	3,554.81
Dues & Subscriptions-JB	0.00
Equipment Leasing	407.69
Insurance Expense	
Business Insurance	4,789.25
Disability Insurance	4,650.53
Total Insurance Expense	**9,439.78**
Malpractice Insurance	
Malpractice Insurance- Physician 1	11,949.77
Malpractice Insurance- Physician 2	11,794.66
Malpractice Insurance- Mid-Level 1	2,603.79
Total Malpractice Insurance	26,348.22
Interest Expense	6,157.28
Meals & Entertainment	5,005.51
Medical Dues & Licenses	2,329.00
Medical Expenses-(Employees)	0.00
Merchant Card Fees	1,647.73
Miscellaneous Expense	44.85
Office Supplies	28,757.39
Payroll Expense	832,130.55
Postage & Freight	2,101.17
Rent Expense	53,701.01
Repairs and Maintenance	1,011.01
Seminars, Education & Training	2,157.76
Telephone Expense	10,589.52
Travel Expense	5,394.33
Uniform Expense	1,212.40
Website Expense	867.00
Total Expense	**1,052,992.14**

We discussed that to obtain the income figures depicted in the examples above, one needed to run a report by CPT code. But where do we collect the data for the practice's expenses? The answer lies in your General Ledger Report.

General Ledger Report

The General Ledger Report is primarily a record of your practice's financial transaction. If you have Quickbooks or any other accounting software equivalent, you should have no problem in getting this report.

Moreover, my guess is that you already receive a similar report, called a Profit & Loss or Net Income Report, from your accountant. You can ask the accountant to provide the P&L in a spreadsheet format (or export it yourself), and the expense data will be mostly compiled already.

Where Are We Going?

Pretend you are a practice management consultant and you are given the sheet for the 5 -FTE provider practice to review.

What draws your attention? What are questions that come to mind? Can you determine if this practice is profitable or losing money?

How much are their operating expenses? How much money is left over before physician compensation? Is there enough money left over to pay pediatricians and shareholders after expenses are paid?

If you handed this sheet to a practice management consultant, they would most likely review it like this.

The practice's operating expenses are $1,165,700.

Of which, $520,868 went towards professional services, $56,217 went to the laboratory (most of the cost were allocated to supplies), and $20,741 was assigned to the billing office and so forth.

If this spreadsheet represented my practice, I could tell you, with confidence, how much it costs us to remain open for business before physician expenses ($1,165,700).

I can also state, with certainty, that the practice took in $4.9 million and that after expenses, the practice is left with $2.7 million before physician and shareholder compensation.

Benefits Of The Cost Accounting Method

It is worth mentioning that the goal is not to be overly compulsive over the data and the numbers. You do not want your analysis too granular since you could easily miss the big picture.

Still, for the purpose of budgeting, a certain level of specificity is certainly a worthwhile time investment because it helps you identify how much it costs your practice to manage these areas of the practice.

For example, looking at the billing line item, you may determine that outsourcing the billing may cost you less, thus allowing you to repurpose the billing staff to do other things.

Alternatively, you may determine that your advertising expenses could be put to better use by updating your practice's website.

These are decisions that you probably already make but without data. And without the data we've reviewed so far, your decisions are no better than flying a plane without instruments, relying only your gut instincts.

Without hard figures, how do you have any real assurance that outsourcing the billing department or repurposing your advertising expenses are wise business choices?

The Budgeting Process

Step by step guide

Step 1—Estimate Expenses

I usually start the budgeting process by determining the practice's expenditures for the coming year. Recently though, I discovered that some of my colleagues begin the process by estimating the revenue first.

There are valid arguments for each first step. Still, I am choosing my preferred method because, well, it is the way I am most familiar with. But I believe you benefit equally regardless of how you begin. The important thing is just to begin.

Having said that, the first step of creating a budget is estimating your practice's expenses for the upcoming year. So I start the exercise by reviewing our practice's "actual" expenses for the prior year.

Income Statement or Profit & Loss Statement

I rely on my accountant for this information, although sometimes I grab the data myself directly from Quickbooks.

The recommendation is to obtain the practice's expenses report as early in the year as possible. Keep in mind that your accountant may not have the practice financials completed by early January.

However, they will most certainly have a preliminary report. If they do not have one, ask for it. Generating a prelim report on expenses entails little more than pressing a few buttons on a keyboard.

The purpose of Step 1 is to frame your mind around anticipating cost increases (and in some cases cost decreases) that the practice will incur.

For example, is your practice

planning on hiring staff? If so, significant adjustments to the salary expense and employee liabilities will need to be made.

How about your rent? Is your practice at the end of a five-year lease? Is the rent expected to increase? Perhaps you are considering opening another location?

What areas need to be reconsidered from a cost perspective?

Going through the expense report line by line also serves another important purpose. For me, the exercise often draws my attention to areas of the practice that need to be further examined.

For example, I may look at our practice's cost for health insurance or advertising and follow up with those cost items later to make sure we're not receiving a smaller benefit from the same or higher costs.

If the line item appears high, I may consider exploring opportunities to reprice our employees' health insurance premiums.

I also may take into account repurposing the money allocated to advertising into things like Search Engine Optimization (SEO) or make an improvement to our website.

Accounting For Specials Circumstances

Show of hands. How many have heard these questions or variations of these questions before? "What do you mean you don't know what's wrong with my child?" "Why isn't the medication you prescribed working?" "How long be before she gets better?"

Conventional wisdom leads many to believe that because medicine is a discipline in science, then outcomes, results, and conditions are well documented and easily anticipated. Hence, the reason many parents are dumbfounded when doctors don't have exact answers for them about their child.

What many parents and patients do not realize is that there's just as much art to medicine as science.

Business in general, but specifically budgeting, is similar to medicine in that it is not always exact. When you are budgeting, you are engaging in a sophisticated game of guessing.

In other words, based on the "dated" information you currently have, you are attempting to assert what will happen in the future.

But that does not mean we can throw our hands up and hope for the best. First, we need to be flexible. Second, we need to make an extra effort to adapt for special circumstances. And we can best respond to special circumstances by using the acronym LOAD.

The LOAD technique helps organize potential situations and categorize them so you can make the decision if these costs should be

factored into a reserve category on your budget. Here are some steps you can take to determine if you need to budget for additional special circumstances:

List all potential issues that could affect the budget throughout the budget period.

Order the issues from the least likely to occur to the most likely.

Assess the cost of each issue if this circumstance were to manifest as reality.

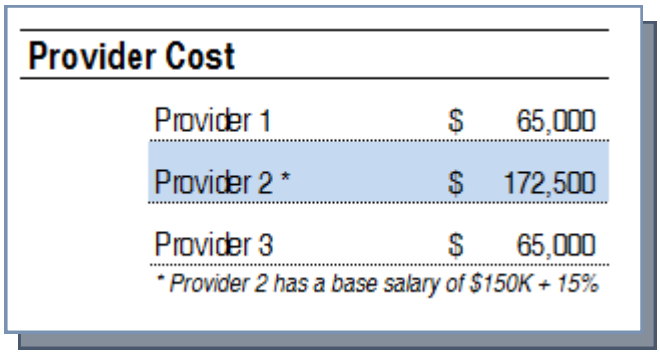
Determine if this cost should be factored in to a contingent reserve category on your budget.

Step 2–Determine Provider Cost

If you are a solo physician, you may consider skipping this step. However, if you have employed physicians, then it's important to determine your employed provider's labor cost. Remember, this step needs to be performed before shareholder compensation is determined.

Experts recommend that provider cost be estimated, and reported separate from other expenses. Doing so helps the budgeting process in many ways, but the main reason is that it simplifies the process.

Graph 10



We will discuss the benefits further in Step 3 - Estimating Revenue.

So let's take a look at the breakdown of our provider cost. In the illustration, we see provider 1 & 3 are part-time employees. In essence, 1 FTE when we combine those two providers.

Provider 2 is a full-time provider. His compensation consists of $150k base salary plus a 15% incentive based on production. Provider 2's total compensation is $172,500.

Keep in mind that practice administrators and physician managers tend to underestimate labor cost. To refresh your memory, you can revisit what were the two primary expenses for a medical practice.

Step 3—Estimate The Revenue

My friend Paul Vanchiere, co-founder of the Pediatric Management Institute, has been working in healthcare for a long time. He began his career in healthcare before he even knew it was a career.

His dad—a pediatrician as well- was the CEO of a 18-physician independent pediatric practice when he was growing up.

After college, Paul returned to work for his father. And before opening his own consulting firm, he worked for one of the largest children's hospitals in the country as a financial analyst, among other responsibilities.

Paul helped managed the revenue side of budgeting for about 200 general pediatricians. According to public records, this particular network's physicians compensation budget is in the neighborhood of $80,000,000.

Talking to Paul one day, I mentioned that I thought a network that size would have a sophisticated system in place to create a budget. He said to me, "Actually, it is really easy."

I perked up as if I was going to receive the numbers for the winning lottery. This was the person that did what I was doing but on a big scale.

If I could find out how a large children's hospital does their budgeting, then I'd have a proven, fail-safe budgeting method for any pediatrician's practice.

Paul said they use a straightforward method with just three pieces of information:

Revenue per Encounter
Days Worked
Encounters per Day

Huh? Is that all?

He assured me that was all the extensive network needed to estimate physician revenue.

So, if this is the way large children's hospitals do it, then I see no reason why we ought to recreate the wheel. So let us talk about these 3 -part data sets and how the figures apply to our revenue estimation step.

a) REVENUE PER ENCOUNTER

To obtain the revenue per encounter, you will need to turn to your practice management system. Run a report that totals the practice income for an entire year.

Using the same report or another report from your practice

$$\frac{\text{Total revenue for the year}}{\text{Total encounters}}$$

Now let us work the formula using approximate numbers to get a better sense. Let's say your practice generated $725,000 in 2015. The total number of encounters during the same period was 5750. Let's plug the numbers to see what the revenue per encounter is.

Total Revenue for the Year: $725,000

Total Encounters: 5750

Replace the description with the numbers and we have our revenue per encounter.

$$\frac{\$725{,}000}{5750} = \$126$$

The Power of Revenue Per Encounter

Before moving forward to the second item on Paul's list, I wanted to spend a moment talking about how important it is to calculate this value and how it can be used in other areas besides budgeting.

Simply put, revenue per encounter is among the most important figures you can monitor. For starters, it is an excellent barometer of your practice's financial health.

A consistently healthy revenue per encounter assures strong financial results. Furthermore, monitoring your revenue per encounter alerts you of potential pitfalls. For example:

Are claims being processed timely?
Are claims being paid correctly?
Is the practice being paid fairly?
Is your payer mix excellent, fair or poor?
Are you following proper CPT coding guidelines?
Accounting for seasonality

Back to budgeting and revenue estimation

Graph 11

Month	Revenue	Encounters	Revenue Per Encounter
Annualized	632,222	4140	152.71

An important consideration to make is determining which number to use in your budget for your revenue per encounter.

In other words, should one use the **annualized** or **monthly** revenue per encounter number?

Although it is easier to divide the revenue value by 12 and call it a day, dividing the income into 12 equal parts has the potential to cloud your view of your practice's finances.

Here is why:

The business of pediatrics is seasonal (which should not be news to you), but that also means expenses tend to trail the income seasons.

School Physician Season

The best example of this is school physical season. This is when practices administer a significant portion of their vaccine inventory to patients. But the invoice for vaccines administered during the summer months are not due until at least 60 to 90 days after the purchase.

In essence, the invoice for a vaccine purchased and administered in July will not be due until September or October.

That is why experts advise against dividing the annualized revenue in 12-equal parts. Instead, customize the timeline for seasonality. You'll notice this method is especially useful when budgeting for months when cost are more likely to increase. Graph 12 gives us a better look at revenue per encounter by month.

Graph 12

Seasonality

Month	Revenue	Encounters	Rev Per Encounter
Jan	$40,827	375	$108.87
Feb	$48,387	400	$120.97
Mar	$43,011	320	$134.41
Apr	$46,297	310	$149.34
May	$49,781	300	$165.94
Jun	$59,000	320	$184.38
Jul	$64,700	370	$174.86
Aug	$68,000	345	$197.10
Sep	$56,765	320	$177.39
Oct	$55,878	350	$159.65
Nov	$51,727	360	$143.69
Dec	$47,848	370	$129.32

Note: Revenue per encounter by physician group or by individual provider?

A common question that many physicians and practice administrators have is: Should revenue per encounter be measured as a group or should it be measured per physician?

There are many variables among physicians. The number of daily encounters each doctor is going to have is different. Same with the number of days worked.

Revenue per encounter is also a significant variable. A young physician may see more newborns and wellness visits whereas a pediatrician that is closer to retirement may not be too interested in seeing newborns. Payer mix would naturally vary widely among them.

Hence, the **answer is per provider.**

It is worth noting that for budgeting purposes, mid-level providers should be treated just like physicians. Therefore, a Nurse Practitioner or Physician Assistant's revenue per encounter should also be determined and monitored in the same way one measures an MD.

b) DAYS WORKED

For this step, what we are looking for is an estimate of how many days a provider is going to work in the coming year. You can use

historical data or simply ask the physician how many days they plan on working.

Practices handle this in various ways. Some take out a calendar and physicians count the exact days they will be working, while others will estimate the amount of vacation or days off they'll take in a year and subtract the number to the total available work days.

The method by which your practice determines the days worked is not as important as settling on a number of days. This data is indispensable to create an accurate budget for your practice.

c) NUMBER OF ENCOUNTERS PER DAY

The final item for estimating revenue is calculating the number of patient visits a provider saw during any given period.

To obtain this data, you will need total number of encounters seen in a given year, per your practice management report. You will also count the number of days worked, as determined in the previous step. Then, simply divide:

$$\frac{\text{Total encounters}}{\text{Working days}}$$

Let's assume a provider took a 2-week vacation and worked 5-days a week for 50-weeks, giving them 250 working days that year. Below, we apply that value to determine the number of encounters per day.

Total Encounters: 5750

Working Days: 250

$$\frac{5750}{250} = 23$$

Now that we have done our research, analysis and run our reports, we can start taking steps towards estimating the revenue for our budget. Below is a graph that illustrates how all the pieces we have been discussing come together.

Graph 13

Revenue Projection By Provider

	Days Worked Per Week	Encounters / Week (18 per day)	Estimated Work Weeks Per Year	Estimated Revenue Generated *
Provider 1	2	36	48	$216,000
Provider 2	4	72	50	$450,000
Provider 3	2	36	50	$225,000
Provider 4	4.5	81	50	$506,250
Total		**225**		**$1,397,250**

** Estimated Revenue is calculated based on an average of $125/enc*

Taking a close look, we see the chart (Graph 13) shows each provider estimated revenue for the year taking into consideration how many days each provider is working; how many encounters each will see a day; and lastly the number of estimated weeks per year the physician or mid-level provider will work.

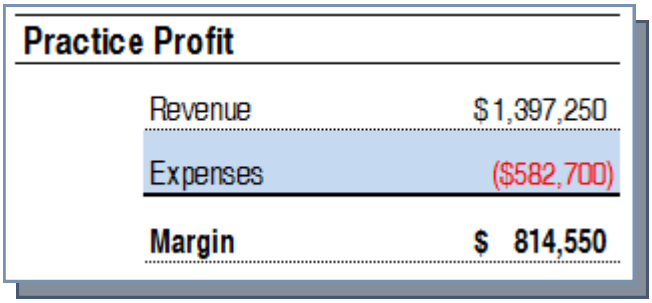
Using our revenue per encounter number we addressed earlier, you can calculate the income for each medical provider.

Step 4—Determine Margin Before Provider Compensation

The next step is to determine your practice's margin. This number is easy to calculate once you have your practice's estimated income and your estimated expenses.

The margin shown in the graph on this page is the remainder of cash. Colloquially, we can refer to it as the practice's pot.

Graph 14



Keep note that the expenses shown in graph 14 do not include provider compensation. I purposely excluded both shareholders and employed physicians' salaries/bonuses out of this equation.

As you may recall from the budget/expense illustration we used earlier, the exercise excluded physician expenditures in the costs but included them under a separate line item.

> "Try, try, try, and keep on trying is the rule that must be followed to become an expert in anything."
>
> -W. Clement Stone

Step 5—Determine Incentive Bonus Cost For Employed Providers

Many practices have arrangements with their employed providers to pay them a percentage after collecting an agreed amount. The agreement may sound something like this: "The provider will receive X% for generated income above $450,000."

The revenue that is required by the provider to generate before receiving additional revenue is referred to as the **threshold**.

Thresholds can make budgeting complicated, because it is hard to estimate the allocated cost for providers. Hence, the recommendation to exclude both employed providers and shareholder salary expenses in the total practice expenses shown in Step 2.

To budget for other or difficult to forecast expenditures, it is easier to calculate them separately. Graph 15 shows an example of how threshold, incentive bonus, and salary can be arranged to budget accurately.

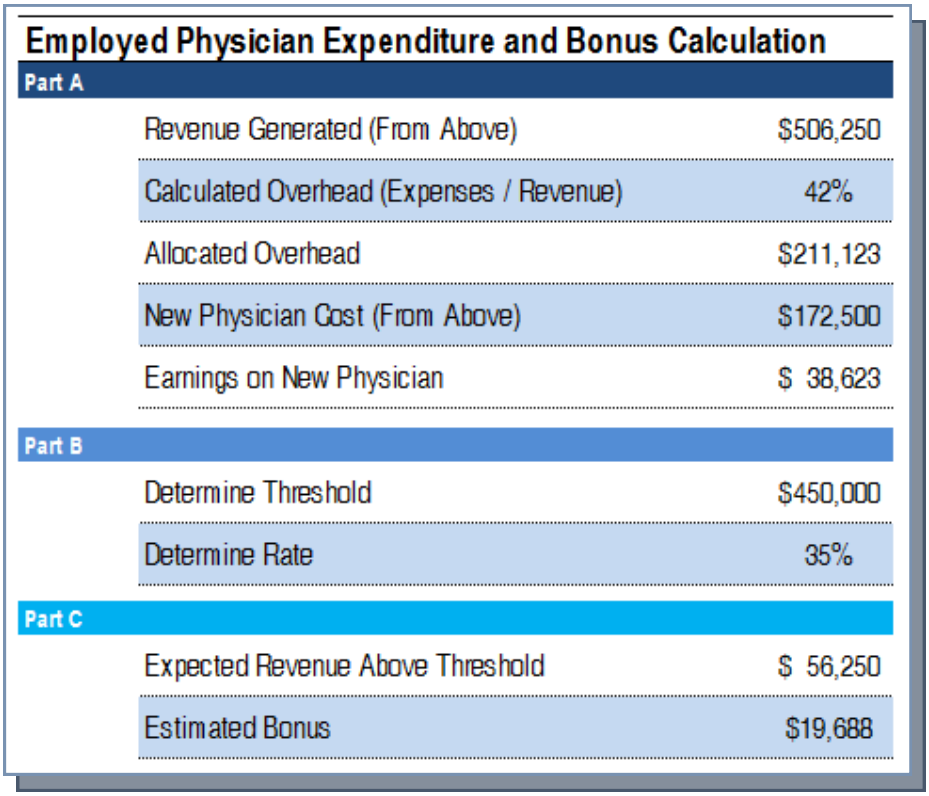
In Step 3, we estimated the revenue for each provider. In this step, we will take Provider 4's estimated revenue and place it in the top right-hand cell of the spreadsheet.

Looking at graph 15, we also see that 42% of overhead is allocated to the physician's estimated revenue; thus, $211,123 is subtracted from the estimated revenue of $506K.

Next is the medical practitioner's salary. We examined this in Step 2.

The last line of Part A shows what the physician earned for the practice: $38,623

Graph 15



Employed Physician Expenditure and Bonus Calculation	
Part A	
Revenue Generated (From Above)	$506,250
Calculated Overhead (Expenses / Revenue)	42%
Allocated Overhead	$211,123
New Physician Cost (From Above)	$172,500
Earnings on New Physician	$ 38,623
Part B	
Determine Threshold	$450,000
Determine Rate	35%
Part C	
Expected Revenue Above Threshold	$ 56,250
Estimated Bonus	$19,688

If your practice has a threshold agreement with the provider or if you do not have one in place, but would like to provide one, Part B is where the threshold is accounted for.

Following the illustration above, the provider receives 35% of revenues received above the $450K threshold.

Pact C contains the calculations of how much it would cost the practice to offer 35% above the $450K threshold.

The first line of Part C "Expected Revenue Above Threshold," subtracts the threshold from the provider's revenue ($506,250). The difference is $56,250. The second line of Part C calculates 35% on the difference between the income and the threshold.

In this example, the practice's profit is $18,936.

Benefits of setting up a template in a spreadsheet

I mentioned early on that learning Excel was a worthwhile endeavor. This step provides a perfect illustration of the benefits of using spreadsheets.

With a pre-configured spreadsheet template, you can explore and create multiple scenarios to determine what the practice can afford to pay. You are able to, for example, adjust the percent amount or the threshold and see the hypothetical results.

Furthermore, the analysis is based on objective data. The process and the tools provide clear detail that will undoubtedly help you make sound, practical, and most importantly, wise business choices.

Instead of using a back-of-the-envelope approach to determine the value of any given provider, you could input the numbers for a physician and determine if they really do generate more revenue than they cost, and by precisely how much.

Candid Conversations

Another tremendous benefit of this approach is the ability to have an open conversation with your employed physicians, using hard numbers to help make tough decisions.

Salary and compensation discussions tend to be passionate.

Employees naturally want the highest compensation possible. And as employers, you want to pay your employees fairly. However, expectations do not always meet reality. Which often leads to hurt feelings, offense, and other uncomfortable situations.

With its spreadsheet and systematic process, Step 5 has the potential to remove, or at least temper, the emotions attached to salary negotiations and discuss the numbers objectively.

The data shows this is not about what providers thinks they deserve. However, about how much they can generate so that you—as a practice—can afford to pay.

Step 6—Determine How Much Is Left For Shareholders

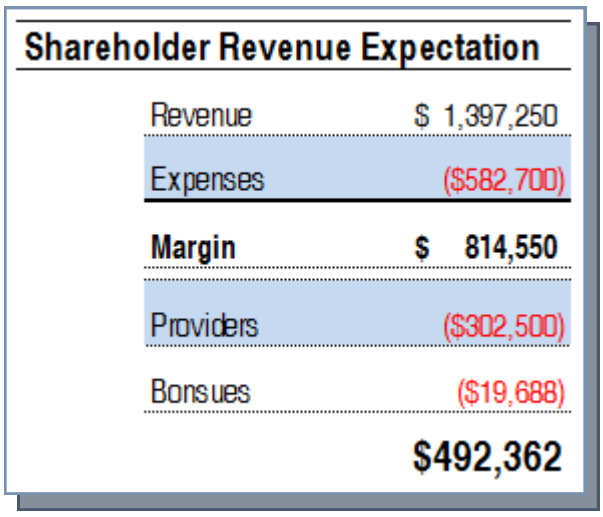
How shareholders pay themselves varies from practice to practice. However, one of the most common ways shareholders distribute profits is by dividing the practice's profit based on a formula at the end of the year.

In real life, it can play out like this. Each shareholder receives a base salary and at the end of the year, if the practice was in the black (e.g. profitable), the proceeds are divided accordingly to a formula specified in the shareholder agreement.

So, how do we know how much will be left in the pot, so to speak? Let's look at the numbers.

This step pulls in the figures we've gathered so far and applies a few simple calculations to determine how much revenue the shareholders have left to work with.

Graph 16



Let's recap. In Step 4, we took our estimated revenue, minus our estimated expenses, to determine the practice's margin. Next, we add up provider's salaries, plus all the bonuses and subtract that number to determine our margin.

In the example above, this practice has nearly $500K to split up among the shareholders.

Step 7—Shareholder Salary & Benefits

This step is a brief overview of how a shareholder's cost can be prepared. Other details, such as shareholder salaries, bonuses, benefits and distribution plans merit their own workbooks.

For the purpose of our budget discussion—and in the interest of thoroughness—I provided a brief illustration to give a complete sample of the budgeting process.

Graph 17

Shareholders Salary & Benefits Calculations	
S1 Mgt Fee	$22,000
S1 - Salary	$105,600
S1 - Total	**$127,600**
S2 - Retirement Contribution	$24,000
S2 - Health Insurance	$22,900
S2 - Life Insurance	$4,800
S2 - Salary	$205,000
S1 - Total	**$209,800**

Let's examine graph 17. We see that Shareholder 1 receives a $22,000 thousand dollars a month in management fees and salary. Shareholder 2's breakdown shows all the different costs that are assigned to them.

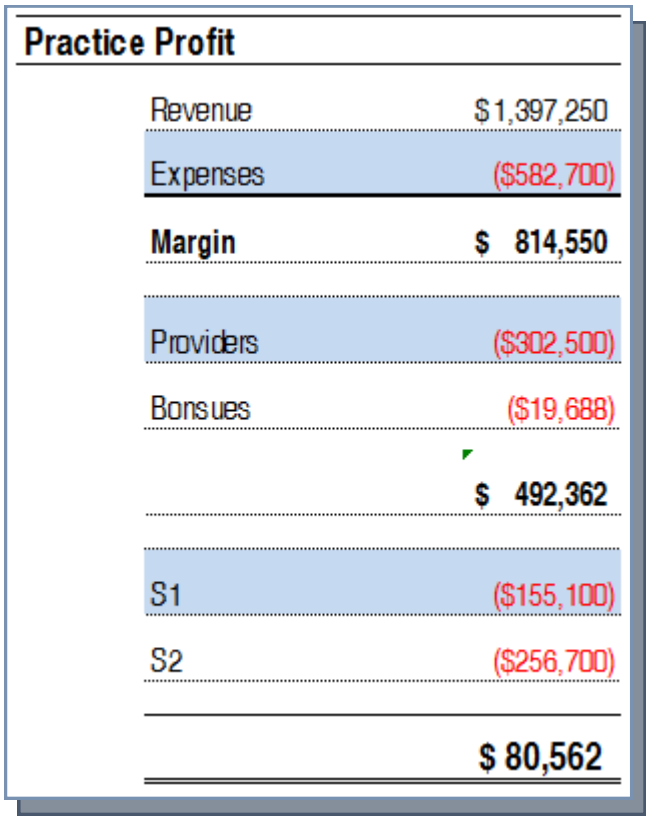
By itemizing each shareholder's cost, the practice gets a crisp, clear view of the practice's financials. I would also argue that documenting expenses one-by-one, brings a level of transparency among shareholder that is based on hard figures and not merely emotions.

Step 8—Determine Practice Profit

The final step is to compile all the results into a single calculation. Let's take a look at the results:

The last graph summarizes each one of the steps and aggregates them into a single estimate.

Graph 18



So, how did we do with our hypothetical budgeting process? According to our graph, the practice's year-end profit is $80,562.

Guess what? You've completed the steps to set up a professional budget for your practice. How does it feel?

Forget It, This Is Too Much Work

We all have certain traits that spark curiosity, motivation, and patience for different things. For example, many people love doing handy work around the house. They like to fix things and tinker around.

I, am not one of those people. I do not have the right talents to do handiwork—I lack curiosity, motivation and above all, patience.

Tell me the toilet needs repairing or there is a leak under the sink, and I flinch. Even a simple task like putting up artwork or hanging curtains is like throwing me a ball of kryptonite. Not only does handy work make me weak, but it seems to render me useless.

Unfortunately, as a homeowner and a dad for many years, I have had no choice but to do some handy work around the house.

What I've come to realize is that my dislike for repairs and fix-ups around the house is partially dictated by my perpetual disorganization and lack of proper tools.

Due to my general disinterest, I tend to not have the right tools for the job. Even the few tools I do have are usually scattered around the house.

So I waste time just gathering tools. Only to find out when I find them that they haven't been charged since the last time I used them. The result? An unpleasant experience, of course, which leads to even more time wasted.

Sometimes things are different

The few times I have worked with proper tools, however, things ran so much better. It is far less frustrating and, I admit, quite satisfying. "Me, man! Hand, work, hard. Me, great! Now kill bison with bare hands!"

Addressing The Burden

You may be thinking that gathering the information for the budget on a monthly basis may be too much—too overwhelming and time-consuming. Not to mention it isn't your thing.

You may even say, "I didn't go to medical school to spend my time staring at spreadsheets!"

But just like things go smoother for me when doing home repairs if I'm organized and have the proper tools, the monthly budgeting process can also be done quickly, efficiently and in a timely manner if you are well prepared with the right tools.

If you set up the reports that you need and have the spreadsheet tailored to your practice, an office manager (or managing partner) can put together a spreadsheet in a couple of hours.

Only Cooks In The Kitchen

I know this suggestion is not practical for all practices, but experts recommend that doctors do not spend time on this task. **Why?**

Because the doctor's time is better spent on patient care. Even when the doctor is the primary stakeholder, it is still best to have someone else gather the information and put it together for them.

Keep Cash Flow Flowing

Early on as an inexperienced practice administrator, I was told by the accountants that the practice had to distribute all the profits to the shareholders before the end of the year.

Our accountant's instructions were in fact common. Many practices disperse the company's revenue (assuming there was a profit) among shareholders rather than accumulate the practice's earnings.

However, this advice presented a problem for the new practice administrator, aka me.

The problem? I did not have enough cash in our checking account to pay expenses for the months of January, February and March. Which, by the way, are the months when flu invoices are due.

Our practice also has a large expense every March. March is when our malpractice insurance renews. The malpractice insurance company used to require payment-in-full for the entire year.

We were able to negotiate quarterly payments, but half of the yearly premium must be paid by March 21st. Ouch.

Like many, we would have to draw on our line of credit to keep paying the bills until cash flow would be restored. And although lines of credit are intended to help business get by when cash flow is low, it seemed to me that this yearly tradition was not only unnecessary but also preventable.

HEDGING YOUR PRACTICE'S CASH FLOW

To mitigate our cash flow problem at the beginning of the year, we instituted a process that would address the need to disperse the funds, while simultaneously protecting the business's cash flow.

At the end of the year, instead of shareholders receiving one check, I would issue two checks (both in aggregate would equal the shareholder's corresponding payout) dated Dec 31st.

The second check could not be deposited until April 14. That small adjustment helped us resolve the issue of depleting our checking account and avoided the need to borrow money to pay the bills.

Who Should Be Involved?

We have already established that creating a budget is a challenging task. Therefore who you decide to include in the budgeting process is an important decision.

Depending on how large your practice is, the budget process will require input from many areas and departments.

As best as you can, incorporate team members and stakeholders that are strategic thinkers, as well as people with the ability and incentive to determine more cost-effective ways of doing things.

In addition, people who understand the business of managing a medical practice and what it takes to generate funds should be a part of the process. This will help to determine how much money the organization will need to make in order to meet budget goals.

Conclusion

It is worth mentioning that the budgeting process is not finite, but rather a series of steps taken to achieve an end. And that end is often is often a moving target.

In fact, some argue the budget itself be a living and breathing thing that is always adjusting, modifying and changing. So keep that in mind when embarking on this project.

Colin Powell said, "There are no secrets to success. It is the result of preparation, hard work, and learning from failure."

As we conclude, I also want to mention that it is OK if you do not get the budget right on your first try. Like anything else, budgeting is something we get better at over time.

I'll be the first to admit that my budgeting skills are still evolving. I've come a long way, but I would be dishonest if I said my practice's budgets are perfect.

In fact, one of the reasons behind writing this material was so that I could improve and polish my budget preparation.

So with that said, give yourself grace.

However, don't delay. The upside of creating a budget - even if it is not perfect - far outweighs the downside of not having one.

Even if the budget is a notch less than perfect, the process of gathering the information, understanding what you are looking at, and how the reports fit into the big picture, is valuable in its own right.

Still, if you feel that you need help or perhaps your practice does not have employees with the proper skill set to perform all the task described in the is resource, don't fret.

I've made arrangements with Paul Vanchiere from the Pediatric Management Institute to offer a special discount for those of you that bought the book, but prefer a seasoned professional to walk you through the process.

You can reach Paul directly at paul@pediatricsupport.com or by visiting http://pediatricmanagementinstitute.com/

Budget on!

About The Author

Brandon Betancourt wants to live in a world where independent pediatricians remain relevant, manage thriving practices and above all, are profitable.

As a practice administrator, he's been spotlighted in FierceHealth, Medical Economics, AMA News, Medscape and Pediatric Consultant 360. He's also been a faculty member for numerous AAP NCE conferences, lectured at the Pediatric Practice Management Institute Pediatric Conference, as well as local AAP Chapters.

When Brandon is not improving his practice's collection protocol, creating social media content, building his team's culture or studying his practice's key financial indicators, you can find him writing professional bios in the third person.

Brandon blogs frequently at PediatricInc.com. There you can find Brandon's commentary on implementing business strategies that help practices remain profitable.

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Thanks

I want to thank Paul Vanchiere for helping me put together this ebook. Paul was instrumental. In addition to his wise feedback and council, Paul contributed much of the content's framework. He also created and shared with me the budgeting spreadsheet that's included with this workbook.

And to you, the reader.