

Creating a Practice Budget That Encourages Practice Success

A practice budget is the foundation for successful financial management. Talk to your practice advisors about this more complex analysis process.

By Bill Miller

Effectively operating and managing a successful dermatology practice in today's highly competitive and increasingly complex environment can be arduous. Therefore, providers must know how to accurately assess the impact of threats and opportunities confronting their practices. An analysis of these developments with good information allows practice stakeholders to act in a decisive and timely manner. In order to achieve great success in your practice, you must consistently recognize, develop, and apply proper information and analysis. This article outlines a process and recommended format that will assist you in creating a practice budget.

Proper planning and budgeting is the cornerstone of practice success. A budget provides a forecast, which incorporates a practice's goals and objectives. The principal benefit of budgeting is that it demands the focus, discipline, and organization of all stakeholders in the practice. Development of a budget includes the following components:

- Examination of historical financial and production information.
- Assessment of changes likely to impact future financial results including strategic opportunities, capital requirements, physician plans, etc.
- Forecast of future productivity, revenue, and expense.
- Integration of the budget with financial reporting.

The ability to accurately predict future practice results—while continu-

ally measuring actual performance as compared to forecast—helps take the guesswork out of practice management and provides a feeling of control.

Examine Historical Data

The budgeting process should begin in the fourth quarter of your practice's fiscal year. This will allow you to assess nine-month productivity and financial data and provide a strong foundation for planning and forecasting results for the coming year.

An historical review of productivity and revenue should include an assessment of total patient encounters by physician and net revenue rate per encounter. Net revenue is calculated by multiplying gross charges by the collection rate. The collection rate is determined by dividing net collections by gross charges. I recommend using a 12-month computation period when calculating the collection rate. This analysis will assist in forecasting production and revenue for the budget year. You can use a simple spreadsheet tool to track information by month to identify seasonality trends in the practice (see Table 1).

In addition to reviewing historical production and revenue, it is important to assess practice expenses. Review each and every line item of expense on the income statement and make sure you understand what is included in each category. Access to the general ledger is also important for identifying the detail or backup for the various

categories of expense. To ensure consistency in data reporting, make sure to review expense categories with your accountant.

Another good idea is to examine the previous year's expenses in comparison to published data, i.e., the Medical Group Management Association's Annual Cost and Production Report Survey, in order to benchmark your expenses and determine if they are in line with industry standards. If they are outside of these standards, it may be necessary to conduct further review. (Note: The MGMA is located at 104 Inverness Terrace East, Englewood, CO 80112-5306, phone: 888-608-5601.)

Assess Future Changes

Performing a thoughtful analysis and review of goals, objectives, and key initiatives of your practice for the coming year will assist in planning and forecasting results. Items for review should include physician schedules, capital expenditures, physician compensation issues, staffing changes, new facilities (or expansion of current facility), changes in service mix, marketing programs, and changes in facility or equipment lease rates. Remember to closely examine any changes in provider staffing levels, including retirement or "slow down" of a member, as well as anticipated new hires. Gain consensus among all stakeholders regarding assumptions to be used in the budget forecast.

Table 1: Historical Physician Productivity and Revenue Analysis

Doctor #1	Jan	Feb	Mar	Apr	May	Jun	Totals
Total Patient Encounters*	427	509	546	442	528	560	3,012
Gross Charges	\$94,965	\$120,001	\$130,375	\$98,164	\$120,100	\$129,200	\$692,805
Collection Rate	0.66	0.66	0.66	0.66	0.66	0.66	0.66
Net Revenue	\$62,677	\$79,201	\$86,048	\$64,788	\$79,266	\$85,272	\$457,252
Net Revenue per Encounter	\$147	\$156	\$158	\$146	\$150	\$152	
Average Net Revenue per Encounter							\$152

*Patient encounters represent all office visits billed with evaluation and management (E&M) CPT codes, as well as all "no charge" visits.

Table 2: Physician Revenue Forecasting Analysis

Doctor #1	Jan	Feb	Mar	Apr	May	Jun	Totals
Number of Clinic Sessions	21	24	25	19	24	20	133
Number of Patient Encounters	26	26	26	26	26	26	
Total Patient Encounters	546	624	650	494	624	520	3,458
Net Revenue per Encounter	\$145	\$145	\$145	\$145	\$145	\$145	
Net Revenue Forecast	\$79,170	\$90,480	\$94,250	\$71,630	\$90,480	\$75,400	\$501,410

Forecast Future Results

Forecasting should reflect the stated goals and objectives of the practice and physicians. To estimate revenue, review the desired physician schedules and identify the number of clinic sessions (defined as a four-hour session) available per month by physician multiplied by the estimated number of patient encounters per session. Simply apply the estimated net revenue rate per encounter, and revenue forecasting will be complete. When estimating the net revenue rate, take into consideration any proposed reductions in reimbursement. For example, the 2006 Medicare physician fee schedule changes are expected to result in a 4.4% decrease over 2005 rates. An illustration of a simple physician-revenue forecasting tool is provided in Table 2.

Many dermatology practices have other lines of business that do not relate directly to an individual provider's productivity. Examples include a medical spa or retail sales. Forecasting revenue for these business

units should be done in a similar manner, starting with a historical assessment of production and identification of a revenue rate per unit of service, i.e., per procedure performed in the spa. To estimate revenue for the budget year, determine projected volume, forecast changes in the revenue rate per unit, and apply the revenue rate times the projected volume to identify the total revenue forecast for these other service lines.

When forecasting expenses, you can use two expense categories: cost of goods sold and operating expenses. Cost of goods sold represents goods purchased in direct relation to the service delivered or product sold and includes surgical supplies, injectibles, cosmetic supplies, etc. Regarding the forecasting of operating expenses, a greater amount of detail and attention should be spent on significant expense items such as compensation (physician and staff), marketing and advertising, insurance, building and occupancy, and equipment rental.

As it relates to staffing costs, be sure to develop a plan that includes salaries, benefits, payroll taxes, overtime pay, and bonus compensation. Determine also if staffing levels are expected to change in the forecast year. If no changes are planned for provider levels, service line mix, or location expansion, there is likely to be no change in staffing levels. Alternatively, if new providers are being considered or new locations developed, you must assess the impact on staffing and anticipated changes included in your plan.

Similarly, for marketing and advertising, I encourage the development of a marketing plan detailing planned expenditures. Using the same basic approach will allow you to project other significant expense line items to more accurately predict future expenses.

Capital budgeting is an integral part of the overall budgeting process. In order to create the capital budget, identify anticipated purchases, estimated cost, and timing of the acquisition. Forecasting capital expenditures should

Table 3: Budget Worksheet (Partial Illustration Only)

	9 Mos.9/30/xx	Average	Jan	Feb	Mar	Apr	Total	% of Total
Operating Revenue:								
Professional Receipts	\$687,384	\$76,376	\$79,170	\$90,480	\$94,250	\$71,630	\$335,530	90.14%
Botox & Fillers	\$75,862	\$8,429	\$9,500	\$9,500	\$9,500	\$9,500	\$40,000	10.21%
Other Income	\$2,472	\$275	\$275	\$275	\$275	\$275	\$1,100	0.30%
Patient Refunds	(\$5,212)	(\$579)	(\$600)	(\$600)	(\$600)	(\$600)	(\$2,400)	-0.65%
Total Operating Revenue	\$760,506	\$84,501	\$88,345	\$99,655	\$103,425	\$80,805	\$372,230	100.00%
Cost of Goods Sold:								
Surgical Supplies	\$41,843	\$4,649	\$5,000	\$5,000	\$5,000	\$5,000	\$20,000	5.37%
Botox & Fillers	\$38,367	\$4,263	\$4,700	\$4,700	\$4,700	\$4,700	\$18,800	5.05%
Total Cost of Goods Sold	\$80,210	\$8,912	\$9,700	\$9,700	\$9,700	\$9,700	\$38,800	10.42%
Gross Margin	\$680,296	\$75,589	\$78,645	\$89,955	\$93,725	\$71,105	\$333,430	89.58%
Operating Expenses:								
Depreciation	\$12,315	\$1,368	\$1,500	\$1,500	\$1,500	\$1,500	\$6,000	1.61%
Employee Benefits	\$20,511	\$2,279	\$2,500	\$2,500	\$2,500	\$2,500	\$10,000	2.69%
Insurance	\$15,060	\$1,673	\$1,750	\$1,750	\$1,750	\$1,750	\$7,000	1.88%
Interest	\$3,560	\$396	\$500	\$500	\$500	\$500	\$2,000	0.54%
Marketing	\$16,614	\$1,846	\$2,000	\$2,000	\$2,000	\$2,000	\$8,000	2.15%
Salaries - Staff	\$160,521	\$17,836	\$19,619	\$19,619	\$19,619	\$19,619	\$78,477	21.08%
Salaries - Physicians	\$174,350	\$19,372	\$22,000	\$22,000	\$22,000	\$22,000	\$88,000	23.64%
Other	\$122,869	\$13,652	\$14,750	\$14,750	\$14,750	\$14,750	\$59,000	15.85%
Total Operating Expenses	\$525,800	\$58,422	\$64,619	\$64,619	\$64,619	\$64,619	\$258,477	69.44%
Net Operating Income	\$154,496	\$17,167	\$14,026	\$25,336	\$29,106	\$6,486	\$74,953	20.14%
<i>NOTE: This is a partial example for illustration purposes only. Actual budget will include a 12-month forecast of revenue and expense. Line items for revenue and expense should replicate those items shown on the practice financial statement to provide comparison of actual results to forecast.</i>								

relate directly to the stated goals and objectives of the practice as set forth in its business plan. Capital expenditures will normally result in an increase in expense for interest (if the purchase is financed) and depreciation, which should be included in the expense forecast. Once revenue and expense projections are complete, make sure that you compile the results in a spreadsheet tool to illustrate monthly revenue, expense, and net operating income (see Table 3).

Integrate the Budget with Financial Reporting

The final step in the budget process is

implementing the plan and monitoring results compared to the budget. Developing comparative monthly reports that illustrate actual results compared to budget and conducting regular meetings with the management team and physicians to review results will help ensure practice success. The comparative reports will assist in identifying any aberrancy for review and any corrective action plans that you may need to implement.

Long-Term Payoff

A properly executed budget provides a meaningful benchmark to measure

annual performance and predict future results. It acts as a control mechanism to facilitate appropriate intervention and provide all stakeholders with a better understanding of variables that affect profitability. The budgeting process is an investment that is well worth the time and resources and, if not compromised, will yield significant long-term rewards.

Of course, there are other approaches to creating a practice budget, and some individuals may approach the process differently. Be sure to coordinate with your practice accountant or financial advisors when setting out to create a budget. ❏