Budgeting: Part 1

Make or Break Your Practice

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"Do not save what is left after spending, but spend what is left after saving."

- Warren Buffett

While budgeting is not typically taught in medical schools or residencies, it's a skill well worth developing. The exercise of creating and maintaining a budget brings extra insight and discipline to a physician's business habits, resulting in a healthier practice with fewer unnecessary problems. This article describes three steps you can take to establish an effective budget for your practice.

"I know I <u>should</u> have a budget for my practice, but I never seem to get around to it."

Sound familiar? You're not alone. Many practices never manage to establish a budget, and many others establish a budget and then never look at it again. However, **Budgeting = Awareness!** Practices without budgets face a multitude of problems, including embezzlement, over or under-staffing, waste of supplies, inappropriate purchasing, compensation debates among physicians, inadequate savings for practice improvements and higher-than-necessary income taxes.

"Beware of little expenses; a small leak will sink a great ship." **– Benjamin Franklin**

From GPA Capital's decades of experience, whether you are seeking a loan or can increase capital organically, the understanding and implementation of a strong budgeting process is critical to the long-term success of your practice.

What budget type do I use:

Not as if the medical industry doesn't have enough rules already, the financial industry has its own set of rules and regulations which should be tempered by reality. The result should provide you with the most flexible sand adaptable working system.

My recommendation to my clients is to look at the regulations with which you must operate and then create a hybrid comprised of the budget types below that give you:

- ✓ Beginning and ending cash per period

- ✓ Clearly depicts source and continuity of revenue
- ✓ Separates diverse revenue sources
- ✓ Sets up rules, e.g. *"if this, then that"*
- ✓ Ease of constant use and follow up
- ✓ One that coincides with your account's "chart of accounts" *
- ✓ One that easily bridge the gap with tax preparation

* The chart of accounts is a listing of all accounts used in the general ledger of an organization. The chart is used by the accounting software to aggregate information into an entity's financial statements. See sample, next page.

Definitions:

A flexible budget is usually designed to predict effects of changes in volume and how that affects revenues and expenses. To accurately predict the changes in both sources and uses of funds, management must identify the fixed costs and the variable costs.

A flexible budget is a budget that adjusts (flexes) for changes in the volume of activity. The flexible budget is more sophisticated and useful than a static budget, which remains at one amount regardless of the volume of activity.

A static budget is a type of budget that incorporates anticipated values about inputs and outputs that are conceived before the period in question begins. When compared to the actual results that are received after the fact, the numbers from static budgets are often quite different from the actual results.

The flexible budget is especially useful in businesses where costs are closely aligned with the level of business activity, such as a retail environment where overhead can be segregated and treated as a fixed cost, while the cost of merchandise is directly linked to revenues.

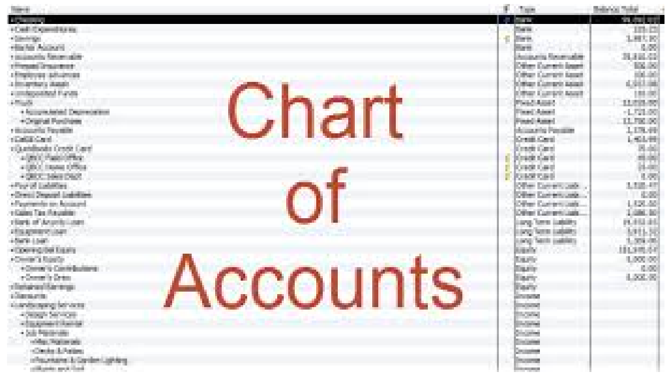
A rolling budget is continually updated to add a new budget period as the most recent budget period is completed. Thus, the rolling budget involves the incremental extension of the existing budget model. By doing so, a business always has a budget that extends one year into the future.

Continuous budgeting is the process of continually adding one more month to the end of a multi-period budget as each month goes by. This approach has the advantage of having someone constantly attend to the budget model and revise budget assumptions for the last incremental period of the budget.

Activity Based Budgeting (ABB) is a method of budgeting designed to provide greater transparency into the budget process. In its most basic form, ABB is a method of budgeting in which revenues generated from one revenue source are allocated directly to the unit responsible for the activity.

Know what's a "cash expense" and what's a "paper loss." The paper loss ultimately results in cash left over at the end of the period by saving you on taxes…it's all interrelated.

SAMPLE CHART OF ACCOUNTS
This sample chart of accounts incorporates standard expense categories for office-based practices



REVENUE

- Payor Reimbursement
- Cash Pay
- Third Party Patient Financing
- Ancillary Services
- Research and Academic

EXPENSES

- Doctor/Owner wages, benefits, retirement plan and continuing education
- Associate provider wages, benefits, retirement plan and continuing education
- Ancillary provider wages benefits, retirement plan and continuing education
- Staff wages, benefits, retirement plan and continuing education
- Insurance: Business & Malpractice
- Dues, donations, subscriptions and contributions
- Fees: Business permits, labs
- Janitorial/maintenance
- Marketing: Meals and entertainment advertising and promotions
- Legal, accounting and consultants
- Rent and utilities
- Supplies: clinical and office
- Meals: Business/staff meetings
- Repairs and maintenance: Building, equipment or contracts
- Outside services
- Travel and professional meetings
- Miscellaneous
- Postage
- Doctor-owner net income
- Taxes and licenses
- Telephone/answering service/pager
- Uniforms and laundry
- Furniture and fixtures
- Merchant credit card fees

LIABILITIES

- Contractual Adjustments, Payer Settlements, charity care and bad debt
- Capital (IRS section 179) purchases of new equipment and/or software
- Mortgage payments
- Lease payments: Equipment
- Loan payments: individual, student and/or auto loans
- Leasehold improvements

The budget offers insight on how revenue is generated and what expenses you can control.

Here are six basic steps to get ready to prepare a budget:

1. Know all your revenue sources

Obtain an understanding of how you are generating revenue in your practice by reviewing the codes you most commonly bill for.

Your practice management software should be able to produce a report by CPT code, including how much revenue was generated by each code. Reviewing this report will give you the ability to identify where your time is most profitable and which activities can be delegated to physician assistants or nurse practitioners.

2. Compare your activity with benchmarks available from MGMA or professional specialty associations.

MGMA®
Medical Group Management Association

At GPA Capital, we track many practices creating our units of comparison that we apply to our clients' needs. Your Commercial Loan Professional should be able to advise you on these KPI (Key Performance Indices).

3. Identify payers

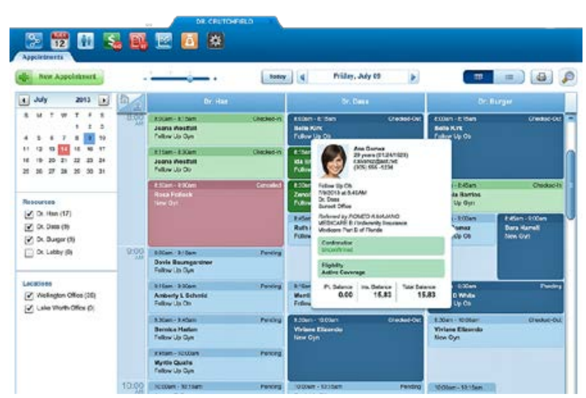
Determine who is paying you by reviewing a billing report by payer. What is your payer mix? Is a significant percentage of your revenue coming from one or two payers? What is the reimbursement rate for those payers?

Consider working to reallocate the payer mix within your active patient base to avoid a heavy concentration with any one payer, working toward a more balanced mix of revenue in your practice by reviewing the codes you most commonly bill for.

4 Review contracts

Review your payer contracts for possible renegotiation of reimbursement rates. Do your reimbursements and contractual adjustments for each payer match the terms of the contract? Are your collection percentages in line with industry averages for your specialty?

5 Analyze your office schedule



How far out are you booking appointments? Are you full? Does your template allow for a long and short appointments? Minor adjustments to the template can improve patient wait times and increase the number of patients who can be seen in a day, reducing the lead time for call-in appointments.

6 Review your fee schedule.

Review your fee schedule for necessary adjustments. If your reimbursements are at or near 100%, it's likely that your fee is too low.

Now build your budget

Now you can begin to construct a revenue budget or you can adjust last year's revenue number that will potentially be above the 5 percent annual automatic budget increase.

On the expense side, budgeting is more than finding ways to save money on pencils. Benchmarks are available to reflect each expense category as a percentage of practice revenue.

This is a good starting point to determine if your practice's expenses are in line and to establish a budget for the coming year based on your budgeted revenue. Adjustments can then be made for specific line items as necessary.

While many believe preparing a budget means copying last year's numbers, increasing revenue by 5% and decreasing expenses by 10%, the reality should be much different. And, so will the results.

Look for Part 3 of our 5-part series next week. Click here if you missed Part 1, "The 5 C's of Credit"