WITH YOUR C FUTURE IN MIND

Financial Considerations – From Graduation to Owning A Practice

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School of Dentistry
University of California
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Supplementary Information

Understanding Work Relationships

Employee

- Under direction and control of an established dentist
- Little independence and no ownership interest
- Patients belong to the owner dentist
- Provided an assistant
- Paid on hourly, daily or percentage of production basis
- Receives payroll check and W-2
- Report income as wages on tax return

Independent Contractor

- Works in the practice but schedules own patients and controls own work
- Independent
- Brings in own patients
- Hires and pays own assistant and lab bills
- Paid on hourly, daily or percentage of production basis
- Receives a Form 1099
- Reports income on Schedule C of tax return

Employee vs. Independent Contractor

Employee

- Deduct business related expenses on Schedule A
- Payroll taxes are withheld
- The employer dentist bears the risk for payroll taxes
- Most likely relationship for the new dentist

Independent Contractor

- Deduct business expenses on Schedule C
- Make quarterly estimated taxes, pay self employment taxes
- The employer dentist bears the risk for payroll taxes
- Most likely relationship for experienced or semi-retired dentist

Employee vs Contractor

1. Behavior control – Business has a right to direct and control how the work is done
2. Financial control – Business has a right to control the financial and business aspects of worker’s job
3. Type of relationship – Intention of parties, benefits, integration of services, available to perform services for others

Source: https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee

and http://www.irs.gov/pub/irs-pdf/p1779.pdf

Advantages of Contractor Status

- Less taxes – On $150,000 of income the tax savings can exceed $6,000
- Greater retirement plan contribution – On $150,000 of income the contribution for an independent contractor is $23,000 more

What is a Business?

- When you acquire a dental practice what are you really buying?
- Answer: You are buying a group of assets or stock – It’s important to note the difference
- The assets are of two kinds:
- Tangible (“Fixed”) Assets (About 40%)
- Intangible Assets (About 60%)

Fixed Assets

- Equipment (Dental, Office, Computer)
- Furniture
- Fixtures
- Improvements

Intangibles (Goodwill)

- Relationships
  - Patients (Patient Records)
  - Vendors / Suppliers
  - Other Practitioners
- Going Concern
  - Systems
  - Employees
  - Reputation
  - Location

Intangibles (Goodwill) (cont)

- Agreements
  - Leases
  - Rental Agreements
  - Agreements Against Unfair Competition

Major Functions of a Business

- Marketing
  - Attracting appropriate patients
  - Inspiring patients to refer others
- Production
  - Scheduling
  - Treatment Presentation
  - Treatment

Major Functions of a Business (cont)

- Administrative
  - Accounts Receivable and Collections
  - Training and Education
  - Compliance With Laws and Regulations
  - Human Resources
  - Accounting and Legal

New Skills Are Required

Skills at Graduation

- Clinical – 100%
- Managerial – Minimal
  - Business Planning
  - Organizational
  - Communication
- Leadership – Minimal
  - Strategic Planning
  - Communication
  - Inspirational

Skills Required in Practice

- Clinical – 33%
- Managerial – 33%
  - Business Planning
  - Organizational
  - Communication
- Leadership – 33%
  - Strategic Planning
  - Communication
  - Inspirational

Developing Business Skills

- ✓ Take practice management courses
- ✓ Actively participate in your local dental society
- ✓ Seek out opportunities in your social, athletic, and religious organizations to organize events and take on leadership responsibilities
- ✓ Teach at the dental school
- ✓ Volunteer in local charities
- ✓ Join public speaking organizations

Putting Your Team Together

- Dental Broker ***
- Dental CPA ***
  www.adcpa.org
- Attorney ***
- Financial Lender ***
- Insurance Advisor(s)***
- Dental Consultant
- Equipment Specialist
- Lease Consultant
- Design Consultant
- Cost Segregation

*** Essential

Dental Broker

- Gathers and disseminates information about practices for sale
- Brings sellers and potential buyers together
- Receives a 10% commission on the sale of the practice (incentive bias toward seller)
- Negotiates between seller and buyer
- Administers escrow

Dental CPA (for buyer)

- Performs “due diligence” on the practice by evaluating the general and financial condition of the business
- Identifies strengths and weaknesses
- Performs cash flow analysis to determine affordability
- Analyzes and recommends asset allocation

What Is A CPA?
(Certified Public Accountant)

CPA Requirements

- Accounting and business education
- Passing Uniform CPA Exam (2 ½ days)
- Two years general accounting experience supervised by another licensed CPA
- Passing an ethics course

CPA Continuing Education

- Total - 80 hours every two years
- Accounting and Auditing – 24 hours every two years
- Ethics – 8 hours every six years
- Fraud Prevention – 8 hours every two years

Typical Additional Education

- Business – Masters in Business Administration (MBA)
- Taxation – Masters in Taxation (MST)
- Financial Planning – Graduate of a financial planning program and designation as a Certified Financial Planner
- Security Licenses for investment advisory services

Typical Services Provided

- Accounting and preparation of financial statements
- Tax planning and preparation of tax returns
- Business planning
- Personal financial planning
- Investment advisory services
- Consulting
- Pension administration

Benefits of a Dental CPA

- Understands the issues and challenges facing dental professionals
- Familiar with industry standards
- Experience of working with many practitioners
- Knows a network of other dental advisors
- Focuses only on the needs of dentists

Attorney (for buyer)

- Drafts and/or reviews buy-sell agreement, lease, and related legal documents
- If buyer chooses to practice as a corporation or buy into a partnership, attorney will prepare incorporation, partnership, and related documents

Lender

- Evaluates the buyer's credit worthiness
- Establishes the terms of dental practice acquisition loan
- Provides funds to purchase the practice
- Tracks the buying dentist's practice performance

Insurance Advisor

- Professional liability insurance
- Personal and overhead disability insurance
- Property insurance
- Life insurance
- Workers compensation insurance

Dental Consultant (optional)

- Can fix broken or poorly working systems like accounts receivable, scheduling, recall, hiring, firing, compensation systems,
- Can facilitate team building
- Can create a marketing plan
- Can fine tune hygiene
- Can help adjust fee schedule

Equipment Specialist (optional)

- Can help evaluate the condition of the equipment that you are buying
- Can help establish a value of the equipment for price allocation purposes

Lease Consultant (optional)

- One of your biggest expenses is the rent that you will be paying for your office space
- There are dental lease specialists that will help you negotiate the best lease terms for you on the lease that you assume from the buyer

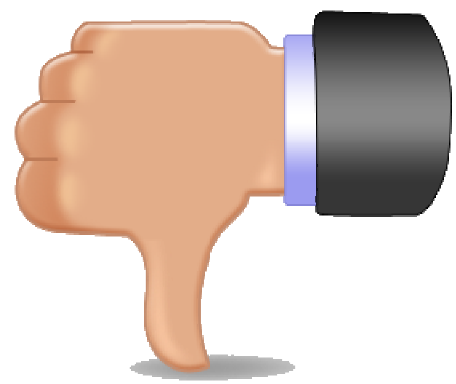
Design Consultant (optional)

- A dental office design consultant will be a must if you start your own practice and design your own space.
- If you purchase a practice and plan to make major renovations, the design consultant again can be invaluable

Cost Segregation (optional)

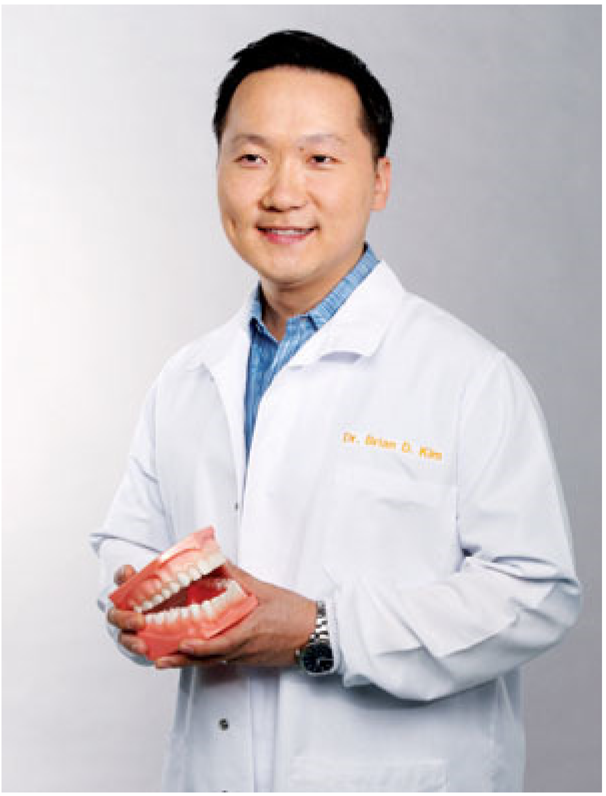
- Cost segregation is a technique approved by the IRS that accelerates and maximizes the tax deduction called depreciation
- Cost segregation studies can be done on start up practices and existing practices
- The cost of the study is higher on existing practices
- Cost segregation studies can save you tens of thousands of dollars

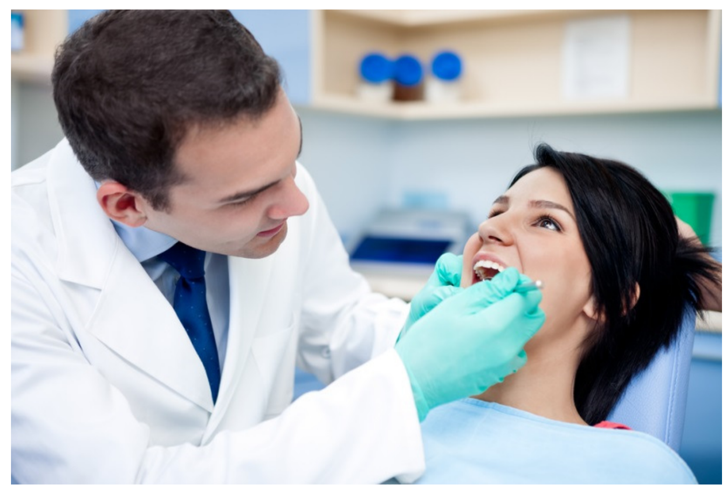
Buying or Starting a Practice?



Pros & Cons

Buying a Practice





Pros

- Instant cash flow stream
- Instant patient flow
- Stepping into a fully functioning business (already proven in marketplace)
- Established relationships with patients
- Experience as a working team (employees)
- Established reputation
- No increased competition

Cons

- Acquiring existing problems or incompatible practice style (patients may be alienated, employees may leave)
- Requires a lot of time and energy to shape it into the new dentist’s own vision
- May require significantly more debt than building one
- New dentist may feel overwhelmed at first
- Often older equipment/needs facelift
- Space, flexibility may be restricted

Starting a Practice

Pros

- Practice is built according to the dentist's own vision from the beginning
- Employees are trained to fit the dentist's style
- Starting a practice may require less debt, but not necessarily (Investment of $300,000 - $500,000)
- Allows the practitioner time to build up clinical speed and confidence
- Patients are all "home-grown"
- Equipment, furniture and improvements are new (may attract more patients and result in lower repair and replacement costs)

Cons

- Requires a heavy marketing effort
- Recruiting and training of staff
- Often requires augmenting income with part-time work at another practice (diffusing one's energies and focus)
- Time consuming/Requires patience
- Increases competition in the community

Evaluating a Practice

Tips To Evaluate A Practice

- ✓ Be Methodical and Thorough
- ✓ Use a checklist that forces a methodical step-by-step evaluation
- ✓ Request information (Be firm, persistent, polite and professional)
- ✓ Work with someone knowledgeable (Appraiser, broker, CPA or consultant) in the evaluation process
- ✓ Retain an attorney, preferable in dental practice transactions
- ✓ Resist Pressure
- ✓ Buy a practice that’s appropriate for you

Practice Purchase Considerations

- Form of practice – Sole proprietorship, corporation, S corporation (special tax election), partnerships, LLCs not allowed in California
- Cash Flow – Projection for first 3 years
- Type of Transition –
  - Outright purchase
  - Associate for several years, then buy
  - Selling dentist continues in the practice

Purchase Considerations (cont)

- Marketing – Marketing is more important than ever and often neglected. Get professional help
- Consulting – Most practices have system deficiencies that can be corrected with the help of an appropriate consultant

Purchase Considerations (cont)

- Employees – Employees are your largest expense and one of the biggest factors in the success or failure of your practice
  - Family members?
  - Transition strategy
  - Compensation and benefits
  - Training and team building
  - Office politics

A principle of selling is that people buy based on emotion and justify the purchase with logic. The principle applies to most purchases including dental practices. Buying is emotional. Use a checklist.

- Prestige
- High Performance
- Luxury

- Practical
- Economical
- Efficient

Riding the Financial Roller Coaster

- A practice purchase is unique from a tax and cash flow perspective
- In the year of purchase there are large deductions resulting in unusually low taxes. Cash flow often seems adequate
- In the second year the deductions go away resulting in a "normal" tax liability. If not planned for there can be a big tax surprise.
- Most practice acquisition loans have 7 or 10 year terms. At the beginning interest is high, which lowers taxes and enhances cash flow. As the loan matures interest decreases and principal increases, resulting in higher taxes and lower cash flow. If the practitioner has not worked to keep profit up at a respectable level, they will feel squeezed and often have to borrow money to pay taxes.

Mistakes Dentists Make

- ✓ Fixating on some aspects of the practice and ignoring others
- ✓ Not using dental specific advisors
- ✓ Not using a checklist
- ✓ Not doing an adequate chart audit
- ✓ Not doing adequate due diligence
- ✓ Negotiating a practice purchase without the requisite knowledge
- ✓ Not thinking ahead into the future
- ✓ Not buying a practice that is appropriate

Addendum A
ADA Resources For New Dentists

- The ADA Practical Guide to Starting Your Dental Practice
- Associateships: A Guide for Owners and Prospective Associates
- Becoming a Strong Leader
- Establish Your Practice Philosophy
- Build a Solid Office Infrastructure
- Build a Cohesive Office Staff Structure
- Build Your Marketing Engine
- A Dentist’s Guide to Practice Leadership
- Terminating Employment
- Dental Letters
- Dental Office Design

Addendum A
ADA Resources For New Dentists

- New Dentist Resources
- http://www.ada.org/en/member-center/member-benefits/new-dentist-resources
- New Dentist Conference – Check the ADA web site

Addendum B
Checklist for Practice Purchase

Physical Plant – Exterior Location

- Neighborhood – Commercial, residential, mall?
- Traffic volume?
- Availability of public transportation?
- Availability of and proximity to dental specialists?
- Availability of and proximity to dental labs
- Is there easy access to restaurants, banks, stores?
- Is the location free of noise and air pollution?
- Is the location free of crime and unpleasant sights?
- Other tenants in the building? If so what type of businesses?

Physical Plant - Exterior

<u>Appearance</u>

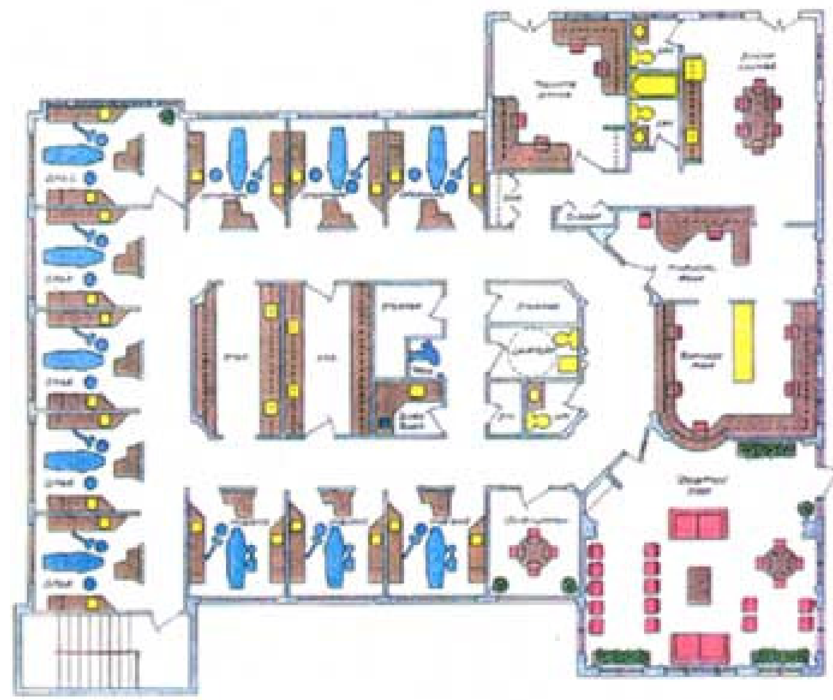
- ❑ Is the building professionally and attractively landscaped?
- ❑ Professional, neat and attractive?
- ❑ Is there a prominent and professional looking sign place?

<u>Parking</u>

- ❑ Proximity and availability of spaces (for patients, employee and doctor)?

Physical Plant – Interior
Size of the Office

- Number of square feet used? Available?
- Adequate for present needs?
- Is there space for expansion?
- Number of operatories?

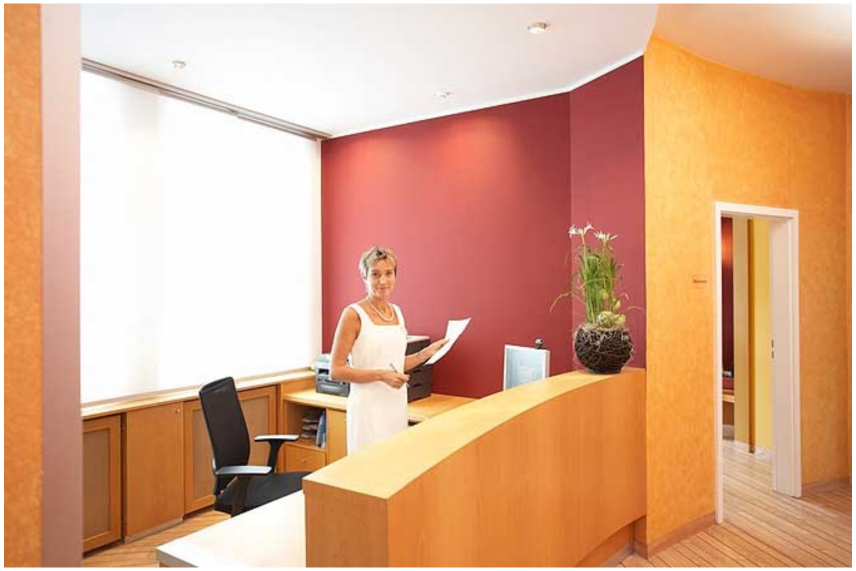


Physical Plant – Interior Layout

- ❑ Easy flow and convenient?
- ❑ Open with privacy partitions or walled?
- ❑ Adequate room to work comfortably?
- ❑ Position of equipment and related wiring efficiently designed and safe?

Physical Plant – Interior Appearance

- Attractive, neat, clean, orderly and in good repair?
- Are the indoor plants, flowers, furnishings and pictures in appropriate locations?
- Does the office feel open and inviting?



Physical Plant – Interior Equipment and Furniture

- ❑ Adequate for present needs?
- ❑ Relatively new and in good repair?
- ❑ What will need to be purchased, replaced or repaired?
  - ❑ Immediately?
  - ❑ Within one year?
  - ❑ Within three years?

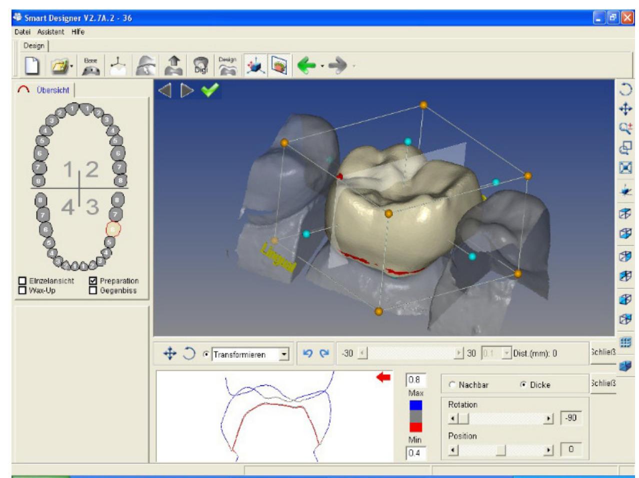
Physical Plant – Interior Cabinets

- Adequate for present needs?
- Relatively new and in good repair?
- Is there sufficient cabinet space if the office expands?

Physical Plant – Interior Computers & Software

- ❑ Name and reputation of practice management software?
- ❑ Speed, capacity and software adequate for present needs?
- ❑ Is technical support available and helpful?
- ❑ Is the hardware and software sufficient if the office expands?

- ❑ What will need to be purchased or replaced?
  - ❑ Immediately?
  - ❑ Within one year?
  - ❑ Within three years?



Patients

- What is the number of active and inactive patients?
- What are the demographics of the patient base?
- Note concentrations within patient base?
- Is there an effective recall system in place?
- Turnover rate? Reasons for turnover?
- How are patients rewarded and for what?
- Is there a system or policy for purging undesirable patients?

% of Population Visiting the Dentist Per CDC 2013

Age 2+	66.2%
2-17	83.0%
18-64	61.7%
65+	60.6%

Preventative procedures have increased,
routine restorative procedures and extractions have decreased.

Staff

- Is the office appropriately staffed?
- Turnover rate? Reasons for turnover?
- Is the staff highly motivated? How are they rewarded?
- How well does the staff interact with each other? Dentist? Patients?
- Are there appropriate staff meetings and training in place? Effective?
- Demographics of staff?
- Compensation expectations, fringe benefits?

Staff, continued

- What are the office politics?
- What are the office policies and procedures?
- Does the staff reflect your values and principles?
- Do staff intend to stay or leave if the practice is sold?
- Does the practice retain a professional human resources consultant?
- What are the staff issues to be addressed?
  - Immediately?
  - Within one year?
  - Within three years?

Financial

Obtain 5 year Trend of Fee Collections, Expenses and Profit

- Note that adjustments usually need to be made to obtain a true picture of practice performance
- Are ratios and percentage high, low or average relative to other practices?
- What is the amount and percent of profit relative to fee collections?
- Percent of administrative salaries to fee collection?
- Percent of clinical salaries to doctor production?
- Ratio of hygiene production to hygiene salaries?
- Percentage of staff salaries to net fee collection?
- Percentage of dental supplies to net fee collection?

Collections, Expenses and Profit (cont)

- ❑ Percentage of lab expenses to net fee collections?
- ❑ Percentage of lab expenses to lab related fees?
- ❑ Percentage of rent expense to net fee collections?
- ❑ Obtain 5 year trend of assets and liabilities (If possible)
- ❑ Review production, receivables and adjustments for at least three years
- ❑ Review the aging of accounts receivables and uncollectible accounts
- ❑ Examine last 5 years tax returns or schedules. Compare with financial statements

Review the Fee Schedules

- What is the office policy regarding fee adjustments (fraud alert)?
- How do fees compare with norms in the area?
- What is the five year trend in fee increases?
- Breakdown of fee revenue by type of procedure?
- Breakdown of fee revenue by type of payment
- Ratio of laboratory related revenues to laboratory related costs?
- Percentage of revenue from Delta, PPO’s?
- Percentage of revenue from capitation programs?
- Percentage of production collected?

Assets

- Review depreciation schedule and business property statements
  - Are assets replaced, repaired and updated regularly?
  - Is the office technologically up-to-date?

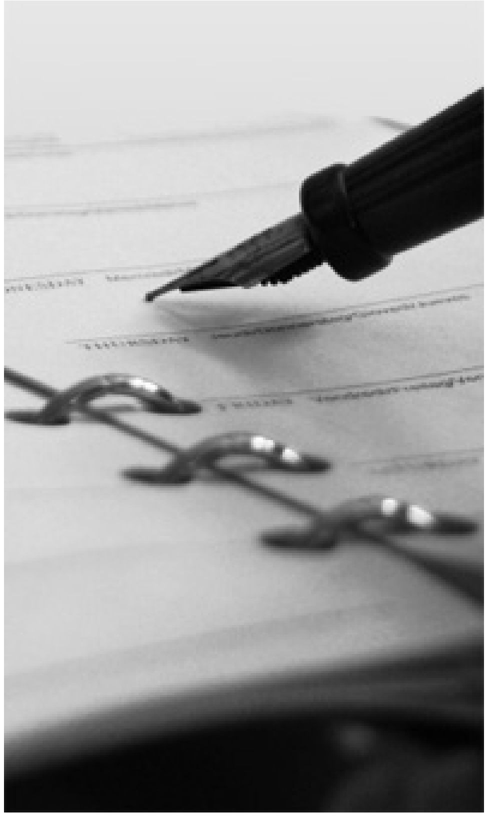
Current Office Lease Obligation

- Can it be assumed? Renewed?
- How does the rent compare with the market value rent in the area?
- What is the reputation of the landlord in maintaining the building?
- Is any change in building ownership anticipated on the foreseeable future?

Financial Matters

- What are the office policies in regard to patient financial agreements?
- Does the office sponsor a retirement plan, and what are the related obligations?
- How does the office check patients' credit?
- What internal controls are in place to minimize errors and embezzlement?

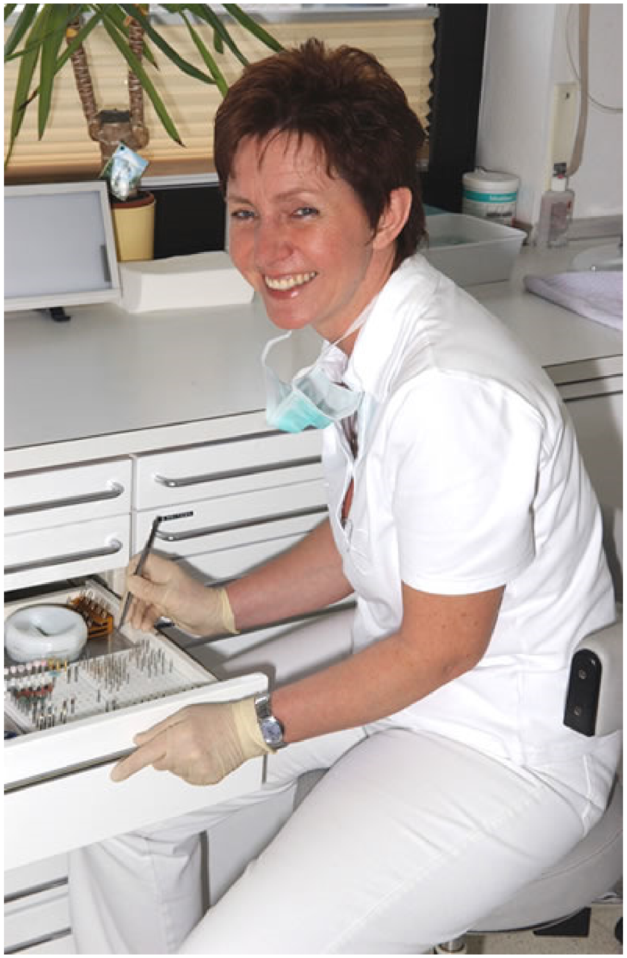
Administrative and Scheduling



Administrative and Scheduling

- ❑ Year that dental practice was established?
- ❑ Office hours (weekly schedule)?
- ❑ Number of days worked in the last 12 month?
- ❑ How is the scheduling and recall done? Are they effective?
- ❑ What is the missed appointment rate? How is this tracked?
- ❑ What is the percentage of holes in the schedule? How is this tracked?
- ❑ How effectively does the front desk fill holes in the schedule?
- ❑ What contracts are in place with PPO's and insurance providers?
- ❑ Does the office accept assignment?

Clinical



Perform a Chart Audit

- Examine at least 20-30% of the charts using a random method
- What is the overall quality of the treatment planning?
- Is there thorough and comprehensive treatment planning?
- Is the treatment planning tailored to the patients needs and wants?
- Does the dentist follow through with the treatment planning?
- Is the dentist conservative, moderate or aggressive in treating patients?
- Is the medical/dental history current?
- Are patients provided alternatives in their treatment planning?
- How would you rate the quality and quantity of radiographs?
- Are clinical findings adequately recorded/charted?
- Note time since last appointment and frequency of appointments.
- Note general demographics: age, gender, location of residence.

Clinical

- Rate the office's clinical emergency preparedness.
- Are California Board of Dental Examiners infection control regulations followed?
- What is the overall quality of the dentistry?
- How much re-work is done?
- Is the dentistry progressive and up-to-date?
- Is there a specialty or bias toward certain procedures and/or avoidance of other procedures?
- What is frequency and quality of the continuing education of the current dentist?

Interview the Specialists Used by the Practice

- What is the reputation of the specialist?
- What are the specialists comments and opinions of the practice?

Interview the Practice's Dental Laboratory

- What is the reputation of the dental lab?
- What are the dental lab's comments and opinions of the practice?

Legal Liability

- Has the practice been sued for professional malpractice or received other negative publicity?
  - What were the circumstances?
  - What was the outcome?
  - What was the effect on the reputation of the practice in the community?

Treatment

- What is the average number of cases presented each month?
- What is the average amount of treatment presented each month?
- What is the average percentage of cases accepted each month?
- What is the ratio of crowns to other restoration procedures?
- What is the ratio of hygiene perio to adult prophies?

Intangibles and Miscellaneous

Intangibles

- Is there an identifiable philosophy of practice ?
- What are the values of the practice?
- Is there potential for growth?
- What is the reputation of the practice in the community?
- Have any complaints ever been filed with the Dental Board of California about the practice?
- What are the problem areas in the practice? How is the office dealing with them?

Marketing

- Obtain demographics of the practice from the practice management software.
- New patient trend over the last three years?
- Number of active patients at the end of the last three years? (Active patients are those that have been treated in the last 18 month)
- Calculate the estimated attrition rate
- Sources and percentage of new patients obtained from those sources (advertising, referrals, promotions).
- What is the current marketing plan, written or implied?
- Number of similar practices within 3 miles of the office?
- Population density on the local area?
- Does the practice use a marketing consultant?
- Does the practice have a web site? How does the web site support the practice?

Any Questions?