MEDICAL PRACTICE EXCELLENCE IN THE 21ST CENTURY

How to improve your financial skills in 5 key areas.
Part 2 of a three-part series.
By Margie Satinsky, M.B.A.

This article is the second in a three-part series on medical practice excellence in the 21st century. The first article explained the five components of managing a balanced practice. It also provided suggestions for organization and management, business planning and marketing.

This second article focuses on financial management.

The third article will cover improving healthcare delivery and clinical outcomes.

If you are a physician who is baffled by the financial management of your practice, but you are uncomfortable admitting your knowledge gap, rest assured that you are not alone. Many of your colleagues share your discomfort. Undoubtedly, financial management of a medical practice is complex, but hoping that a practice will miraculously survive and thrive without managing finances just won't work.

Successfully managing your finances involves five key components:

1. financial planning and budgeting
2. accounting
3. revenue cycle management
4. managing overhead expenses
5. developing and maintaining internal controls.

This article provides an overview of each of these important components.

1. Financial Planning and Budgeting

Part 1 of this series discussed the importance of having a strategic business plan and supporting financial plan for your practice. The financial plan helps you convert good ideas into reality, and it should include 5-year forecasts, a plan for financing your practice, and an annual budget that projects your volume, revenue and expenses.

You need two budgets, an operating budget and a capital budget. Before you project any numbers, create a budget planning team that includes one or more physicians, your practice administrator/manager, administrative and clinical staff, and an external consultant, if needed. Talk with each other before you start counting!

Your operating budget should include projections for patient volume, revenue from patient services and other sources, and operating expenses. Ask your budget planning team to list assumptions about your practice and about the environment in which you practice. **Figure 1** lists the assumptions that a dermatologic surgery/plastic surgery practice used in developing its operating budget.

To project volume from patient services, consider both the number of patients that you expect to see each day and the distribution of visits and/or procedures by CPT code. Use both historical information and your budget assumptions to help you.

With respect to patient revenue, multiply your volume projections by your practice fees to obtain the gross patient revenue. Be sure to build in a deduction for the "contractual allowance" to reflect the percentage of your total charges that the managed care plans will not pay. Once you have your net revenue, deduct a bad debt allowance that is appropriate for your mix of insurance and self pay, since not all plans and patients will pay what they owe.

For your operating expense projections, identify each expense category. Review past expenses and make appropriate adjustments. Your accountant and/or an external practice management consultant can provide guidance.

After you have projected your volume, revenue, and expenses, prepare a budget planning worksheet that shows net profit (loss) before physician compensation. If you are not satisfied with your net income on the first attempt, review and adjust your assumptions and numbers. Repeat this exercise until you are comfortable with the bottom line.

You need a capital budget as well as an operating budget. Follow generally accepted accounting principles to spread depreciation over the appropriate time period.

Figure 1. SAMPLE OPERATING BUDGET ASSUMPTIONS FOR A DERMATOLOGIC SURGERY/PLASTIC SURGERY PRACTICE

- ***Fee schedule.*** The practice is a network provider for seven managed care provider plans, and much of its elective surgical business is self-pay. The practice will revise its current fee schedule so that gross charges are set at a fixed percentage of 2007 Medicare. For CPT codes that Medicare does not reimburse and for all supplies, the practice will set fees at the market level.
- ***Managed care.*** During the coming year, the practice will renegotiate the reimbursement rates with all seven of the managed care plans with which it has contracts. The budget will reflect the average expected increase in net revenue.
- ***Revenue from health education.*** New lunch and learn patient seminars will produce additional revenue.
- ***Revenue from clinical trials.*** The practice already participates in clinical trials and will double its revenue from this activity.
- ***Net collections***. The implementation of a new practice management system that includes an accounts receivable management module is expected to enhance collections and reduce bad debt.
- ***Staffing.*** During the coming year, the practice will hire 2.5 new FTEs.
- ***Wages and salaries.*** All employees in the practice will receive a 2% cost-of-living increase and up to a 3% additional merit increase. These increases will be phased to coincide with each employee's anniversary date.
- ***Employee benefits.*** The employer share of health insurance will increase by 6%.
- ***Staff education.*** The practice will standardize its financial commitment to staff education, allowing $500/employee for training. Supervisors and managers will receive an additional $500/employee.
- ***Telephone system.*** The practice will replace the current telephone system.
- ***Information technology.*** The practice recently purchased and implemented a new practice management system. During the coming year, it will purchase an electronic health record application from the same vendor.
- ***Travel.*** The practice will standardize the travel allowance for its four physicians. The partners will determine the new amount.

2. Accounting

The second component of good financial management is accounting. You must document what has happened in your practice and review the underlying activities.

Each month, your accountant will provide three standard reports:

1. the income statement
2. the balance sheet
3. the cash flow statement.

Each report provides dollar amounts and relates them to a period in time. **Figure 2 on page 50** provides details.

Although the monthly reports that your accountant provides are important, remember that they focus on the big picture. In order to identify problem areas, look at payer-specific reports that are generated by your practice management system. For example, your income statement might tell you that your accounts receivable has increased, but it won't tell you if a particular payer is causing the problem.

3. Revenue Cycle Management

As physicians who focus on skin and aging, you generate revenue from multiple sources. If you participate in managed care networks, the plans pay you negotiated rates for the services that you provide to patients. If you don't participate in these networks or if some of the services that you provide don't meet plan definitions of covered services, patients pay you directly. If you participate in clinical trials, you have still another source of revenue.

Many activities within your practice, both administrative and clinical, contribute to your ability to generate as much revenue as you can as quickly as you can. Rather than separating the different activities that affect your revenue stream, examine all the activities together as a total revenue cycle. **Figure 3 on page 50** provides an illustration of revenue cycle management.

Here are suggestions for improving your revenue cycle management.

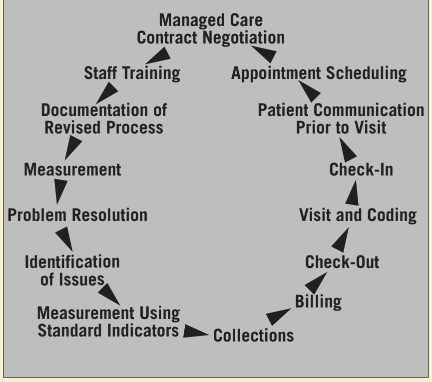
- If your practice contracts with managed care plans, then regularly take the initiative and request higher rates of reimbursement that at the very least cover the average annual increase in your operating expenses. If you aren't comfortable handling this responsibility yourself, engage an external consultant to do the work and/or teach you what to do.

- Take advantage of financial incentives for providing and documenting quality care that may be offered at the federal, state, and local levels. For example, at the federal level, the Centers for Medicare & Medicaid Services (CMS) offers physicians the opportunity to participate in its Physician Quality Reporting Initiative (PQRI). In 2007 eligible physicians who submitted quality information in accordance with program guidelines potentially earned a 1.5% bonus that was based on total allowed charges between Jul. 1 and Dec. 31, 2007. In the private sector, many of the managed care plans and other organizations already reward physicians who demonstrate what these payers define as "quality performance."
- When patients call for appointments or request them electronically, capture accurate demographic information and verify insurance eligibility before the visit. Diligence in checking can result in fewer claims denials.
- Before patients arrive for visits, give them your financial policies and have them acknowledge your rules in writing.
- Request patient payment at the time of the visit. After the second no-show, charge for the visit; encourage prompt payment, but be willing to develop payment plans to help patients meet their financial obligations.
- Code each visit appropriately, and make sure you remain current on annual coding changes.
- Make sure that the billing staff or your outside billing and collection agency scrubs claims before sending them to various payers. What's the point of doing a sloppy job with claims submission and accumulating a list of pending or rejected claims? If your claims are clean from the start, you'll receive more money sooner.
- Take advantage of opportunities to submit claims online directly to payers and to have payers deposit reimbursement directly into your bank account.
- If your practice management system vendor offers a digital lockbox option, take advantage of this method for scanning, indexing, and storing online your checks, EOBs, statements, and insurance correspondence.
- When you receive notification that a claim has been pended or denied for lack of information, follow up immediately.
- Make sure your collection staff or your outside billing and collection vendor pursues unpaid claims on a methodical basis. A good rule of thumb is to work the more recent and larger dollar claims first.
- Separate unpaid claims that are 90 days or older from the others and send them to an external collection agency.
- Develop and implement a clear policy for write-offs. The financial profile of your practice should reflect what you can realistically expect to achieve.
- Develop and document clear policies and procedures for all aspects of revenue cycle management, including appointments, check-in, check-out, and billing and collections. If you establish your policies and procedures ahead of time, you can avoid making on-the-spot decisions that may turn out to be inappropriate.
- Abandon the habit of judging your financial performance by comparing each month's net profit (loss) with that of the previous month. Measure your revenue cycle management program regularly by using standard ratios (**see Figure 4 on page 52**).
- General financial information is helpful, but you can only act on payer-specific detail. Make sure your practice management system can generate clear payer-specific reports that you can regularly review. For each CPT code that you use, monitor whether or not your actual payment matches the rates that your contract says you will get. If you discover problems, notify the payer and resolve the issues before they escalate.
- Know where to get the information that you need. Each month, your accountant will provide summary financial information. The details are in your practice management system, so make sure it provides the data that you need. If you and your staff have difficulty accessing information in

Figure 2. REPORTS THAT YOUR PRACTICE SHOULD REVIEW EACH MONTH

- ***Income statement*** — revenue collected from patients and payers and expenses paid by your practice. This report is sometimes called the profit-and-loss (P & L) statement. The report tells you what happened during a particular period in time. For example, it shows you what happened during the past month, during the past month during the last fiscal year, and during the year-to-date. Look carefully at your total revenue, total expenses, expense ratio, and profit before physician compensation.
- ***Balance sheet*** — your practice's financial position at the end of a particular point in time. This report lists your assets, liabilities, and owners' equity. With respect to time, most practices use what is called a modified cash balance sheet that enables the practice to show items other than pure cash and recognize assets and liabilities that the practice is expected to pay or receive within 1 year.
- ***Cash flow statement*** — a summary of the sources and uses of funds. In general, cash moves in and out of your practice in relationship to operations, investments, and financing.

Figure 3.



your practice management system, go back to the vendor and explain what you want. It's all there; you just need to learn how to access it.
- Clarify responsibility for your revenue cycle management program. Within your practice, the practice administrator or manager should take charge and work closely with both an internal team and external advisors.
- If you need guidance, seek help from a general practice management consultant. Accountants report on the activity that has occurred and make sure you have proper controls in your practice. Identifying operational issues and resolving problems is the responsibility of your staff and you.

4. Managing and Controlling Overhead Expenses

Your practice has two types of costs.

1. ***Direct costs*** are associated with the delivery of patient care.
2. Your ***indirect costs***, or overhead costs, are not connected with the production of goods or services. Nonetheless, they are an important component of running your business.

Industry standards suggest that overhead costs should represent between 45% and 60% of your total operating costs, depending on your specialty and the services you provide. If your overhead costs are outside the recommended range, carefully analyze each overhead item and take corrective action. **Figure 5** lists three problems that frequently contribute to high overhead costs.

5. Developing and Implementing Internal Controls

Not only do you need good financial planning/budgeting, revenue cycle management, and control of your overhead expenses. You also need internal control systems that help you manage the cash in your practice. **Figure 6** provides suggestions.

CREATING A "SOUND" FINANCIAL PRACTICE

Sound financial management of your practice is essential. Make sure you understand the importance of financial planning and budgeting, revenue cycle management, accounting, managing overhead expenses, and developing and maintaining internal controls. Use a combination of internal staff resources and professional external consultants to help you maintain financial as well as clinical excellence. ■

I would like to acknowledge and thank Dr. Robert E. Clark of Cary Skin Center in Cary, NC, for his input into this article.

Ms. Satinsky is the author of the Handbook for Medical Practice in the 21st Century *(2007). She is President of Satinsky Consulting, LLC, a healthcare consulting firm that provides services to medical practices throughout North Carolina. Her areas of expertise include information technology planning, strategic business planning, managed care rate negotiation and contract review, marketing, operations improvement, HIPAA Privacy and Security Rule training, and new practice start-up. She has an MBA from the Wharton School at the University of Pennsylvania, and advanced training in healthcare negotiation and conflict resolution from the Harvard School of Public Health. She is an adjunct faculty member at the University of North Carolina School of Public Health and on faculty at Duke Medical Center's Business of Medicine Program for residents.*

Figure 4. STANDARD RATIOS FOR MONITORING YOUR REVENUE CYCLE MANAGEMENT

- ***Net Charges to Cash Collections***
- ***Net Collection Rate***
- ***Gross Collection Rate***
- ***Net Days in Receivable Outstanding***
- ***Aged Trial Balance***
- ***Payer-Specific Information Showing Payment Rate and Actual vs. Expected Reimbursement***
- ***Bad Debt***

Figure 5. PROBLEMS THAT FREQUENTLY CONTRIBUTE TO HIGH OVERHEAD COSTS

1. ***Nobody's in charge.*** If roles and responsibilities are ambiguous, chances are that nobody is monitoring overhead expenses and seeking solutions for problem areas. Reread Part I of this series of articles on organization and management.
2. ***High staff turnover and recruitment expenses.*** Unclear job expectations discourage employee loyalty. Take time to create a standard job description format and make sure that each employee knows exactly what is expected of him or her.
3. ***Insufficient managed care revenue to support a practice of your specialty and size.*** Regularly renegotiating managed care contracts is a necessity of doing business. If you neglect this task, you may not generate sufficient revenue to cover your practice expenses.

Figure 6. SUGGESTIONS FOR DEVELOPING AND MAINTAINING INTERNAL CONTROLS

- Use multiple bank accounts to help you manage your cash. For example, use the cash in your operating account to support your accounts payable and payroll. Keep a separate interest-bearing money market account for money that you don't need immediately, and transfer funds from it when you need them. Consider setting up a separate payroll account.
- Manage your incoming cash carefully by depositing collections daily, copying insurance remittance forms and attaching explanation of benefits, managing your cash flow daily, paying your bills on time but not early, and by asking your bank for the protection of a working capital line of credit.
- Manage your petty cash by keeping a small amount in the fund, limiting responsibility to the fund to one physician and your practice administrator/manager, using "received of petty cash" forms, documenting all disbursements from petty cash, and by keeping a detailed log.
- Regardless of the size of your practice, maintain a system of internal checks and balances so that the responsibilities of handling cash collections and deposits are divided.
- Protect your practice from fraud by bonding all staff members.