# "WORDS" TO PRACTICE BY: A GUIDE TO UNDERSTAND THE BUSINESS VERNACULAR OF A HEALTHY PRACTICE

**Key terms to understanding the financial health and value of your practice**

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**Introduction:**

Clinical practices are under significant financial stress, and at a time when monitoring financial benchmarks is critical, many physicians remain confused about the terms and values to be used. This toolbox attempts to define and clarify common business measures used to measure, monitor, and value your practice's financial health.

Physician practices are small businesses. Therefore, knowledge regarding the *business side* of practice is key to continued success. According to a recent physician foundation survey, 8% of medical practices are going out of business due to the COVID-19 pandemic. Gastroenterologists saw the 2nd largest drop among specialties in healthcare utilization during COVID-19 this year. In April, the drop was an enormous 77% in utilization due to the drop in elective procedures[1]. With this added pressure, as an owner or employee of a practice, a solid understanding of financial terms and benchmarks of your practice will help you determine not only the financial backbone of your practice, but also the valuation of your practice. Financial terminology can also help you determine your individual value as a gastroenterologist. The landscape for GI practice seems to be changing with consolidation of groups small and large, both in hospital purchases of practices and in private equity investment. Understanding these financial concepts is key for effective administrative discussions with your business leaders (CFO, CEO, accountant, office managers) or potential suitors (private equity, hospital systems, clinical systems). In the everchanging healthcare environment, this information will help you as a physician navigate tough business decisions you will have to make. We encourage you to use this information as you review your financial statements, contracts, and business operations.

## Background:

## Key financial terms to be familiar with:

**Balance sheet.** The balance sheet represents the financial balance of a company at a **point in time.**

**Assets = Liabilities + Owners' Equity**

1) Assets: These are resources owned by the company and have current or future economic value expressed in dollars. Assets generally include *financial assets* (bank deposits/cash collected, accounts receivable) and *physical assets* (real estate, durable equipment/furniture, inventory, even "*contra assets*" such as accumulated depreciation).
2) Liabilities: These represent financial obligations owed by the company and are grouped into current liabilities (coming due within the operating cycle) and long term liabilities. These typically include payable *salaries, interest, taxes, pension plan*, 401K, *lines of credit* for example.
3) Equity: These include stockholders' equity of the company such as *owned stock* and *retained earnings*.

**Profit and Loss statement (P/L)**. This report summarizes the company's revenues, expenses, and net income over the practice's operating cycle (period of time). If ancillaries are held in separate associated companies, this can be combined in one statement for all associated revenues/expenses or individual statements per company.

1) Revenue: All *income* from professional fees and other ancillaries such as research, pathology, billing, infusion, and anesthesia services.
2) Expenses: All costs associated with generating revenue. These include *insurance, salaries*, 401K *distributions, license, business expenses, utilities*, *rent* and similar expenses which are considered operational costs.
    a. Direct expenses are those directly associated with the physician and delivering your product or "patient care" – these include your direct clinical support staff costs, your salary, your benefits, your health and malpractice insurance, and CME as a few examples.
    b. Indirect expenses are generally those that may not be involved in revenue generation; these expenses maintain practice function and include utilities, billing staff cost, administrative staff costs, supplies and rent.

Together with the balance sheet, the P/L statement can give you a general sense of the financial health of your practice.

## Key Operational Terms to be familiar with:

**Accounts receivable or AR**

1) Balance of money due to the practice for services provided. This is considered an asset.
2) Fundamental for business analysis and measures practice liquidity.

**Relative value unit: RVU**

1) Methodology used by the Centers for Medicare and Medicaid services (CMS) and in some form by private payors to determine *physician payment*.
2) Defines a services value relative to all other physician services and procedures and ultimately determines compensation.
3) It is made up of three components for a total RVU.

a. All components are factored for geographic differences based on area of country services are provided.
b. The wRVU is the component for direct physician work effort.
    i. **Total RVU** = wRVU + $RVU^{PE}$ + $RVU^{L}$
        1. **wRVU** = work value per Computerized Procedural Terminology (CPT) code**;** **$RVU^{PE}$** = value of practice expense; **$RVU^{L}$** = value of professional liability insurance expense
c. To convert to dollars, the Total RVU is multiplied by a "conversion factor" or dollar amount per RVU. This conversion factor is updated each year by CMS.

**EBITDA:** Net earnings *before* interest cost, taxes, depreciation (hard assets), and amortization

1) Represents "revenue – expenses". Note that EBITDA does not include tax liability, interest paid on debt, depreciation on hard assets, or amortization (ex: software cost).
2) Is considered a Non-GAAP (generally accepted accounting principles) measure, and ignores costs of assets and working capital needs.

## ***Putting it together*: how these terms inform the value of the practice. Some examples of typical questions to consider.**

### *How do I determine if my practice can cover operations and produce income? In other words, what is my "break-even analysis"?*

**Break-even analysis** is performed to identify the point at which total cost and total revenue are equal. It looks like a margin of safety for an entity based on *revenue collected* and *associated costs.* It is also a useful tool to estimate the number of units of work, and therefore income, needed to be profitable.

- Consider an operating cash flow analysis (from your P/L statement). Record all income and all costs over a set period of time (6 months for example)
    - Operating income /liabilities X 100: if >1 then cash covers costs.
    - Example: 1,500,000/1,100,00 X100 = 1.36

### *What is the RVU system and how it is used in my practice or employment?*

- Many practices use RVUs to determine your pay, bonuses, and ultimately the financial value of the service you provide.
    - **wRVU** based compensation is the most popular payment method for employed physicians
        - Example: *Professional services agreement* (commonly called PSA) with hospital for consultative services or call coverage will be based on wRVU [2,3].
        - Example: If employed by a hospital, your pay is likely based on a wRVU. When evaluating a contract know what your wRVU's currently are and if the benchmarks and expectations in the contract are reasonable.
    - **wRVU** based compensation, after value-based payment models came into place, now may include other modifiers for payment of services; this effects rate of $ per wRVU [4]

        - includes modifier for quality, promoting interoperability, improvement activities and cost
        - non-productivity incentives, when fulfilled, can help you achieve maximum payment
- If you sell or merge your practice with another, evaluate the wRVU of all physicians to ensure all are doing similar workloads to avoid future problems
- Can use wRVU to compare physician effort/production in the practice
- If you or your practice is negotiating with a hospital, be aware: the average revenue generated by a gastroenterologist for their affiliated hospital in 2019 was $2.9 million dollars.[5]
- Considerations with wRVU based contracts:[6,7]
    - RVU values for procedure and intellectual work is not necessarily intuitive
    - Know what you are being paid in $$ per wRVU
    - Know if your pay rate per wRVU is a flat rate, blended or variable (based on payor mix). Payment for wRVU from insurance providers can be different from Medicare rates.
    - Know how uninsured patient wRVUs are accommodated in pay structure
    - Know how long after a bill is submitted will you get paid for your wRVU…6 weeks? … 3 months?
    - Ensure you have access to the accounting books for your billing and consider an audit (for example sometimes coders will not submit certain CPT codes due to high denials or effort needed by coder to get reimbursement)
    - Be aware bundled or multiple procedures at the same time, as in GI procedures, can cause you to earn less per wRVU.
    - Be aware that wRVU based payment models do not compensate you for other duties such as teaching, directorships, etc.…

## *Accounts receivable is the lifeblood of practice, how do I understand the nuances of this value*?

- AR is a fundamental factor to determine business liquidity
- AR can be useful to monitor performance of physicians, payors and even staff
- AR monitoring can foreshadow cash flow problems (ex: if days in AR increase progressively then cash flow will suffer)
- Denial rate goal should be less than 2% for charges and AR
- *Average daily charges* = total charges in 6 months/ total days in 6 months
- ***Days in AR****: average number of days it takes to collect due payments*
    - Total AR / average daily charges = **DAYS IN AR**
        - What is a good number? (Keep in mind that Medicare generally pays within 14 days after electronic claim)
            - Estimates: 30 days is high performing billing dept; 40-50 average performance; 60+ is poor performance… and if electronic then <30 is benchmark

        - Evaluate AR using aging buckets: 0-30 days; 31-60 days and 61-90 days, 91-120 days. Get reports to look at amounts $ of the AR is in each bucket. The goal is to have the majority of AR < 60 days.
        - Consider posting targets for staff and reward excellence
        - Know AR per payor if possible. Address issues with specific payors as they arise.
- Consider a review of "Optimizing Revenue Cycle Output." ACG Practice Management Toolbox; March 2018. (see resources below)

### *Our billing is clearly different than collections. How do I know we are getting paid correctly*?

**"Collections" analysis** to determine NET COLLECTIONS or adjusted collection rate (ACR) is a way to measure the practice's effectiveness in collecting reimbursement dollars and is a benchmark of financial health and revenue cycle.

- How much of the money allowed to collect (including contractual adjustments) did you actually collect? For example, the XYZ insurance allowable for "service A" is $96.50. Did you actually collect that amount?
- Net Collections = payments received / agreed-upon fees X 100
    - To calculate ACR = [Payments – credits / charges – contractual adjustments] X 100
    - Ideally this should not be less than 95%
    - Consider that providers may have different agreed-upon fees.
    - Review this calculation over a six-month time horizon.
- Observe collection rates and subdivide per payors. Then compare to highlight problem payors.
- Collections can be used to compare physician production, but collections are affected by types of payors that patients have in each physician's individual practice, the AR variance of payors and it may be difficult to equilibrate those factors.

### *EBITDA is a fancy accounting term. Why is it important?*

- Used to determine profitability of practice and used to estimate value
- Used to compare practice "A" to practice "B" and overcome differences in structure or tax basis (LLC, S Corporation, or limited partnership for example)
- For the most accurate EBIDTA, ensure that your AR is up-to-date
    - Also consider reviewing your real-estate or rental income with experts if involved in the sale of your practice. For example, rental income may have a higher multiple placed on its value and subsequent impact on practice value.

## Conclusion:

The health of any business hedges on the constant review and knowledge of how to interpret the product and its cost. A medical practice is no different. It is never appropriate to hand over the entire

day-to-day operation of a business to others without having sufficient input, oversight, and guidance. Schedule a business check-up on a set schedule and do not deter from it. This should be a regular review for you and your partners. It could save your business in the long run and decrease anxiety about your financial livelihood. Remember that a business is not an exact science. Your business knowledge comes from your own observations and experiences. As you familiarize yourself with common terms and formulas, managing and overseeing the business side of your practice will become more rewarding and enlightening.

We have included references and resources from outstanding sources to expand your knowledge base.

References:


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Resources:


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5) Affiliation Options for Physicians: Current and Future Strategies and RVUs at Work: Relative Value Units in a Changing Reimbursement World, Third Edition; Coker Group Books.
6) 10 benchmarks and 10 best practices to improve billing and collections- Medical practice management resources. www.medpmr.com. Assessed AUG 2019.