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FISCAL RESPONSIBILITY IS MANDATORY—not optional—to compete and survive in a challenging health care environment. An important aspect of management of a medical practice, or a similar health care entity, is monitoring the finances of the organization. Typically, those who are responsible are generalists or administrators with broad skill sets in business operations, not accountants or financial managers. Monitoring and observing historical and current data allow the administrator to make informed decisions or, in other cases, to communicate important financial information to those who are decision makers for the practice. This complete resource simplifies the financial planning process while establishing a foundation for making these necessary decisions in developing and maintaining financial systems to ensure a profitable practice. Whether one is considering entering private practice as an owner or employee, or currently working for a medical practice, this practical resource provides in-depth information on the fundamentals of financial management and future economic planning.

Financial management of the medical practice encompasses gathering data, interpreting data, and responding appropriately. Financial management comes from various roles within the practice, with responsibilities spanning numerous job descriptions. Some tasks and oversight will be at the administrative level, while other responsibilities will be at the ownership level. The savvy manager will understand the nuances of data, the information that it yields, and the applications that must be made to achieve a viable business organization.

The purpose of this book is to help management generalists and administrators attain a sufficient level of understanding of the financial aspects of practice management so that they may successfully function in this position. This latest edition applies best practices, identifies current trends, and examines savvy processes that will enable administrators to gain greater control of their practice’s financial performance even in the midst of health care reform and the economic downturn. The authors, on the basis of their many years of work with physicians and hospital networks, address the economic landscape of the current health care environment and project the prospective impact on medical practices, especially as they plan for a financially secure future. Filled with charts, checklists, examples, and sample reports, this book presents the necessary tools and fundamentals to assist the management generalists and administrators in their position.
The authors recognize that the administrator of the practice may or may not have formal accounting training, hold a position of ownership, and be the ultimate decision maker in the practice. The objective of this book is to provide foundational information to nonfinancial managers that can be enhanced or supported by accounting professionals who are selected to serve the practice. With a strong foundation, the practice administrator or management generalists’ role will provide the practice with sound operational processes and fiscal stability. As the landscape of the health care environment continues to evolve, education as to what options are available to medical practices and the financial impact these decisions will have will be vital to whether medical practices will be able to survive and thrive.
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Controlling Expenses

OUTLINE

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   A. Types of Expenses
   B. Expense Management Tools
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      2. Trending Analysis
      3. Benchmarking Analysis
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Medical practice expenses are typically considered to be all outgoing disbursements of the practice. In a broad sense, expenses of closely owned medical practices can be broken down into two categories: operating expenses and physician-owner expenses. Operating expenses, often also called overhead, are expenditures that are related to the practice’s day-to-day operations. Examples include rent, medical supplies, staff salary, and employed-provider salaries. The last of these encompasses compensation and benefits related to physician owners of the practice. In most private medical practices, physician-owner expenses
are essentially the operating profit that remains after all overhead has been paid: in other words, all before-tax earnings.

This chapter primarily focuses on the operating expenses, ie, items prior to physician-owner expenses. These also include expenses relative to employed providers. The objective of this chapter is to consider the best ways to manage and control general operational expenses (ie, overhead).

### Expense Management

Traditionally, the task of expense management is carried out by the management team of the practice. These individuals do not have to be accounting/finance experts, but to conduct effective expense management, they should have:

- Knowledge of how overhead expenses will be presented, reviewed, and analyzed;
- Comprehension of some of the basic concepts (ie, definitions) of expenses; and
- Attention to specific areas that comprise the majority of a practice’s expenditures.

### Types of Expenses

For practice management to develop an effective expense management plan, it is essential for managers to understand the characteristics of expenses. In financial management, there are two basic types of expenses:

- Fixed expenses
- Variable expenses

**Fixed expenses** are expenses that remain relatively stable each period, regardless of revenue or patient volume. These include such costs as rent, malpractice insurance, information systems, and furniture/equipment (via depreciation). Staff salaries, if paid on an annual salary basis, should also be considered fixed expenses.

**Variable expenses**, on the other hand, tend to fluctuate as the patient volume/revenue changes. Examples of these include medical supplies, outsourced billing costs (if based on a certain percentage of collections), and hourly wage expenses.

In most cases, fixed expenses account for a larger portion of the total overhead for medical practices. Moreover, the majority of these
are relative to the operational functions that the practice must possess in order to operate appropriately. For example, a practice must have an office facility to see patients. Therefore, it is essential to closely control this type of expense. The good news is that once a certain amount of fixed expense is absorbed, any additional revenue will flow to the bottom line. However, the bad news is that fixed expenses will exist regardless of how much revenue is generated. Thus, in the low-revenue-generating practice, the fixed expense will be a much greater percentage (common-sized), resulting in lower margins (incomes) to the physicians.

Variable expenses are less controllable, yet should only change with volume. Because they are a much smaller percentage of the total overhead, they have less of an effect on total profitability. They are very important, nevertheless, as a part of the expense control process.

In cost accounting, a break-even point refers to the point at which expenses and revenue are equal. For medical practices, the break-even volume can be used to determine the amount of patient volume or revenue that must be realized to pay for the overhead required to operate the practice, the majority of which is fixed expenses.

Figure 3-1 illustrates the relationship between fixed and variable expenses, and the results of profitability opportunities. This figure clearly shows that fixed expenses encompass a certain segment of the total practice overhead, which is plotted via a straight line. Variable expenses are plotted on an angled line, with the profitability being everything over the plotted break-even point. The figure shows the

![Figure 3-1 Cost-Volume-Profit Graph](image-url)
operating loss area as well as the operating income area. Once fixed costs are covered, they will effectively remain unchanged even with increases in income. The only expense that results after fixed costs are covered is a small portion of variable expenses. Therefore, the profitability of the practice greatly increases at that point.

To translate the theory in Figure 3-1 to the real-world medical practice, the opportunities for increased income are usually stated in a practical way. For example, the most practical way to generate an increase in income is simply to increase the number of encounters per day (based on the knowledge of the average amount of revenue per encounter). As a result, the number of encounters may be plotted on a similar graph to illustrate the break-even point. Figure 3-2 shows that once fixed costs are covered, the practice can generate greater operating margins merely by changing the additional variable.

In Figure 3-2, the vertical column of the graph is expensed in thousands of dollars of revenue. The horizontal line considers number of patient encounters. The illustration depicts how profit (the space between the revenue and expense lines) increases as the angular line of revenue goes up. The revenue increase can also be readily seen in Figure 3-2. For example, at 3,000 patient encounters per year, the practice will generate a revenue total of $200,000. The profitability is much lower at that point, probably $50,000. Compare those results to the performance results at 6,000 patient encounters. At that level, revenue is $400,000 and expenses are only about $175,000, so the profit is $225,000. This clearly illustrates that with virtually the same amount of fixed costs between the two levels of productivity, the only difference is a small increase in variable expenses as the number of patient encounters/revenue increases. In this example, revenue is increased by 100% (e.g., $400,000 vs $200,000) while expenses have increased by only $25,000 (variable expenses). This is the key to profitable