# Case Study

## Discussion Questions and Possible Answers

**This case study is fictitious but the fact pattern is typical of small practices in northern California. You will receive information including practice documents such as financial statements, usually from the practice broker, which you will use to evaluate the practice for purchase. The following questions are typical issues that one addresses when purchasing a practice. A dental CPA can help you evaluate a practice for purchase. A separate set of financial statements is provided to you that is well formatted so that you can compare it with the profit loss statements in the case study which are not formatted very well, but typical of what you will see.**

**In Blue are possible answers to the questions. Since many of the questions are open-ended, answers can differ and/or be more extensive.**

1. This practice has no capitation. Is that a significant fact, and, if so, why?
   *Capitation is a program that provides a fixed fee for serving a group of patients. The problem with capitation is that the amount provided is relatively low and the incentive is to do as little as possible so profitability and patient care inevitably suffer. For most buyers who want a traditional dental practice no capitation is good and makes the practice more attractive to buy. Capitation requires a high volume/low fee practice structure.*
2. Is this a good location to have a dental practice? Why or why not?
   *We know that the practice is in a 55 year-old building. Is it in need of extensive repairs and or improvements? If so, the rent might go up to cover the costs. The building is located in a blue-collar neighborhood surrounded by retail and restaurant businesses. Blue-collar might suggest that more patients depend upon insurance. We know that insurance reimbursements are generally going down. Is the neighborhood thriving? The presence of small businesses suggest that it is. What is the trend? Is the community*

*improving or in decline? What are the long-term prospects? Local and regional economic forecasts and reports might provide clues about the long-term prospects for the community. Local real estate agents would know whether property values are trending upward or downward. Are there any large businesses in the area that employee a lot of people? If a business like that shuts down or moves out of state or out of the country many of your patients may be out of work. That will affect your practice. What is the competition? How many other dental practices (general and specialties) are serving the community? Is there a saturation or plenty of room for growth?*

3. Last year the practice had 1,125 active patients. This year the number of active patients is 1,100. How many patients did the practice "lose" due to attrition?
   *(1,125 patients last year) + (10 new patients per month x 12 = 120) – 1,100 = 145 patients lost to attrition*
4. What's considered an "active patient?"
   *"Active patient" usually means a patient that has received treatment within the last 18 months. Some people use 24 months, but 18 is more common. Practices normally have many inactive patients who have not been in treatment in the last 18 months for various reasons. When you do your chart audit you will get a sense of how extensive the inactive patients are. What is the practice doing to get those patients into recall and into an active status?*
5. Dr. Seller reviews his fee schedule every five years. What does that information tell you about Dr. Seller's fee schedule? Are his fees high, low, or just right?
   *A doctor should review and adjust his or her fees once a year. The fact that the doctor hasn't reviewed his fees for five years suggests that the fees may be low, but not necessarily. Fees should be checked against recent surveys of a representative sampling of dentists in the local area. Some use fees from insurance data bases that are adjusted for the local area as a reference for comparison purposes. Because fees are often dictated by insurance companies with whom the doctor has contracted, the doctor is*

*often restricted from raising them. Some practitioners have resorted to negotiators who bargain with insurance companies for higher fee reimbursements. Some insurance companies will negotiate and make concessions. Others flatly reject this type of negotiations so it doesn't always get results. Some doctors decide not to contract with insurance companies and as a result can set their fees as they wish. However, making a decision to do that requires careful consideration. If not careful not contracting with insurance companies can result in a large loss of patients from the practice which can be devastating. In those situations always work with a dental consultant.*

6. The current wages for the dental team total $243,000. The most recent year had $595,200 in fee collections. Do you feel that's the right amount of wages to be paid in this practice? Why or why not? If not, what would you do to correct the situation?

   *Wages as a percentage of net fee collections should generally be about 25%. In this practice the percentage is $243,000 / $595,200 = 40.8%, obviously very high. Further investigation must be done. Perhaps the office is overstaffed for the available work and patient base. In that case employees may need to have their hours reduced or their employment terminated. In many cases the number of employees is appropriate for the patient base and available treatment but the production/collections are low. If the production is low because the fees are low, then raise the fees where appropriate to match the service provided. If the fees are OK then the doctor or hygienist production may be low. Isolate whether it's a doctor or hygienist problem. Perhaps the hygienists are doing root planning and scaling (CDT codes 4341 and 4342) but reporting their work as prophies (code 1110). That would result in lower hygiene production and collections. Perhaps the doctor is just slow or somehow impaired from being more productive. Selling dentists are normally older doctors and older doctors are more inclined to have medical issues. Doctors can be efficient by doing multiple procedures in a single appointment. Maybe the doctor is not doing that. Doctors can be more efficient by working two chairs instead of just one. Maybe the doctor is not doing that. Perhaps there are holes in the*

*schedule and the front desk is not keeping the chairs full. Perhaps the production is OK but the front desk is not doing an efficient job of collecting the fees from the patients and insurance companies. As you can see, there can be many reasons for low fee collections.*

7. Looking at the financial statements provided would you consider this a "profitable" practice? Why or why not?
   *The profit benchmark is 35%. The doctor's auto expense, continuing education, and professional dues are not included in profit so we back that out. Starting with the most recent year "Operating Profit" we add back the expenses $139,025 + $1,700 + $980 + $2,100 = $143,805 / $595,200 = 24.2%. Practice profit is obviously low compared to the benchmark and is not highly profitable.*
8. Kate and Natalie are the hygienists. Kate is being paid $62,000. Natalie is being paid only $35,000. Is Kate being paid more because she's a much better hygienist?
   *Hygienists often work less than full schedule in any one practice. In this case Kate may be working two days per week and Natalie is working one. Unless there is a big difference in skills, experience, and longevity they are likely making the same rate, $55 – $60 per hour.*
9. The practice offers a 10% discount to senior citizens. Where or how would you find out how many senior citizens are in the practice?
   *The practice management software is Eaglesoft. Eaglesoft would collect and store demographic data about patients and would most likely have this information that could be printed out in a report.*
10. The practice accounts receivable are 1.8 times one month's collections. Would you rate the collection efforts as good, bad, or just right? Why?
    *The goal is for the accounts receivable balance to be equal to one month's collections or less. One month's collections is $595,000 / 12 = $49,583. The actual receivables balance is $90,000. Therefore, the receivables needs to be investigated to determine why it's so high. Is this a current problem or an ongoing problem? Can the person who handles accounts receivable explain why they are so high? What does the current aging look like? An aging of receivables is simply a report that shows how much of the accounts*

*receivable have been outstanding 0-30 days, 31-60 days, 61-90 days, and more than 90 days.*

11. If you bought this practice and felt that expenses were too high, do you think it would be good idea to save money by not having a retirement plan? Why, or why not?

    *The retirement plan is employer sponsored. When a practitioner sells their practice the retirement plan technically ends for the selling dentist and the funds are rolled over into individual retirement accounts (IRAs). The new owner has the option of establishing a retirement plan. However, from the employees' standpoint nothing has changed. They are still coming to work as before and doing their jobs. If the new dentist doesn't continue with the benefits that were in place before, the employees feel that something has been taken away from them. I once saw a new dentist who bought a nice big practice but thought his expenses were too high, especially in light of his large practice loan. He slashed employee benefits. The employees, who had experience, knowledge, and strong relationships with the patients, became understandably upset and quit. He had to scramble around and put together a whole new dental team which upset his patients which in turn negatively impacted his revenue and cash flow. The fiasco was totally avoidable if the new dentist had simply seen the practice through his employees' eyes.*

12. Dr. Seller owns a 50% interest in the building with his sister. How would that fact affect your decision to buy the practice?

    *If the selling dentist (or the selling dentist's family) owns the building and rents to himself, then the rent may be arbitrarily set high or low to serve his own interests. Determine what the fair market rent is in the community. If you buy the practice the selling dentist will likely charge you the fair market rent on the community, not the rent you see on the financial statement that he is charging to himself. Use the fair market rent to evaluate the purchase of the practice. If the seller sells the building to a third party the new owner will set the rent at the fair market value if the selling dentist didn't when he sold you the practice. The fact that the seller and his sister own the building 50-50 should be irrelevant to your evaluation of the practice for purchase.*

13. In the most recent year the lab expense was $69,900. Would consider that expense to be high, low, or just right? What does that tell you about the practice?

    *Lab expense is typically 7% - 10% of net fee collections. For this practice the lab expense is $69,900 / $595,200 = 11.7%. This is a little higher than normal. In the other years it was 8.1% and 9.3% which falls within a normal range. The practice does a significant amount of crown and bridge and perhaps in the most recent year had some large cases. These percentages don't necessarily suggest that the dentist is aggressive when it comes to restoring teeth. The percentages aren't unusually high. As the new dentist how do you view yourself as far as treatment planning and follow-through? How do you compare with the selling dentist?*

14. 60% of the patients have dental insurance. 40% of the patients are private pay. How does that information affect your decision to buy the practice?

    *40% private pay is relatively high. Private pay would indicate the portion of the practice that has no insurance restrictions. A prospective owner would want to find out what insurance carriers made up the 60% and the restrictions on fees.*

15. If you were interested in making the practice more profitable, what changes would you make to the procedure mix?

    *Endodontics, oral surgery, periodontics, implants, and the use of lasers are all areas in which more apparently could be done. If you could do some of those procedures yourself then you would not have to refer as many cases to specialists. However, the practitioner has to be trained and qualified to do the procedures. A new dentist usually has his or her hands full just doing basic procedures. However, if a practitioner has a long-term strategy to get a lot of continuing education and gradually take on more procedures that ordinarily are done by specialists, then the practice can gradually become more profitable just by changing the procedure mix alone.*

16. In the second preceding year depreciation expense was $2,400. What is depreciation?

    *Depreciation is the deduction of asset cost. When a business owner purchases an asset, the general rule is that the cost can not be expensed in*

*one year because the asset has a life that exceeds one year. Therefore, the cost is expensed in portions over a period of years. Dental equipment is expensed over six years as follows:*

*Year 1 – 20.00%*

*Year 2 – 32.00%*

*Year 3 – 19.20%*

*Year 4 – 11.52%*

*Year 5 – 11.52%*

*Year 6 – 5.76%*

*There are exceptions to this rule that allow expensing in the year of purchase. They are called bonus depreciation and section 179 expensing but that is beyond the scope of this presentation.*

17. Cameron was hired in April, 1996. Halle was hired in November, 2009? Which team member do you feel is more deserving of a raise?

*When purchasing a dental practice you will suddenly be thrust into the responsible position of managing employees. They are depending upon you to judge their work fairly, reward them appropriately, provide them with a safe working environment, train them as necessary to do their jobs, and to follow the labor laws. That's a big responsibility and mistakes can result in lawsuits. You would be wise to retain the services of a company or firm that can assist you with employment law that also works with lots of dentists. They can help you determine fair compensation and employee benefits.*

18. In the preceding year the insurance expense was $25,800. What types of insurance does a dental practice typically have? Is all insurance deductible for tax purposes?

*Types of insurance typically found in dental practices include:*

- *Professional liability insurance*
- *Workers' compensation insurance*
- *Health insurance*
- *Property insurance*
- *Officer life insurance*
- *Auto insurance*

- *Overhead insurance*
- *Personal disability insurance*

*Officer life insurance and personal disability insurance are normally not deductible*

19. How much debt does this practice have? A lot or a little? How do you know? Does it matter for purposes of buying the practice?

*The practice has little debt. The interest in the last three years was only $200, $100, and $140. This is likely to be related to a credit card. The amounts appear to be too small to be associated with any significant loans. The seller's debt is normally not a consideration and is irrelevant to purchasing a dental practice unless you are buying stock of a corporation which is not the case here. The case study is presumed to be an asset sale of a sole proprietorship.*

20. If you were to buy this practice, would you make any changes? If so, what changes would you make?

*Problem areas that need to be investigated include:*

- *The high labor costs relative to fee collections*
- *The high accounts receivable*

*A business plan for the next 3-5 years including a marketing plan should be done.*

*Regular meetings with the dental team will be important to learn more about the practice, the employees, and the patients. This can also be used as a venue for the team to develop confidence in you as the new doctor.*

*A special effort has to be made to develop relationships with patients and to reassure patients that they are in good hands under your leadership as the new doctor.*