

The Millennium Process

The process for the Millennium is to go through an analysis of what occurred in each practice and what the percentages were. To look for trend of each practice is a tedious activity but yields more substantial fruit than merely going to the bottom line.

The purpose of the Millennium is to tear down each component of each practice to see similarity of commentary that is occurring within each practice and understand how that similarity affects each practice in the room. A person who has a Millennium report should be marking up that report, or place notes electronically on their own computer, of why things occurred in one practice versus another.

For example, let's look at drugs and professional supplies. We will see a wide variance of what occurs in drugs and supplies mainly because of the convention of accounting. Some practices will be on the modified accrual basis of accounting and others will be on a modified cash basis. Theoretically, a practice on a modified accrual basis of accounting would have the least variance in cost of professional services without a major change in either philosophy or mode of operations in practice.

If a practice has cost of professional services that includes all other components (i.e. radiology, laboratory, hauling expense, and body removal, professional supplies, and other costs relating to the direct provision of services), there should be little variance because these are what are called "direct costs". They have a direct relationship to the total gross income in the practice. If, on the other hand, we find an accrual based practice having a wide variance of cost of professional services to total gross income, we believe 1) there could be a defalcation issue, 2) poor inventory cutoff because drug and professional supply inventory must be taken at the beginning and end of the year, and 3) the accruals are faulty because they are closing their books and records way too soon, or they have a poorly designed inventory system so that the inventory count or extension of the inventory on a pricing basis is inadequate.

We see all these variations and one thing that comes to mind is that the practice itself has trouble with internal control. The internal controls do not safeguard a consistency in terms of the cost of professional services; therefore, a couple of things could be occurring. The purchasing agent – the individual in practice who is purchasing the drugs, is not purchasing them at a price that is as good as another practice. In the Millennium activity, we will be focusing heavily on drugs and professional supplies. Things that change the pricing of drugs and professional supplies include utilization and acquisition cost. Some practices have a better best price than other practices. Some practices monitor their inventory and control that inventory without having pilferage or other outsourcing of inventory in an unauthorized basis. Some practices have a high component of theft in practice and others have massive waste that can only be measured in each practice through the Millennium when we have a good beginning inventory, a good ending inventory, purchases that are not polluted because of inappropriate classification, and finally a good ending accrual based cutoff.

The Millennium Project also provides a regression model. The regression model is geared into gross income, one of the first and major areas of study that we have in the Millennium Project. Each project has its own story of why its gross income increased or decreased from year to year. As part of the Millennium activity, we like to spend time in understanding why the gross income changed; so we ask each participant to refer to their regression model. Some practices may have multiple regression models within one Millennium report because we want explained some trend line that may be inappropriately affected by a significant change that happened in the practice in one base year that is not going to consistently follow in others. You will see, in some Millennium reports, two different regression models shown in one report.

The management letter explains our thought process of why one practice will be different than another practice in some issue of change in gross income. We focus on gross income because there are a couple of different issues that affect gross income. First of all, accrual based practices have receivables. Receivables change and with that change, the amount of cash that can be collected changes. An accrual based practice with good accounts receivable control should have a very reliable gross income in similar manner to a good practice on an accrual basis of accounting that has good cutoff of inventory control so that the cost of professional services is reliable.

Things that affect gross income in the practice include but not limited to: allowance for bad debt that can be written off in practice to practice, the amount of gross income that can be collected in one practice versus another, the write-offs that occur that are authorized discounts and manual-based discounts, or discounts that are off the menu. Discounts off the menu include forgetting to charge for services rendered, decisions made by the doctor to intentionally not charge for services rendered, or potential discounts that can be identified based on the doctor's incompetence because the doctor thought the result was not was hoped for, the doctor did not charge for services in this specific area. We would hope that each practice, when they take their Millennium report back to the practice and performs a doctor-by-doctor analysis and runs the same calculations to see what the rate of increase of each doctor is, year-by-year, based on their production reports.

The Millennium report becomes a study aid that the VMG member takes back to the practice and then drills down again to determine why one practice changed year-by-year. The quarterly reports allow members to make an assessment on a more frequent basis and the purpose of the Millennium report is to take the burps and bubbles that occur on a quarter-by-quarter basis and assess why things occurred in practice based on changes that can happen, such as the acquisition of a mode of practice, the change in the number of available clinicians in a practice year-by-year, the ability of the practice to collect on fees without the necessity for bad debt write-off.

Even on a modified cash basis of accounting, the basis of accounting has a direct bearing in terms of the practice to generate profit.

This also assumes that each VMG member is prepared to discuss the fluctuations that occurred in their practice year by year since, theoretically, they have the Millennium report prior to the time of the meeting. The purpose of the report and the aggregation of the group as a whole are to have each member prepared to tell the story of what occurred in their practice year by year. To just sit there and say, "Well, I don't understand" cheats the rest of the group out of a learning process.

Another benefit of the Millennium activity is that there will be epiphanies that evolve in the course of the meeting not only from the members' presentations of why fluctuations occurred but the interrogatories that occur from the floor by each member. Enough time is allocated to allow members to analytically question and hold each member's feet to the fire of what variation occurred in their practice and why things could have changed. For example, a member may make a statement about why the practice gross increased. There would be follow-up questions not only by facilitator and Owen, but also by each member reviewing the activity to go beyond the opening volley of commentary to determine the real logic and reason of what happened in the practice.

The purpose being that each member not only wants to help the practice at question, but also wants to learn what specifically happened in their practice that they can take back and make changes to possibly impact their earnings. Also, lessons of failure can be extremely valuable. Those practices that do not increase at the same level, or possibly had decreases in gross can become valuable learning opportunities for the group as a whole as long as each member in the group is willing to positively interrogate the subject practice at question of what happened so they can learn from others' mistakes.

The other exercise of the Millennium Project is the first time we have financial data available. Management data is different from financial data. In a letter that was submitted to one of the management groups, the distinction is made of what is managerial reports, financial reports, and tax returns? Managerial reports have a perspective that is different than financial reports and tax returns. For example, the quarterly report information that we accumulate and compile and, therefore, submit back to each member is based on managerial information. The VMG quarterly report format uses this managerial information. There are inherent deficiencies in the managerial report. The advantage of a managerial report – that is, it is extraordinarily timely. There is a variation between timeliness and accuracy. An accurate report is one that takes time to prepare. A managerial report accepts the deficiencies that occur in immaterial accuracies in order to have information on a timely basis.

Financial-based reports – that is, reports that are used for the Millennium Project, are completely different in scope than managerial reports because many months are available after the specific close of the year-end where the accountants have the availability to ensure the accuracy of the financial information. The accruals that are established and adjusted, reclassification of expenses that may have been inadvertently placed in one

account versus another, the cost that should have been adjusted out as capitalization items versus costed items all have a bearing in terms of the final financial result. The Millennium report takes advantage of the accuracy of the reliability of accruals, reclassifications, and capitalizations versus expense items to receive information that is superior to a managerial financial statement.

This reporting information is compared to another form of financial-based activity – the tax return. The financial statements received by us and the tax returns must be coincident in terms of ending entries. We have found, in some managerial reports that we have reviewed, financial information may not be accurate and we accept that financial inaccuracy, but the tax return information and the financial statement information having the advantage of the availability to make the appropriate accrual and reclassification items should be extraordinarily accurate and most certainly should be coincidental – that is, the tax return information should be reconciled to the financial statement.

Some of the VMGs provide information where the financial statements are not reconciled to the tax return. Ultimately, we will rely on the accuracy of the tax return because in the reporting process, final information submitted to the VMG member with the greatest level of accuracy is the tax return. That return is signed by the practitioner and the preparing accounting firm under of perjury that everything is true and correct.

Honesty is the Best Policy

In the Millennium Project, part of the process is to teach each doctor how defalcations and collusion for absconding assets or acceleration and enhancement of liabilities has a horrible impact in practice. For example, expenses that are not true expenses in practice cost the practice on a 5:1 ratio. Discounts indiscriminately offered cost the practice \$5 for every dollar of consistent discount. Part of the process for the Millennium Project is in the capitalization. We wish to dwell on the decision-making that the practice has so that practice can see how \$25,000 of inappropriately placed expense can impact \$125,000 of value at the point of sale. Since no one knows the day or the hour, we hope to drive home the benefits of honesty and appropriate classification and how investment in the administrative arm of the practice can generate more income and more wealth for the practice because of appropriate classification.

Interrelationship of Information

We have talked separately now about the correlation of gross income with cost of operation. Now let's talk about ratio and product mix. In focusing on gross income, one of the aspects that need to be discussed is product mix – that is, the portion of income in each practice that is generated from product versus services. In one practice, the cost of professional services may be much higher than another practice and, ironically, one practice that grosses less income may be worth more than another practice that has a higher gross income because the product mix is so heavily geared to low profit margin items such as the vending of drugs and supplies. Those practices that focus on the higher component of service will generate a higher profit margin. Also, the ability of the practice to charge a higher fee for services rendered will cause the ratio of profit – the bottom line, the expected earnings to be much higher than another practice with comparable gross income because the component of mix of gross income requires less cost because that practice is generating more gross income – that is, more fees with less effort and less cost to produce that gross.

The dollar value of gross income is only one component that we explore in the Millennium Project. We also review product mix and the ratio that exists in that product of the income that is generated for product, vis-à-vis the cost to acquire that product. We would focus on specific line items such as laboratory. If the accounting information is available and reagents are reclassified from drugs and professional supplies to laboratory costs, there is a direct correlation in how levels of service and income stream affect the earnings. Another classic example of this direct correlation that can happen from a Millennium Project would be radiology costs. Those practices that do have their total gross income generated by segment of practice and have that available at the meeting for analysis have the added advantage of allowing us to drill down into the specific components of profit from isolated areas of segment of service.

Philosophy in Practice

Also a correlation of the Millennium activity is philosophy. Each practice has its own philosophy towards charging, providing service, and monitoring the efforts of their doctors. The old adage comes to bear, "If it can't be measured, it can't be improved" is a significant caption as it relates to the Millennium Project because our

hope and effort is that, in each Millennium meeting, the doctors will be inspired to go back to their practice and start to re-measure (or measure for the first time) those components that are discussed of why one practice improves over another practice.

The Millennium Project, in its philosophic mode, is really a Roman-based examination of conscience – that is, making an assessment in the course of the meeting of the things that other people do, vis-à-vis our practice, and making a real time determination that things need to change. This reconciliation of what occurs in one practice vis-à-vis the total practices in the Millennium Project allows the practitioner to go back and have the moral fire power to ensure that alternative operations occur in their own practice.

The Third Harvest – Using Base Information from the Millennium to Provide to Consultants

As part of this project, every practice will see a need to gain outside advice and counsel. Ironically, the Millennium Project provides any consultant with an extremely good snapshot of trends that occur in practice over four base years. We have no problem with having information that already now is in the hands of each practice in electronic format to e-mail the current Millennium activity to their consultant of record so that they have a chance to provide further commentary. The more eyes that review data the more formats in which it is reviewed the better the opportunity to improve the practice. Many consultants have used the summarized reports from the Millenniums as the basis upon which they do their pre-consultory homework. Practices pay for the assimilation of comparable information. The consultant has this comparable information available immediately in front of him and does not, in essence, have to take another x-ray of the practice for the same issue. The Millennium Project becomes a good way to send information to a consultant as a means for a pre-assessment of where the practice is going.

War Stories Brought to the Home Front

In the course of the Millennium Project, there will be stories told about how a practice changed its operations internally. The war story may be so parochial as to identify a specific change in a specific doctor that caused the entire gross of the practice to be altered materially. In the Millennium Project, what hopefully occurs is that there is a recounting of these war stories back on the home front – that is, when the Millennium report is brought home, it is something that can be shared with the principals of the practice and possibly with specific isolated individuals to bring home the idea that it is not necessarily the economy or the lack of facilities or the ability of the practice to attract additional doctors to cause the gross to go up, but real life, real time stories that occurred in other practices that are now documented and available. Of course, each practice is not capable of sharing information of the other practices by name, but the war story is available and can then be used as part of the process towards individual mentoring of doctors within a practice so that the value of the Millennium can span for a whole year in meetings with associates and principals as to how to improve their practice margins.

The war stories are also capable of being shared with specific key members such as practice managers. Each component expense is identified by major caption such as facility cost, administrative cost, payroll cost, professional costs, etc. so that each Millennium project for a specific practice can then be shared with key people on a need-to-know basis.

If He Can Do it, So Can I

In the course of the Millennium, there will be stories of why things occurred in one practice versus another. Perhaps there was a service added that allowed leverage of the practice, not by a doctor but by a technician. Perhaps new equipment was purchased that was used in a unique and fresh way. The Millennium Project allows us to drag the stories out of each practitioner through the appropriate interrogatories that happen as part of the Millennium activity where one doctor just will not let the comment “Well, your practice increased by 33.0%, why did it happen” and have the inquiry being “Well, we’re just more efficient doctors” there is a story behind it. In the Millennium Project, part of the role of the other members is to drag that story out so they can learn what worked in the practice so they can possibly assess whether they can do that in their own practice, too.

The lesson of qualification as part of the Millennium Project that discussion will be the volume of dollars that a practice can handle. A lot of practices will express the familiar refrain, “We need more doctors”. A second thought process is to qualify the practice instead of quantify. Practices rank their clients: A, B, C, and D. A practice may need to unload some of their D clients in order for their margin to improve. Ironically, advertising, as an expense item, is a tool for qualification of practice.

Every practice should reassess its present client mix to determine how they can class up their practice by taking more of the A and B clients and weed out those clients that are less than performing for their practice group. Ironically, with better clients and fewer doctors, a doctor may make more money. Sometimes, the caption is, "Why should we be worried about expanding our practice when we don't have enough doctors to handle the volume we have now?" The answer is: Perhaps the qualification of the practice is demanded so that you can constantly improve the layering of clients that occur in practice.

In the Millennium Project, we should talk about firing clients to improve margin. How every profession constantly reassesses its client mix, as well as product mix, to determine how they can improve the value of each man-hour that occurs in practice. If a doctor shortage is available for a specific year, a practice can make more money with fewer doctors if they qualify their client base. The Millennium Project will focus on the precious resource utilization of existing man-hours and facilities to generate better gross.

The Millennium Project is a way to get to the real story. Sometimes, practitioners gloss over details but they know the specifics, they just have not recounted it. An example might be a change that occurs in an expense item from year to another. For example, employee benefit costs could change substantially. Staffing costs could change in a specific area and there needs to be a reason why that happens. The interrogatory opportunity of the Millennium Project will allow that story to unfold.

Deliverability

Part of the Millennium Project is not only to drive home the idea of how practice gross is affected by cost of operations as well as capital items as seen in the computation of goodwill from average earnings, but also to provide an opportunity for debate as to the ability of the practice to deliver the goodwill that is generated. It is one thing to calculate the goodwill; it's another thing to deliver the goodwill. A practice that depends on a few highly compensated extraordinarily educated and trained doctors to generate an income stream may have high excess earnings but an inability to deliver that to the next buyer. The goodwill value then is not only measured in terms of the dollars that can be produced by the doctors after cost of operation, but similarly how many of those dollars can truly be delivered to another party.

Query: is it worthwhile to spend money to make the practice goodwill deliverable? Is it worthwhile to waste earnings in order to build operational probability for continued going concern? These questions should be explored as part of the Millennium process. Each practitioner should be making their own assessment; again, their own self-examination of conscience of how their practice is operating. Ironically, the practices with the highest profit margins may be in the greatest danger of folding under the weight of too Scottish attitude of expense control.

The debate then becomes an issue of road kill efficiency versus intellectual property effectiveness.

The Summary of Practice Value

Risk is a component of success or a detriment that causes the practice to tumble. The higher the risk, the greater the probability that the practice will progress provided that risk is based on a calculated benefit versus an anticipated detriment. The summary of practice worth is the summary sheet of how well the practice controls risk based on the resources that are available. The summary takes into consideration the tangible assets, the intangible assets, as well as those Netherworld assets such as receivables.

A practice's net fair value is increasing based on the willingness of the practice to take a risk in one year and then harvest that benefit in the next two, three, or four years to come. A practice that stops taking risk soon finds its level of gross income to diminish because the risk is the means by which the practice aggrandizes its transactional opportunities.

Owen E. McCafferty, CPA, Inc.