General practice management toolkit

Managing your financial resources

Module 7

General practice management toolkit: Managing your financial resources

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Introduction

A medical practice is a business. Managing your finances is essential for a viable practice and for your career. Good practice management and good financial management underpin clinical excellence.

Learning outcomes

After completing this module, you will be able to:

- understand the principles of good financial management
- identify sources of income and costs in general practice
- understand budgeting and financial reports
- recognise the processes used to develop fee policies.

1. Your career – your assets

Sound financial management is a core requirement for all GPs.

Whether you are working for yourself, in a group or for someone else, understanding the basics of financial management is important. If you are a practice owner or an associate GP your interests in financial management will generally be broader than if you work as an employee or an independent contractor. The structure of the practice will impact on your financial relationships. Decisions regarding business and/or employment arrangements should take into consideration your individual circumstances and career plans. The possible options are discussed in *Module 3 – Business structures*.

Like many other aspects of general practice, the financial arrangements in general practice have changed over time. Income from general practice may not be the sole income for a doctor and, as some doctors change careers, it may not be a source of income at all.

Financial problems can cause significant personal and professional stress. Despite having high income earning potential, many doctors have experienced financial difficulties ranging from cash flow problems to large financial losses and even bankruptcy. Your patients do not need a doctor who is distracted with financial worries.

Obtaining expert advice is necessary due to the complexity of financial issues, particularly around taxation. In the area of financial management, it is essential to have a good accountant. Your accountant needs to be able to value add to your business, not just balance your accounts. Though you may need one, a bookkeeper is not a substitute for an accountant.

Caution

Because decisions relating to financial management are extremely important, it is **essential to seek advice** from an accountant to ensure you use the most appropriate structure for your situation. The RACGP provides the following information for **general guidance only** so you can be better informed in your discussions with your professional advisers. The RACGP does not accept any responsibility for reliance upon the contents.

2. Patient fees

General practice is mostly a private professional service in Australia. This involves a contract between the doctor and patient on a fee-for-service basis.

There are a number of health insurance arrangements alongside this contract. Patients are supported in paying their medical costs through these third-party health insurers.

These insurance arrangements include:

- injury compensation schemes (eg. insurance schemes following work-related injury or road accidents)
- private health insurance
- the Medicare Benefits Schedule (MBS)
- self-insurance.

Some GPs and patients see Medicare as a system that pays GPs for their care. However, it is more appropriate to see it as a form of publicly-funded insurance. Medicare provides patients with rebates and is not GP funding. See *Section 2.3 – Medicare* for further information.

2.1 Injury compensation schemes

Some income for general practice services comes from injury compensation insurance (ie. work and road injuries). Generally, these schemes are state or territory based and thus vary across Australia. They can involve payment schedules and reporting requirements that differ across the schemes.

2.2 Private health insurance

Unlike private hospital care, patients are not able to insure privately for most out-of-hospital medical expense gaps. Private health insurance covers part of in-hospital care and some ancillary services. These include services with physiotherapists, podiatrists, dentists and chiropractors, as well as glasses and dentures.

2.3 Medicare

The Australian government administers the *Health Insurance Act 1973* through Medicare Australia. Medicare is the program that provides reimbursement to patients for a proportion of personal medical costs (ie. the Medicare rebate). The services covered and amount of government reimbursement to patients are listed in the MBS. Doctors are free to determine a reasonable fee, which may be above the scheduled patient rebate.

The government view is that the MBS fee also incorporates time to recompense for non-face-to-face activities needed for patient care. However, many GPs hold the view that the MBS fee does not adequately cover this component. Examples include the time (and costs) involved in reviewing results, correspondence and communications on behalf of a patient. Unless these are part of a consultation, they do not attract a patient rebate from the MBS. Similarly, there are restrictions on rebates for pathology and diagnostic tests performed in a general practice. This has an adverse effect on innovations in service delivery.

Maintaining a thorough knowledge of the MBS is required in order to comply with the legal requirements for billing with each MBS item and to ensure all eligible service claims are made.

You can download a copy of the MBS fee summary at www.racgp.org.au/your-practice/business/billing/mbs. A full copy of the MBS can be accessed from www.mbsonline.gov.au

Bulk billing

Bulk billing refers to the process in which the doctor agrees to allow the patient to assign the Medicare rebate to the providing medical practitioner. In this situation, the doctor is not able to charge any additional fee (with the exception of vaccines).

Service Incentive Payments

Service Incentive Payments (SIPs) have been provided through Medicare to target specific areas of health concern. These are supplementary payments to fee-for-service income. Examples include incentive payments for completing an annual cycle of diabetes care or performing a pap test for a woman who has not had one done for at least four years (ie. under-screened).

Blended payments – Practice Incentives Program and other schemes

In the early 1990s, there was concern from the profession and government that the structure of the MBS did not reward quality as much as volume. This led to the introduction of blended payments to provide incentives for general practices that provide comprehensive quality healthcare.

The main mechanism for this is provided under the Practice Incentives Program (PIP). These payments are made to the practice rather than the individual doctor. The formula and items included in PIP are available on the Medicare Australia website. Most PIP payments are based on a measure of the practice size, known as the Standardised Whole Patient Equivalent (SWPE) value. The SWPE value is calculated using MBS claims by patients attending the practice during a 12-month period, known as the reference period. The reference period is a rolling 12-month period that commences 16 months prior to the payment quarter.

Some doctors also receive payment-specified incentives (eg. a rural retention payment) under general practice programs funded by the Australian Government.

2.4 Self-insurance

There is a range of services for which patients currently cannot insure. For example, seeking a medical clearance for a scuba diving course. In effect, patients self-insure for such activities and they are fully funded by patients.

General practices also need to consider the value of the services. Apart from the quality of the medical care, other aspects of the service can be important. For example, patients may place a higher value on the ability to see their GP on the way home from work in the early evening.

3. Fee calculations – considering the cost, price and value

It is important to consider the cost, price and value of services when setting fees. The full cost of services needs to be recovered in patient fees. This may mean some cross subsidising of patients or of services. Unless full cost is recovered, the practice will not have a sustainable financial foundation.

The price of services needs to be equal to, or greater than, the cost of the services. If the price of services is equal to the cost, then no profit is made. Although this may seem self-evident, some patients and doctors see the Medicare rebate as the price of the service – along the lines of a floor price or a recommended retail price. This price needs to be carefully considered against the cost of providing high-quality care.

Factors involved in determining your own fee policy include:

- market forces (mainly local)
- patient demographics and ability to pay
- rebates provided by the MBS
- funding policies and regulatory requirements of the Commonwealth Government and Medicare Australia
- attitude of professional organisations
- public opinion and the attitude of patients in your practice
- attitudes of medical colleagues
- your income expectations and needs.

3.1 Market forces

GPs are a limited resource in some areas of Australia. GPs who are willing (and able) to move to areas of most need would find limited competition or pressure from other doctors to bulk bill. In fact, some communities and practices would be extremely pleased to have a doctor. The high level of bulk billing by GPs is noteworthy. The decision to bulk bill all patients is based on either a business model or a philosophical view about the social role of medicine.

In an area where all other practices are providing full bulk billing, the decision process to do otherwise is complex. Doctors who directly bill patients when cheaper alternatives are available need to provide a point of differentiation.

3.2 Demographics

Local knowledge about the community you service will provide information about patients' ability to pay a gap. A large population base with a small number of GPs will provide more scope to direct bill patients. A population with high levels of social and economic disadvantage could be resistant to paying doctors' fees. This can include neglecting health needs rather than attending a doctor.

3.3 MBS and rebates

The Commonwealth Government determines the amounts of the schedule fees for the range of items listed on the MBS. The profession has no mechanism to negotiate with the government on this fee. It represents the amount that the government is willing to pay rather than a value on the service. The government's contract is with the general public, not with GPs.

Most practices use the MBS as a reference point when determining fees even when they charge more than the schedule fee. The MBS is usually indexed annually. There have been occasions

where the government has frozen the schedule or deferred indexation (as in 2013). Doctors who are not listed on the Vocational Register of GPs have not received indexation for rebates. Practices commonly adjust fees annually and usually at the same time as the annual MBS indexation. The Australian Medical Association (AMA) publishes an annual medical fees list with recommendations on fee levels. See www.ama.com.ay/policy/doctors-fees

The provision of a Medicare Safety Net allows patients some protection from high medical costs. This threshold, which often changes, is calculated by Medicare Australia on the amount of gaps paid by patients between the GP's fee and the Medicare rebate. Most costs are generated through specialist fees, pathology and diagnostic tests. GP consultation items are included in an Extended Medicare Safety Net (EMSN) to an amount of 300% of the MBS. Practices can provide their own safety net as an alternative to give patients confidence of limits to out-of-pocket expenses.

3.4 Government policies

As healthcare is one of the big issues on the political agenda, doctors will always be affected by political decisions. This does not necessarily mean more funding, but GPs will need to develop fee policies to address the range of initiatives put forward by the government.

The process of claiming Medicare rebates is a policy designed to encourage direct billing to patients. From an efficiency perspective, patients should be able to pay the amount above the rebate at the practice and have the rebate paid directly to the doctors' bank account by Medicare. However, this is not currently available.

3.5 Professional organisations

The RACGP and the AMA support GPs to determine reasonable fees. Both publicly state the MBS does not adequately support the costs of patients seeing GPs. This position can be used by GPs when they explain the rationale for patient out-of-pocket expenses.

Each year, the AMA provides a chart (below) showing the widening gap between MBS fees, the average weekly earnings (AWE), the consumer price index (CPI) and the AMA medical fee index (MFI).[2] This is available on the AMA website www.ama.com.au

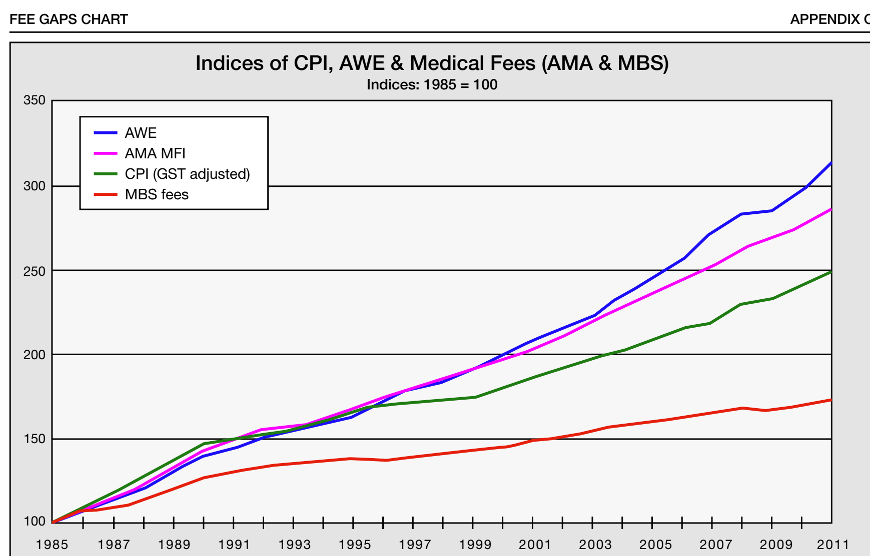

Figure 1. Indices of CPI, AWE & Medical Fees (AMA & MBS)

Source: *Indices of CPI, AWE and Medical Fees (AMA & MBS)*. Available as a PDF at www.ama.com.au [Accessed 21 July 2013].

When several GPs agree to change their billing policy, it is necessary to be sure not to breach Australian Competition and Consumer Commission (ACCC) requirements. The guidelines for this are available from the ACCC website www.accc.gov.au. The ACCC has decided to allow individual GPs working in shared practices, in particular circumstances, to set prices and collectively bargain until 2018.

Seek advice from a legal practitioner to confirm whether your practice is covered by the ACCC determination regarding intra-practice price setting.

3.6 Public opinion

It is important to be sensitive to public opinion, particularly to the views of patients, when determining fees. The majority of patients will accept the fact their doctor needs to charge a reasonable fee, but a small percentage expect 'free' medicine and may complain loudly at the reception desk about any unexpected charges.

The best policy is to make sure patients are well informed of usual fees prior to consultations. This can be done using large notices or patient brochures, or by verbal explanations to new patients. For regular patients, the doctor should explain any additional medical fees or changes. A significant change in billing policy should have a lead-time in order to enable the new policy to be effectively communicated to patients.

3.7 Medical colleagues

It is helpful to understand your peers' attitudes to billing, both within your practice and in the wider medical community, when establishing your fee levels and procedures. It can be helpful to understand how others have determined their fee levels and how well their patients accept these.

Within a practice, agreements on fees can be made without contravening competition laws, as discussed above.

3.8 Your needs and expectations

Ultimately, you need to make the decision regarding your own billing policy and what you believe to be reasonable. Setting fees too low increases the pressure to work faster or longer than may be safe, reduces ability to re-invest in professional development, and may contribute to loss of work satisfaction. On the other hand, if your fees are unrealistically high, you may find patients are either unable to see you or resent you when they have no alternatives.

Many GP services, with an adequate rebate, are currently bulk billed. However, the majority of GPs also privately bill other services (sometimes referred to as 'mixed billing') with successful results. Investing in professional advice from an accountant or management consultant can produce significant benefits in the financial performance of your practice.

4. Understanding financial reports

Ways to ensure good financial management in general practice

- Keep good financial records
- Prepare financial reports
  - monthly statement of financial performance (income statement)
  - annual statement of financial position (balance sheet)
- Perform a simple financial analysis
- Reconcile bank statements monthly
- Prepare a budget annually and compare to actual monthly (or quarterly) reports
- Review fee calculations annually to ensure adequate remuneration

Practice income is a resource for practices. Like information, money flows through a practice. You need to understand the flow of practice income and to be able to make wise judgements about the allocation of practice income to ensure the practice thrives.

Financial literacy is important for GPs. You need to be able to read the documents that provide information about the flow of income and expenditure and to be able to have appropriate discussions with financial advisers.

4.1 Understanding accounting terms

Like in medicine, accounting has a collection of terms that have precise meanings:

- **Accounting** refers to the record keeping and reporting of activities conducted by an entity measured in monetary terms.
- **Financial accounting** involves the preparation of financial reports required by external parties such as the Australian Taxation Office (ATO), shareholders and lenders.
- **Management accounting** is another branch of accounting activities that provides information needed for management decisions. This may report in ratios and percentages as well as dollars.

There are standards for financial reporting that are required in most situations.

In a medical practice, **revenue** is provided from a number of sources, including patient fees, direct government payments (eg. PIP) and the sale of medical supplies (eg. vaccines, dressings). **Profit** is the amount retained after payment of expenses. The term income is also used to describe net profit.

PROFIT (INCOME) = REVENUE – EXPENSES

The **assets** of an entity are comprised of the capital contributed by the owner(s) and the amount of capital borrowed. Hence, **Assets = Capital**. As the capital borrowed is a financial liability, we get the accounting equation:

ASSETS = LIABILITIES + (OWNER) EQUITY

Financial statements are prepared according to specific accounting principles:

- **Income statement** is a statement of financial performance (previously called the profit and loss statement).
- **Balance statement** is a statement of financial position (or a statement of cash flows).

Privately held businesses such as partnerships, sole proprietors, trusts and limited proprietary companies have fewer requirements under corporation law, but still have obligations under taxation regulations to maintain adequate records.

Income and expenses can be recorded as they are received and paid in cash. This is referred to as **cash basis** for accounting. The ATO usually allows medical practices to use cash basis for accounting. In this situation, the statement of cash flows will match the income statement.

A more accurate method of accounting involves recognising a transaction when it is made, rather than when the cash is exchanged. This is referred to as **accrual accounting**.

A balance statement will classify assets and liabilities into different categories to provide additional information. One of the important ways to categorise assets is how readily they are converted to cash.

A **current asset** is an asset that is either cash or can reasonably expected to be converted into cash within 12 months from the date of the balance statement. Cash in the bank and patient accounts receivable are examples of current assets. Assets not defined as current assets are called **non-current** (or **fixed**) **assets**. Buildings, land and equipment are common forms of fixed assets.

Liabilities are also categorised as to when payment is required. Similarly, a **current liability** is an amount that is expected to be repaid within 12 months. For example, accounts payable by patients or a bank overdraft are current liabilities. An amount that is due to be paid at a later date is a **non-current** (or **deferred**) **liability**. These amounts include bank loans and provisions for long-term requirements, such as future staff leave that has accrued but not been taken.

Accounts receivable arise when you have claims against **debtors** (usually patients) for uncollected amounts for services rendered.

Amounts that you owe **creditors** for delivered goods or completed services are called **accounts payable**.

Assets are also categorised according to whether or not they have a physical existence. Fixed assets such as a building or cash in a term deposit account are **tangible assets**. Other assets are classed as **intangible assets**.

A practice's goodwill is an intangible asset. Goodwill is a complex item to record on a balance sheet and it is generally is not included in medical practices'. If recorded, it must be only the actual purchase price of goodwill. Other intangible assets that are not recorded in financial reports relate to the knowledge capital of a business. Investments in training, systems development and skills, while having value, do not have a convention in accounting principles to enable inclusion in the balance sheet.

4.2 Keeping financial records

The process of keeping financial records is called bookkeeping. The historical development has resulted in many, sometimes confusing, accounting terms such as credits, debits, journals and ledgers. Current computer accounting packages have simplified many of the processes involved in data entry and recording transactions.

Double-entry bookkeeping

Each recording of a transaction is an entry. Early accounting required the keeping of books called journals, hence a journal entry. Each entry is transferred (posted) to an account as either a debit or a credit. Using the double-entry bookkeeping convention, the left-hand column entries are debits and the right-hand entries are credits. The convention is arbitrary and should not be confused with other uses of the word credit.

Example:

Cash	
DR	CR

Entries to an account using the double-entry bookkeeping principle require each transaction to be entered twice. There is a credit entry and a debit entry.

The convention requires that asset accounts increase in value when debited, and liability and equity accounts decrease in value when debited. In order to maintain the accounting equation, every debit entry should be balanced by an equal and opposite credit entry.

From the accounting equation (ASSETS = LIABILITIES + EQUITY):

Assets		Liabilities		Equity	
DR	CR	DR	CR	DR	CR
Increase	Decrease	Decrease	Increase	Decrease	Increase

Therefore, an event that requires an entry, such as borrowing money from a bank, would be entered as an increase in liabilities (a credit) and an increase in assets (a debit) and the equation would remain in balance.

If an entry were made to the expense account, such as staff wages, it would be entered as a debit:

Expenses	
DR	CR
Increase	Decrease

In contrast, an entry to the revenue account, such as payment of fees, would be a credit:

Revenue	
DR	CR
Decrease	Increase

Bank statement reconciliation

Performing a bank statement reconciliation is a key task in ensuring business accounts are a true representation of the current financial position. The bank statement will record all transactions as the bank processes them. Some entries on the bank statement may not have been recorded in the practice's accounting system. These are commonly bank fees and interest charges and payments. There are also errors the bank may make that need to be identified. There will also be cheques that have been written but not presented. Additionally, the practice will have some cash and cheques on hand that have not been banked.

Current accounting software is able to simplify this process. It is normally done monthly on receipt of the bank statement.

4.3 Reading financial statements

Income statements

When reading a financial statement, it is helpful to have a point of reference in the same way you use reference ranges when reading pathology reports. This may be a reference to a prior accounting period or to an expected result such as a budgeted amount. Alternatively, the reference may be in the form of a ratio or percentage.

ABC Medical Group Pty Ltd				
Income Statement 30th June 2013				
For ABC Medical Pty Ltd				
			Last year	
Income				
Professional fees	1,500,000		1,455,000	
Grants – PIP	95,000		92,150	
Medical supplies	25,000		24,250	
Interest received	5,500		5,335	
		1,625,500		1,576,735
Expenditure				
Accountancy fees	10,800		9,500	
Bank charges	14,528		14,266	
Computer maintenance	17,570		17,254	
Depreciation	18,100		17,774	
Doctor recruitment	1,250		-	
Fees and permits	125		123	
Fringe Benefits Tax	41,630		35,780	
Hire purchase charges	4,175		4,100	
Insurance	10,210		10,026	
Interest paid	120		118	
Legal expenses	2,500		200	
Locum fees	44,300		23,500	
Medical supplies	46,364		45,529	
Motor vehicle expenses	47,203		46,353	
Payroll tax	16,447		16,340	
Postage	5,375		5,278	
Printing and stationery	3,100		450	
Rent	105,996		104,088	
Salaries – medical	650,977		639,259	
Superannuation	135,432		129,250	
Telephone	12,568		14,300	
Wages	328,240		322,332	
Workcover	3,675		3,609	
		1,520,685		1,459,429
Net profit		**104,815**		**117,306**

Figure 2. Sample income statement

In the income statement for ABC Medical, the current year is compared to the previous year. This should be followed by notes to accompany accounts, which explain the specific account items in greater detail. Professional fees may be itemised according to individual doctors and motor vehicle costs may be assigned to employees as part of a salary-package item.

The bottom line – retained earnings

The most important item to determine in any business is whether it is able to make a profit. The bottom line refers to the last line of the income statement. In a medical practice, such as the example of ABC Medical Pty Ltd, the doctors who own the company are also shareholders. They are drawing a salary that includes superannuation and motor vehicle expenses. Most practices do not retain profits and distribute all earnings each year.

In professional firms such as medical practices, payments to the principals or owners of the business are often structured in a range of ways. Therefore, the profit recorded on the bottom line does not give a true indication of the financial performance. Interpreting these financial statements requires further analysis. In the majority of practices there are no external owners, so the financial performance is usually assessed on the basis of **fees retained**. This is frequently quoted as a percentage.

Example: Dr Andrew Smith, ABC Medical Pty Ltd

Income			
Fees generated	320,000		
Share of PIP	23,000		
		343,000	
Less expenses			
Practice expenses	138,000		
Professional indemnity	13,000		
Motor vehicle expenses	14,500		
Other professional expenses	2,345		
		167,845	
Retained earnings		**175,155**	**51%**

In the above example, Dr Smith retains 51% of his income. This is in the middle of the usual range of 40–60% for medical practices.

Balance sheet

The statement that shows the financial position is the **balance sheet**, which records the assets and liabilities of the entity. This is of particular importance to any party that has provided finance to the business because it will show if the business is **solvent**. Solvency describes whether a business has sufficient funds to pay its debts when they are due.

ABC Medical Pty Ltd		
Balance Sheet		
as at 30th June 2013		
Current assets		
Cash on hand	200	
Cash at bank	32,000	
Accounts receivable	35,000	
		67,200
Fixed Assets		
Plant and equipment at cost	134,000	
less:		
Accumulated depreciation	23,000	
		111,000
Motor vehicles at cost	68,300	
less:		
Accumulated depreciation	32,000	
		36,300
Total assets		**214,500**
Current liabilities		
Bank overdraft	0	
GST payable	4,825	
Hire purchase liabilities	13,560	
Provision for staff leave	12,300	
		30,685
Non-current liabilities		
Loan – Bank West	75,000	
		75,000
Total liabilities		105,685
Net assets		**108,815**
Shareholders' equity		
2000 ordinary shares		
issued at $2		4,000
Retained profit		104,815
		108,815

Figure 3. Sample balance sheet

5. Analysing financial reports

Remember the accounting equation: Assets = Liabilities + (Owner) Equity

Does this hold true for the balance sheet for ABC Medical Pty Ltd?

Total assets	$214,500
Total liabilities	$105,685
Owners' equity	$108,815
	$214,500

5.1 Financial ratios

As stated earlier, all businesses must be in a position to pay their debts when they become due. If a business is unable to pay debts it is termed insolvent. Corporations law makes it an offence to trade while insolvent and there can be criminal penalties. If your entity is not a company, your creditors can apply to have you made bankrupt. This allows the creditors to sell all of your assets, including your house, and prevents you from having access to credit facilities for a period of time. Not only does this cause personal and financial stress, it is damaging to your professional reputation.

The important ratios to calculate from the balance sheet are related to how easily a business can pay its debts. These are termed liquidity ratios. The current ratio is an example.

Current ratio

Current ratio = current assets/current liabilities

In our example ABC Medical Pty Ltd, the balance sheet records current assets at $67,200 and current liabilities at $30,685.

Current assets	$67,200	=	**2.2 : 1**
Current liabilities	$30,685		

Operating ratios

Patients not paying for services is one of the business risks for a medical practice. Some practices avoid that risk by bulk billing, others request payment on the day to reduce the risk and cost of recovering fees. Practices that allow deferred payments, so the patient can submit a claim to Medicare and then post the cheque with the patient's contribution, need to maintain careful attention to managing their accounts receivable. The debtor's turnover rate is a measure of how many days, on average, it takes for an account to be paid.

$$\text{Debtors' turnover rate} = \frac{\text{total credit sales}}{\text{average debtors figure}}$$

From ABC Medical's income statement and balance sheet, we can derive:

Patient fees (from income statement)	$1,500,000
Less fees bulk billed	$750,000
Balance of fees payable	$750,000
Less fees paid immediately	$450,000
Fees payable by account (total credit sales)	$300,000
Accounts receivable (from balance sheet)	$35,000
Debtors' turnover rate	8.6
Divide into 365 to get number of average credit days	**42.6**

Note: for the scenario above, we have used a number of items that would be available from other sources to determine the actual number of patients provided with credit facilities. These are bulk billed fees of $750,000 and fees paid on the day of service of $450,000.

A practice with a debtor turnover rate of 42.6 days may wish to address the way in which it asks patients to pay for their service in order to reduce the cost of providing patients with credit facilities. In a medical practice, it is expensive to administer many small account items, which is an incentive to reduce the provision of credit facilities to patients. Some practices address this by providing a discount for immediate payment.

5.2 Profit drivers for GPs

Profitability is driven by a number of key factors in general practice. These relate to doctor activity, fees and fee payment (accounts receivable), operating expenses (accounts payable), inventory and capital expenditure. By looking at each of these areas in detail, it is possible to identify opportunities to improve financial performance.

There are four key measurements used to analyse profitability from the income-generation side of practice operations:

- Total hours worked (F^t)
- Total hours consulting (face-to-face work) (H^w)
- Total fees generated (F^t)
- Number of services provided (S^t)

From these four measures, we can develop another four calculations that are the profit drivers:

- Hourly rate (HR) = Total fees (F^t)/Total hours worked (H^w)
- Average fee (F^{av}) = Total fees (F^t)/Number of services (S^t)
- Efficiency ratio (ER) = Total hours consulting (face to face) (H^c)/Total hours worked (H^w)
- Service rate (SR) = Number of services (S^t)/Total hours consulting (H^c)

These four drivers act together as a dynamic in the below equation:

$$HR = F^{av} \times ER \times SR$$

Operating cost (or expenses) is the other part of the practice's financial operation. Knowing your operating cost per hour is very valuable when examining how to optimise your financial performance. A simple segregation is staff versus non-staff costs. Staff costs are generally more than 50% of the operating costs.

The *GP Financial Dashboard* comprises a set of metrics for the financial management of a practice. The average fee multiplied by the service rate provides the earning rate. The earning rate can be increased by providing services with a higher value (eg. a procedure) or by providing more services per hour. Services that have a high value usually require more time, which will reduce the service rate. The dynamic between these two factors needs to be considered when deliberating on how to improve income. Your efficiency ratio describes the amount of working time spent producing income.

Awareness of your hourly operating cost will alert you to significant changes in expenses that need corrective actions.

The key outcome is the resulting profit. However, it is important not to see profit in isolation, such as the amount of time taken to generate it. Progressively increasing hours of work to maintain profits is not sustainable.

Below is a representation of the GP Financial Dashboard. There is an example of a dashboard template at the end of the module.

GP Financial Dashboard

Hourly rate	Average fee	Efficiency ratio	Service rate
HR	**F^{av}**	**ER**	**SR**

Cost per operating hour = (**Staff costs** + **Non-staff operating costs**) / **Clinic operating hours**

Profit = **Revenue** **less** **Expenses**

(Fees + other income)

Figure 4. GP financial dashboard

There is a dashboard template at the end of this module.

To track the financial management of your practice, compile and review the information from your GP Financial Dashboard over a period of time. The table below demonstrates an approach to tracking financial management during a financial year.

Example:

	Hourly rate	**Average fee**	**Efficiency ratio**	**Service rate**	**Cost per operating hour**	**Revenue**	**Expenses**	**Profit**
July								
August								
September								
October								
November								
December								
January								
February								
March								
April								
May								
June								

Other measures of performance

Traditional measures of performance in financial analysis, such as return on assets (ROA) and return on equity (ROE), are not particularly useful for owner-operated medical practices. It is difficult to get meaningful benchmarks as there are many different business structures, which provide indirect benefits to the owners.

Measures of productivity, such as fees generated per doctor hour worked and patients seen per staff hour, are more significant. These are two other key drivers behind financial performance in a medical practice. Fees generated per doctor hour worked is the main driver of practice income, while patients seen per staff hour is the main indicator of practice costs.

The measurement of line items in financial reports as a percentage of a reference item is a frequent means of analysis. Examples include expense items as a percentage of total expense and expenses as a percentage of total income. Comparisons can be made with prior accounting periods or budgeted figures, which provides a calculation of variation (or variance analysis).

Break-even point

Many of the costs in medical practices are fixed in advance and do not vary with the activity level (patient service volume). The rent, permanent staff and many of the operating costs are relatively constant regardless of the number of patients seen. These are referred to as **fixed costs**. Some expenses – telephone calls, postage, casual staff and medical consumables – are related to activity level. These are the **variable costs**.

Most of the costs in medical practice are fixed for a given range of activity. The costs increase minimally if a doctor sees an extra 10 patients each day. Whereas, if a practice takes on an extra doctor who requires a dedicated consulting room and is consulting 30 patients per day there is a significant jump in costs. Therefore, one way to make an assessment of costs is to include a relevant range.

In analysing cost behaviour in a medical practice, it is necessary to state the number of doctors in full-time equivalents (FTE) and a patient service volume.

For example:

ABC Medical has 6.5 FTE GPs providing 33,000 – 36,000 services annually.

The costs of operating the practice, excluding principals' salaries, superannuation and motor vehicle expenses, are shown in *Figure 1*.

Fixed costs	$681,130
Average fee	$46.75

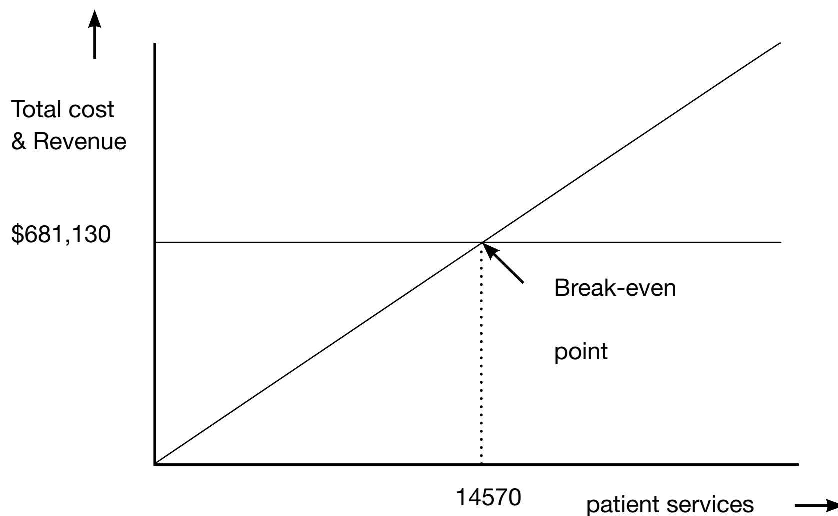

Figure 5. Break-even point for ABC medical practice

For a practice such as ABC Medical, the variable cost is minimal for most patients unless materials or vaccines are used. For this example, we will consider the variable cost (VC) = 0 (zero).

The **contribution margin** is the difference between the patient fee and the variable cost (which is zero in this example). Hence, the contribution margin is $46.75.

The break-even point (BE) is the level of sales (fee revenue) to cover the fixed costs.

BE	=	Fixed costs/Contribution margin
	=	$681,130/$46.75
	=	14,570

This means the practice needs to provide 14,570 services before any profit can be paid to the principals.

As the costs are similar, a lower fee will take more patient services to cover the practice overheads. An average fee of $40.00 would require 17,028 services to meet the practice overheads.

6. Budgets

Budgeting is the process of developing a financial plan for an entity. It is a key management tool to assist with planning and resource allocation decisions and to provide adequate control of business activity and spending. It is usually prepared annually, although, for special projects, it is prepared in the planning stage for the term of the project.

In undertaking a budget, the practice needs to forecast practice activity levels. The main driver for practice activity is the availability of doctors, so the arrival or departure of a doctor will have a significant effect on practice income. Similarly, timing of doctors' leave will impact on cash flow and this should be identified in the budget.

Other constraining factors on the practice may be identified in the planning process. These may relate to staffing (availability of practice nurses) or facilities (practice re-location or renovation).

Budgets involve the allocation of financial resources and should be developed as part of the practice's strategic (long-term) and business plan (one year).

There are four elements to a budget:

- income forecast
- expense budget
- profit and loss budget
- cash flow budget.

6.1 Income forecast

GPs are in the fortunate position of having significant ability to predict income. The main elements are being available to patients at suitable times and charging fees that patients find reasonable. To forecast income, it is therefore a matter of calculating the number of hours you will be available for consulting, and the spread of those hours and your average fee.

To start the income forecast, list the known factors and assumptions. This may include hours worked each day, consulting rate, planned leave and average fees.

Our fictitious ABC Medical practice has four full-time and three part-time GPs (6.5 FTE). They forecast the number of weeks they will be working in the next financial year based on past experience, planned annual leave and conference leave. Using their booking rate, they can calculate how many consultations they will provide in the following year. Doctors starting a new practice need to allow for quieter periods, as they are not likely to be consistently booked in the initial stages.

Example:

Availability/ productivity	Dr A	Dr B	Dr C	Dr D	Dr E	Dr F	Dr G
Weeks worked	46	45	45	46	40	45	45
Hours per week spent consulting	35	35	35	35	20	20	14
Total contact hours							
Per annum	1610	1575	1575	1610	800	900	630
Patients per hour	4.5	4.5	4	4	4	3.5	3.5
Patient attendances per annum	7245	7087	6300	6440	3200	3150	2205
Average fee	$46	$46	$46	$51	$46	$45	$45
Fee income	$333,270	$326,025	$289,800	$328,440	$147,200	$141,750	$99,225
Total fee income							**$1,665,710**

The above table provides an annual estimate of income, but will not determine cash flow for each month. This is particularly important when costs fluctuate or if doctors take extended leave. Some practices manage fluctuations in income by using a bank overdraft or by increasing the working capital.

In order to chart out the practice income, you need to plan when doctors will be consulting over the year ahead, which involves a holiday planner and recognition of when public holidays occur. This can be used to estimate cash inflows.

Work planner

(work leave shown in blue)

	July	August	September	October	November	December	January	February	March	April	May	June	**Total days**	**Weeks**
Dr A	21	13	21	22	20	19	18	20	20	10	21	21	226	**46**
Dr B	21	21	18	20	20	19	10	20	20	10	20	20	219	**45**
Dr C	21	21	20	10	20	19	15	20	16	20	20	15	217	**45**
Dr D	15	21	18	15	20	15	20	20	20	20	20	20	224	**46**
Dr E	15	0	18	18	18	19	18	18	18	18	18	18	196	**40**
Dr F	21	21	18	20	18	19	10	20	20	10	20	20	217	**45**
Dr G	21	21	20	10	20	19	15	20	16	20	20	15	217	**45**

Figure 6. Work planner

Taking the first quarter of the financial year as a sample, the daily work planner converts to the following forecast of cash inflow.

Fee Income	July	August	September
Dr A	$6,762	$4,186	$6,762
Dr B	$6,762	$6,762	$5,796
Dr C	$6,762	$6,762	$6,440
Dr D	$5,355	$7,497	$6,426
Dr E	$2,760	–	$3,312
Dr F	$3,780	$3,780	$3,240
Dr G	$2,646	$2,646	$2,520
Total	**$34,827**	**$31,633**	**$34,496**

The income is reasonably stable in the above quarter, falling in January due to a number of doctors taking leave.

January	
Dr A	$5,796
Dr B	$3,220
Dr C	$4,830
Dr D	$7,140
Dr E	$3,312
Dr F	$1,800
Dr G	$1,890
Total	**$27,988**

This process is followed for other cash inflows. PIPs are received in August, November, February and May.

6.2 Expense budget

If you already have a consistent pattern of expenses, it is possible to develop a simple expenses budget by rolling this forward for the next financial year and using an estimated inflation figure. Accounting software can automate this process. This will reduce the time involved and is often a reasonably accurate way of achieving the budget. After this has been done, it is possible to make variations in known changes to cash outflows for the year ahead. This may be the commencement of a new computer lease, purchase of equipment, or provision for staff leave.

This should be repeated for each month of the full financial year.

Using an expense budget is the primary management tool for controlling overhead expenses. Checking actual expenses against budgeted amounts will provide an opportunity to make corrective actions early.

Examples of issues that can cause overheads to escalate include:

- lack of planning for staff leave
- overstaffing
- purchasing too much stock
- buying equipment before it is needed
- too many people making purchasing decisions without reference to a manager or supervisor
- purchasing non-essential items
- not negotiating or finding lower-cost items or services.

6.3 Profit and loss budget

The profit and loss budget will include non-cash items such as depreciation. Capital item provisions such as staff leave entitlements are not included as they are recorded on the balance sheet. A profit and loss budget will enable an estimate of taxation liabilities.

6.4 Cash flow budget

The composition of the income forecast and the expense budget enables the construction of a cash flow budget. This allows an organisation or individual to know the timing of cash inflows and outflows and the availability of cash in the bank.

The inflows and outflows for each month are recorded with a predicted cash balance.

	July	August	September	October	November	>>>
Cash available						
(beginning of period)						
Cash inflow						
Fee income						
Grants						
Other						
Total inflow						
Cash outflow						
Staff costs						
Non-staff overheads						
Financing expenses						
Taxation payments						
Distributions, drawings						
Other						
Total outflow						
Cash available						
(end of period)						

7. Personal asset management

The term wealth management is financial planning jargon that may sometimes jar with doctors. Many GPs feel uncomfortable with the idea of accumulating financial assets as the rationale for their efforts in providing healthcare. Wealth can be considered the resources accumulated to sustain your standard of living after you stop working. Another perspective is that it is a form of energy storage relating to previous efforts.

Notwithstanding any misgivings about the jargon used, most people wish to be able to support themselves independently of government or welfare. As our life expectancy increases, many are concerned that their resources may not stretch far enough to provide this level of independence according to the standards of living they have experienced during their working life.

7.1 Financial planning

GPs will have different priorities and saving ability as they go through their professional lives. It is helpful to recognise these stages and develop a financial plan that will change over time. For example, financing domestic needs, accumulated student debts and, possibly, children may be dominant priorities in the early part of a GP's career.

Buying into a practice is often a valuable investment as it can increase income at a much higher return than the cost of purchase. As your domestic liabilities come under control, investing wisely should be a priority. **Remember, high returns = high risk**.

Quality professional advice from a financial planner is an excellent investment. However, after receiving the advice, you are the person that has to make the final decision. You should not invest in something that you do not understand. Recognise that some financial planners are rewarded by recommending certain products and may receive trailing commissions. Some managed funds take up to 4% of your initial investment as an entry fee.

Asset protection

As a doctor, there is a possibility that you could be sued for a large sum of money. Maintaining professional indemnity insurance is now a condition of medical registration. Many advisers recommend business and ownership structures that further reduce the risk to personal assets and these should be carefully considered. In addition to medical indemnity, practices require indemnity insurance to cover the actions of staff, as well as public liability insurance.

Income protection insurance is an important tool in financial protection, as is life insurance to provide for any dependants you have. Do not fail to make contingency plans for the unexpected in this regard.

Superannuation

The government provides incentives for people to save for their retirement. The income on money invested in superannuation is taxed at a concessional rate of 15%. Because of the effect of compounding, investments in superannuation funds will grow much quicker than equivalent outside assets. However, the money is locked away until you reach retirement age. Most advisers agree superannuation is a highly effective investment strategy.

Estate planning

Professional advice is recommended in regard to determining how your assets will be controlled and distributed when you die. There are structures (eg. wills, trusts) that can be developed to determine how your estate is managed.

7.2 Loan applications

Businesses usually use borrowed funds to develop and grow. Applying for a loan requires consideration of how the lender will view the risk.

Lenders consider the 3 Cs for credit risk:

- cash flow
- capacity to repay (determined by cash flow)
- character of the borrower.

Lenders require the following details in order to determine your capacity to repay:

- **The practice**: a short description of the practice – its history, key persons, services, number of staff, location and a description of the premises and other key assets. For start-ups, describe the services you intend to provide, projected demand for your services and your marketing plan. Provide research that supports your projections. Information from Primary Health Networks may assist in this area.
- **Professional resume**: detail your professional qualifications and past experience in running a business. If you have no experience in this area, show how you will use other people's management skills (eg. accountant, practice manager, business adviser) to assist in the running of the practice.
- **The loan**: describe the purpose of the loan and the amount required, including how this was determined.
- **Financial statements**: provide a current balance sheet, copies of annual accounts for the last three financial years (if available) and a cash flow projection, which demonstrates how loan repayments can be made.
- **Security**: lenders usually seek some form of security from you, such as assets (property, real estate), surrendering the value of an insurance policy, or a personal guarantee.

8. Financial benchmarking

Comparing your practice to others can give important information regarding performance. Using a broad range of measures allows you to see whether there are areas in your practice that require more focused attention.

A benchmarking report will show where you fit in relation to industry best practice. Your accountant can assist you in this area, but there are also private enterprises that do benchmarking for medical practices.

References

1. Australian Government Department of Human Services. 2014 Medicare Safety Net thresholds. Available at www.humanservices.gov.au/customer/enablers/medicare/medicare-safety-net/medicare-safety-net-thresholds [Accessed April 2014].
2. Australian Medical Association. Indices of CPI, AWE & Medical Fees (AMA & MBS). Available at https://ama.com.au/system/files/17._gaps_chart_-_november_2013_-_colour.pdf

Resources

- The RACGP General practice management toolkit
  www.racgp.org.au/your-practice/business/managementtoolkit
- Medicare Australia
  www.medicareaustralia.gov.au
- Department of Human Services
  www.humanservices.gov.au
- Australian Medical Association
  www.ama.com.au
- Australian Competition and Consumer Commission
  www.accc.gov.au
- Australian Taxation Office
  www.ato.gov.au

Keyword searches

Useful keywords when looking through the web:

- Financial assets
- Equity
- Liabilities
- Revenue
- Accrual
- Retained earnings
- EBITDA
- EBIT

For the best results, use the words in combination by using double quotation marks at the beginning of the first word and end of the last, (eg. “financial assets”).

Example of a GP financial dashboard

GP financial dashboard

Fees	Gross fees	Hours consulting	Services (volume)
÷	÷	÷	÷
Hours worked	Services (volume)	Hours worked	Hours consulting
=	=	=	=
Earning rate	**Average fee**	**Efficiency ratio**	**Service rate**

Cost per operating hours		=	Staff costs		+	Non-staff operating costs		÷	Clinic operating hours	

Profit		=	Revenue (fees and other income)		–	Expenses	

Activities

Activity 1. Performing a costing task

In this activity, you are asked to examine the running cost of a number of operational components of your practice. The purpose of this is to break down and examine the overheads that contribute to your overall financial position.

Step 1. Examine your practice in quarterly intervals and estimate or find out what each component will cost you to operate.

Cost category	Total practice costs for 3 months	Estimate cost for you
Labour costs		
Practice principal/partners – total		
Salaried employees – total		
Locums – total		
Deputising medical service – total		
Total GPs		
Practice staff		
Practice nurse(s)		
Reception/administration		
Business manager		
Practice manager		
Technicians		
Total labour costs		

Non-labour costs (fixed)		
Repairs and maintenance – plant and equipment		
Medical consumable(s)		
Finance management		
Registrations and subscriptions		
Occupancy		
Rent		
Security		
Cleaning, laundry and waste disposal		
IT		
Hardware		
Software		
Internet service provider		
Insurance		
Non-medical		
Professional indemnity		
Income protection		
Contents and public liability		
Total fixed costs		

Non-labour costs (variable)		
Marketing/advertising expenses		
General		
Consumables		
Bad debts		
Utilities		
Electricity and gas		
Telephone and fax		
Education		
Subscriptions, journals and registrations		
Continuing medical education		
Other		
Total variable costs		
Total non-labour costs (total fixed cost + total variable costs)		
Total practice expenses (total labour costs + total non-labour costs)		

Source: Table adapted from PriceWaterhouseCoopers. Medicare Schedule Review Board. A resource based model of private medical practice in Australia – Final Report. 2000 Dec.

Reflect

What overheads do you consume more of? What is the individual cost to you to provide this service? It is important that your fee adequately reflects the cost of providing the service against your practice overheads.

For example, consider if your fees for procedures (ie. immunisation/surgical) adequately reflect the variable costs associated with the service. Consult with you accountant to discuss how fees could be set to better manage your financial position.

Step 2. After looking at your general overhead, perform the same task for income generated.

Availability/productivity	Dr A	Dr B	Dr C	Dr D
Weeks worked				
Hours per week consulting				
Total contact hours (pa)				
Patients per hour				
Patient attendances (pa)				
Average fee charged				
Fee income generated (Average fee charged x Patient attendances) (pa)	$			
Total fee income generated	$			

Step 3. While it does not provide an exact financial position, it is useful in getting a basic idea of where money is being distributed in your practice. Use the information to talk to your accountant about how particular aspects of your income or overheads can be better managed.

Activity 2. Personal wealth management

Case scenario

You are going to see a financial planner. To better prepare your meeting, consider the questions below.

1. **My financial objective is to:**

   Build an investment portfolio (wealth creation)

   Review my superannuation assets

   Provide a retirement income

   Achieve a specific goal

2. **This is part of my overall personal goal in my career to:**

3. **I/we have the following business structure:**

   Incorporated company

   Family trust

   Partnership

   Sole trader

   Self managed superannuation fund

4. **Within this business structure, I want to build my remuneration to:**

   $ in the first year

   $ in the second year

   $ in subsequent years

5. I plan to further my clinical knowledge and undertake further education over a period of:

<2 years

2–5 years

5 years

6. My/our current gross income is:

Client/second income $

Partner $

Other $

Total $

My/our annual lifestyle expenditure is:

<$20,000

$20,000 – $30,000

$30,000 – $40,000

>40,000

Assets and liabilities				
Description	**Market share**	**Liabilities**	**Gross income**	**Owner**
Personal (including family home)				
Investment assets				
Superannuation				
Total				

7. My/our investment/knowledge in this area is:

Experienced

Moderately experienced

Inexperienced

8. My/our lifestyle objectives are:

Short-term (<2 years)

Medium-term (2–5 years)

Long-term (>5 years)

9. My/our proposed retirement years are:

and

These do not cover all of the areas you will need to consider, but it is a start. You should reflect on how these relate to your personal and professional goals. Consider the questions below:

- Is there enough time or do I need to re-adjust other plans?
- How much time does this take away from family?
- What commitments are required?

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