The Physician Practice Executive’s Role in Developing a Compensation Agreement

Historical Paper

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Introduction and Background

Compensation is a systematic approach to providing monetary value to employees in exchange for work performed. Compensation may achieve several purposes such as assisting in recruitment and improving job performance and job satisfaction.¹ When there is more than one physician-owner in a practice, there are many ways to allocate the available funds to them. The job of an accountant or administrator is to find the best method to allocate the funds that is fair and sustainable for the practice and for the physician-owners.

This paper details the process to be used with a group of independent physicians to review its current compensation agreement and develop a revised version that effectively and fairly distributes the income of the practice to all physician partners. Interviews, research and financial analysis methods will be used to develop recommendations during this process.

Articles relating to physician agreements and compensation allocations that have been used by medical practices will be reviewed to examine various methods that may be used to develop agreements.²,³ Interviews will be conducted with medical practice managers, physicians, attorneys and accountants who have experience with physician compensation plans to gain a broad knowledge of models that have been used by others. Interviews with the physicians currently in the practice will be conducted to understand each individual’s perspectives of what should be included in the compensation agreement. Finally, an analysis of fixed and variable costs in the practice will be completed to assist in designing an allocation formula.

Understanding physician compensation agreements

There are many different ways that physician compensation can be allocated. The job of the practice administrator or accountant is to help the members of the practice develop a plan that
will work for all of them. Typically, compensation agreements involve compromise by each member of the practice. The goal of the compensation plan is to ensure members are satisfied with their individual total compensation. This process is projected to take several months to complete since there are many steps involved prior to finalizing the agreement.

Research of compensation plans will begin by interviewing the physicians who will be the beneficiaries of the agreement. He or she will be encouraged to express their goals and concerns during the development of the compensation agreement. Below is a sample of interview questions that may be used as a template.

**Physician interview questions**

- What are the goals of the practice when it comes to allocation of compensation?
- What are your individual goals related to allocation of compensation?
- If there is a compensation agreement currently in place how do you feel it is working for the practice and what do you feel needs to be changed?
- How should practice revenue be allocated?
  - Individual receipts
  - Mid-Level provider receipts
  - Ancillary revenue
  - Miscellaneous revenue
- How should the overhead of the practice be allocated?
  - Fixed overhead
  - Variable overhead
  - Individual expenses
- Are there any other variables that we should consider?
In order to develop an agreement that is well thought out and addresses questions that the physicians in the affected group have not thought about the interviewer will reach out to individuals that have prior experience with compensation agreements. The individuals that may have prior knowledge are physicians that are not directly involved in the group, the managers of the physician practice and managers of other physician practices. Attorneys and accountants that have a medical practice clientele base could also provide valuable information of different methodologies they have reviewed or used. Below is a sample of interview questions for the managers, physicians, attorneys and accountants.

**Physicians, Accountants, Attorneys and Practice Administrator Interview Questions**

- What types of compensation allocations have you encountered either within or outside of the healthcare industry?

- How are the receipts allocated?
  - Individual receipts
  - Additional revenue center receipts
  - Miscellaneous revenue

- How is the overhead allocated?
  - Fixed
  - Variable
  - Individual expenses

- How are the compensation agreements viewed by each member of the related company?
  - Are there any items that the members feel are unfair or should be changed?

- Are there any legal implications that should be reviewed prior to finalizing the agreement?
The next step of the process will be to review case studies of medical practices and methods to allocate the income of the practice. The following sections describe sample allocation methods and the pros and cons of each.

**Allocating net income equally to all physicians**

In this method all of the revenue and expenses of the practice would be recorded. The physicians would agree on the type of expenses that should be allocated to each physician. Some examples to consider are employer payroll taxes, health insurance, disability insurance, malpractice insurance and continuing medical education expenses. After excluding the individual expenses, the net income would be divided by the number of physicians to calculate the income to pay out. This income would then be reduced by individual expenses for each physician. The benefit of this model is that it is very easy for an administrator to track and calculate the payout to each physician. It also eliminates worry by the physicians regarding the type of patient they are seeing and the insurance reimbursement level since it is not based on productivity. The downside of this model is that all physicians do not work the same amount of hours and some work more efficiently than others and are therefore are able to generate more revenue. This may cause some discontent among the higher-producing physicians since the lower-producing physicians will receive benefit from their productivity.

**Salary plus bonus**

The group of physicians may agree on a salary plus a bonus. The bonus structure could be set up to pay a percentage of collections after reaching a certain threshold of collections. Typically the collections would be reduced by the average overhead percentage. The advantage of this type of structure is that it is also very easy to administer. The downside to this type of agreement is that overhead charges could fluctuate annually, causing greater than expected expenses. This could put the practice in a situation where partners would have to agree on how to allocate the
additional costs to the physicians. This may not be an easily-solved discussion when trying to pay a bonus in a certain time frame. It would be best to have the allocation of additional overhead costs agreed to and documented in a compensation agreement.

**Compensation based on productivity**

The physicians of the practice may agree to pay the compensation to the providers based on their individual productivity. The production can be recorded in different ways depending on how the payments flow into the office. Sometimes the physicians are paid on work relative value units (WRVU). This payment method compensates the physician based on work performed rather than the number of patients seen since the level of work required can vary by patient. The production can also be recorded based on individual physician receipts. The physicians would be charged for individual expenses as agreed on by the physician owners. The overhead would be allocated based on the agreement of the physicians; allocation of the overhead can be done in different ways. One method is to allocate specific expense items to cost centers (i.e. physicians). Another method is to identify the fixed costs of the practice and allocate those costs equally to the cost centers. The variable expenses would be allocated based on the receipts of individual physicians. This method acknowledges the highly productive physicians use more resources of the practice; therefore their expense allocation is higher. The benefit of this type of compensation model is each physician receives compensation based on their individual receipts. The physicians that work more hours or are more efficient in their patient flow in order to see more patients are then rewarded for these efforts.

If physicians choose to receive additional training on a procedure that reimburses at a higher level, they are rewarded for spending the time on the additional training. The disadvantages of this type of agreement are that physicians may compete within the practice for a patient with a certain type of insurance or procedure that may pay at a higher rate. The allocation of the
overhead costs can also be very challenging because there may be varying opinions of how the overhead should be allocated. Also, there is more detail work to split the expenses by cost center that is required by the fiscal staff of the practice when they are paying invoices or recording transactions.

When reviewing compensation, the Medical Group Management data is a helpful tool to review to find average salaries of physicians by specialty in regions of the country. This information serves as a guideline for salary ranges for physicians. There are many factors that impact salaries in a specific location including population of the area, the breakdown of patient volume by physician and efficiencies in a practice.

Financial Analysis

After reviewing the different compensation models one must look at the details of breaking down the overhead expenses. Reviewing each item of a chart of accounts is a good place to start. Decisions must be made to allocate each expense as a fixed cost, variable cost or a cost that should be allocated to a specific physician/cost center. Fixed costs are expenses that are necessary to keep the practice running with or without providers. Some expenses that are typically considered fixed costs are building expenses such as rent and utilities as well as staff needed to schedule patients, answer phone calls and provide other administrative functions. Variable overhead expenses are expenses that fluctuate with the volume of patients seen in the practice. Some of the expenses that are typically considered variable are front office and clinical staff that may vary depending on the expected patient volume for the day. Clinical and office supplies may also fluctuate when more patients are seen or a physician is more productive. Some expenses could be considered both a fixed and variable expense. An example is employees of the billing staff. Staffing needs may include personnel required to continually work to maintain the routine billing functions, while other personnel may only be needed due to the
increased volume of work being done by the physicians. It will be necessary to decide if
physician cost centers will be charged an allocation of the fixed and variable expenses.

The remaining expenses are those specifically allocated to a physician or cost center such as
wages and related payroll taxes; benefits such as retirement, health and dental insurance,
malpractice insurance and workers compensation insurance; and continuing medical education
and other expenses as agreed upon by the physicians in the practice.

Some other items to consider in all types of compensation models are methods to allocate the
miscellaneous income of the practice. Examples include other income, ancillary services and
income generated by mid-level providers. If there will be an allocation of these items,
consideration should be given on how to allocate them to various cost centers. Once expenses are
classified as fixed, variable and specific, the best way to apply these costs must be determined.
One could choose to look at the percentage of fixed and variable costs and apply those
percentages to overhead when calculating physician compensation. One could also choose to
classify each payment that is made throughout the year to the different cost centers. This second
process is time consuming for the fiscal staff and it requires a detailed review prior to each
compensation calculation.

Developing Scenarios

After completing interviews with the physicians, managers, attorneys and accountants as well as
other research, scenarios should be developed based on the information gathered. The best way
to provide a realistic picture to the physicians is to use a full year’s worth of income generated
and expenses paid. An ideal approach is to provide the physicians with calculations using the
scenarios that benefit the majority of the physicians. This will allow each of them to see how
their compensation would be impacted by applying the recommended formulas. If
recommending an allocation of overhead based on a percentage of fixed and variable expenses,
those calculations should include a range. For example if 37% of the costs are fixed, scenarios with a 35% allocation of fixed costs and a 40% allocation of fixed costs should be reviewed. Within these scenarios, it is important to include different allocations to distribute the mid-level providers and ancillary service income.

**Follow-up Meetings**

The final step in the process is to meet with the physicians as a group to discuss the scenarios that you have developed, and discuss the positive and negative implications of each. If there are any adjustments to the formulas that the physicians would like to see, make the adjustments to the scenarios and redistribute the calculations to them. After giving the physicians time to review the adjusted calculations, contact each of them individually to discuss any concerns they may have. This process may take a few revisions and discussions with each physician involved. Once consensus from the physicians appears to be in place, finalize the formula to be used and meet with the physicians as a group a final time to make sure there are not any other concerns. After true consensus is reached, contact a business attorney to prepare a legal document that details the compensation agreement. Once received and reviewed, compare the calculations with the legal document to make sure the agreement between the physicians was documented properly by the attorney. Provide the legal document to the physicians for their review. Make any adjustments needed and finalize the document. Present the final compensation agreement to the physicians for signature.

**Conclusion**

Without a documented compensation plan in place for the group of physicians, conflicts could arise for multiple reasons. If there is a change in the way the physicians are practicing, such as increased or decreased hours worked by a physician in the group, or the addition of non-physician providers or ancillary services, one or more physicians could feel like they are not being
compensated fairly. Having a legal document in place that details the compensation allocation model in a practice is beneficial for all of the physicians involved as they will know what to expect when they receive their compensation each year.

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iv Ibid. MGMA Healthcare Consulting Resource Center

v Ibid. Hyden, M. and Wong, M.