5 Tips for Analyzing Practice Profitability

By Cheyenne Brinson, MBA, CPA

How profitable is your practice? Does the revenue from injectables cover costs? Is your med spa generating a healthy profit? Many practices assume all of their service lines are profitable, yet few have the systems in place to make a proper analysis.

Here are five tips for analyzing practice and service line profitability.

1. Set up service lines as cost centers on the Profit and Loss (P&L) Statement.

The first step in analyzing the profitability of a service line is developing a mechanism to track revenue and expenses. Creating cost centers on the P&L is the most comprehensive approach. Regardless of the accounting system you use, creating cost centers should be a relatively straight forward process. For example, in Quickbooks, the use of a "class" is synonymous with a cost center. Set up cost centers for each service line (i.e. med spa, surgery suite, satellite office, etc.) Please note, if the med spa or surgery center were separately incorporated, they would not be included on the practice's P&L but rather maintain their own P&L. However, it's advisable to issue a consolidated P&L of related entities in order to examine the operation as a whole.

Quickbooks has a P&L by Class that shows cost centers side by side and sums to the practice total. This is a good tool to see how the cost center(s) fit into the "big picture." For example, see the chart below:

	Main Office	Med Spa	Surgery Suite	Satellite 1 Office	Total
Revenue	$1,500,000	$500,000	$750,000	$250,000	$3,000,000
Expenses	$750,000	$350,000	$500,000	$275,000	$1,875,000
Net Income	$750,000	$150,000	$250,000	-$25,000	$1,125,000

2. Properly segregate and allocate expenses to the costs centers.

The biggest challenge many plastic surgery practices face is the proper segregation of expenses. Many practices make the mistake of lumping injectables, implants, skin care products, garments, and other big ticket items into a generic medical supplies account. The prudent approach would be to create separate expense accounts for each major expense. Further, classify expenses that are products available for sale as "cost of goods sold" or COGS. Examples include injectables, fillers, implants, skin care products, and garments. An illustration of a P&L with COGS:

Total Income	$1,500,000
Cost of Goods Sold	$500,000
Gross Profit	**$1,000,000**
Total Expense	$250,000
Net Income	**$750,000**

By segregating COGS on the P&L, it's easy to determine if revenue exceeded the direct costs of the products sold.

Another concern is proper allocation of expenses to the cost centers. For example, medical supplies are received at the main office. Surgeons and staff take needed medical supplies with them when they travel to a satellite office. The medical supply expenses are residing on the books at the main office and have not been allocated to the satellite office. Sharing supplies between the surgery suite or med spa is also common—supplies reside in one common area and there is no accounting of which cost center used the supplies.

In order for a practice to analyze the profitability of its service lines, an accurate accounting of expenses must occur. The easiest way to accomplish this is to set up different accounts or sub-accounts with the vendors so that invoices are clearly identified to the appropriate cost center or create separate orders for each. Otherwise, invoices will need to be segregated in the accounting system to the appropriate cost center. Often the person or team in accounts payable do not have the necessary information to make the allocation. Another approach is to pay invoices with separate credit cards for each service line.

Staff allocation between service lines is another area to consider. When a staff member works in one area only, it's easy to assign that staff member to their respective cost center. But what happens when a nurse works in the surgery suite one day a week, sees patients with the surgeon two days a week, and has an aesthetic (med spa) practice the remaining two days a week? Do you have the mechanism to allocate their salary to the respective cost centers? Most time tracking systems allow staff to "clock in" to different departments. That's the most straightforward method of allocation. Otherwise, it's a manual allocation or an estimated allocation based on history. The most important takeaway is to develop some type of time allocation for staff to the different cost centers.

Another overlooked area is rent. Allocating rent by square footage is the most common allocation. For example, if the surgery suite's square footage is 20% of the total square footage, then 20% of the rent cost would be allocated to the surgery suite. But what about a med spa that doesn't have dedicated space or uses some of the same rooms the surgeon uses when they are in surgery? In those instances, allocate rent based on time utilized.

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For the surgery suite, are case costs calculated? There are inventory modules available in some aesthetic practice management systems that allow for the tracking and cost allocation of all supplies used in a surgical case (sutures, gauze, scalpels, etc.)

An often overlooked allocation is the allocation of management and administrative (M&A) expenses to the cost centers. M&A covers a wide array of expenses including management, marketing, billing, front desk, administrative, telephone, etc. Some practices allocate M&A based on revenue while others charge a flat percentage of revenue to cover M&A.

Since physician salaries and their related expenses such as payroll taxes, CME, cell phone, travel, health insurance, or anything that would be a fringe benefit to other classes of employees are not included in the overhead calculation, move these expenses to the bottom of the P&L and exclude them from operating expenses.

3. Ensure revenue is properly attributed to the service lines.

A good P&L will tell the story of how the practice is doing at a glance. To that end, it's advisable to segregate broad categories of revenue for a plastic surgery practice: surgical revenue, office consults/procedures, lasers/devices, fillers/injectables, skin care products, and skin care procedures are examples. The chart below is an example of the income section of a P&L by cost center:

	Main Office	Med Spa	Surgery Suite	Satellite 1 Office	Total
Surgical Revenue	$1,000,000	—	$750,000	$100,000	$1,850,000
Office Consults/ Procedures	$250,000	—	—	$75,000	$325,000
Lasers/ Devices	$75,000	$150,000	—	—	$225,000
Fillers/ Injectables	$175,000	$150,000	—	$50,000	$375,000
Skin Care Products	—	$75,000	—	$25,000	$100,000
Skin Care Procedures	—	$125,000	—	—	$125,000
Total Income	$1,500,000	$500,000	$750,000	$250,000	$3,000,000

In a medical practice, the details of revenue transactions reside in the practice management system (PMS), not the accounting system. Our firm strongly recommends allocating revenue by cost center and line item in a journal entry at the end of the month using PMS reports rather than tediously allocating each deposit transaction in the accounting system.

Likewise, the PMS reports, not the P&L, are the appropriate source to see the breakdown of breast augmentations, abdominoplasties, blepharoplasties, and other procedures.

4. Regularly review reports to analyze profitability.

Now that revenue and expenses are properly allocated on the P&L, the P&L by cost center can be generated and reviewed on at least a monthly basis. The report serves as a guide—revenue minus expense equals profit (or loss). Are your service lines yielding the promised profits?

5. Consider non-financial benefits when analyzing the performance of a service line.

There are some instances where a service line yields a loss, rather than a profit. Does that mean the service line should be discontinued? Not without further analysis.

For example, it's not uncommon for a satellite office to yield a loss. However, in a surgical practice, what was the impact on overall surgical volume? That's often difficult to ascertain if all surgeries occur in one location. Satellite offices frequently are referred to as "loss leaders" (for example, high volume of post-operative visits results in lower income attributed to the satellite office). The cost center itself is not profitable, but overall surgical revenue has increased due to serving more patients in a new geographical market.

The bottom-line is to consider both the financial and non-financial benefits when analyzing the performance of an ancillary.

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