

Module 4 Teamwork Discussion: Strategic Plan Pro Forma and Feasibility

The Pro Forma, Feasibility, Breakeven, Profitability

According to the Federal Accounting Standards Advisory Board (FASAB), pro formas are not written in stone. This is because depending how it is written is dependent on its purpose. There are many different formats and modeling that may occur in a pro forma as exemplified in the 2012 FASAB Handbook (FASAB, 2012). However, all pro formas have similarities by definition, i.e., they forecast company, department, project performance in advance to show financial feasibility, breakeven, and profitability.

A pro forma may be done as an impact analysis for a business venture, which may include building a physical plant, adding a new service or product, or making a capital purchase. Although, we tend to think of the primary document of the pro forma as the forecasting Profit/Loss financial statement, it may also include a statement of cash flows and a balance sheet reflecting the potential impact.

Finally, the pro forma is often used to show at what point the business will break even and when it will begin showing profits. Depending on how close the new project needs to be followed is somewhat contingent on the risk of the venture. The Pro Forma Profit/Loss Statement may show months 1-12, and then years 2-5. Generally, in the first year of the business or project, the Pro Forma Profit/Loss is reported side by side the Actual Profit/Loss.

Healthcare Considerations

When creating a pro forma budget for a medical facility, we have to estimate the change impact to service volume, or productivity. This is going to be based on the payer mix, i.e., insurance company contracts and reimbursement. Volumes of service must be projected and the medical codes representing the services used to estimate the actual revenue and income.

When estimating the costs for a health care pro forma, the medical inflation rate and general marketplace must be taken into consideration. The medical inflation rate is significantly higher than the general inflation rate, or consumer price index (CPI). So, forecasting must be adjusted using the medical CPI.

Additionally, best practice tells us that it is best to underestimate revenue and overestimate expenses and cash outflows, i.e., take a conservative stance. Since, health care is driven by technology and technology is expensive and tends to impact cost, the pro forma should reflect the shelf-life of the technologies. This means that a pro forma should not be unnecessarily extended in years. Computer hardware projections may go out 5 years, since hardware is viable for that period of time; however, software projections should not exceed 3 years. On the other hand, a new building may be projected for the length of the loan, 15, 20, or 30 years. Although, no one can predict what will happen in even 5, and especially 30, years in the real estate market, there are general assumptions that can be made to show long-term feasibility.

Module 4 Assignment: IMPORTANT

Since this is not an accounting class, a pro forma template has been provided to you in an Excel spreadsheet ([Assignment document](#)). The example pro forma illustration below is for a capital equipment business venture and reflects revenue and expenses, profit/loss on purchasing a Magnetic Resonance Imaging (MRI) machine. It is meant only to be background information for your team project pro forma. For your ACO Risk Management Team Pro Forma see illustration 2 and the instructions for completing the Excel spreadsheet template provided in the Assignment document.

General Format of the Pro Forma based on Revenue and Expenses

The general format of the pro forma mirrors financial statements. It is the assumptions and accuracy in forecasting used that go into the pro forma that determines the accuracy of the performance of the document(s). A pro forma has been prepared for the three topics listed below. Choose the one that relates to your team's project.

- o Topic 1: Radiology: Magnetic Resonance Imaging (MRI) Strategic Plan (in progress)
- o Topic 2: Cardiology: Myocardial Perfusion Imaging Strategic Plan
- o Topic 3: HIMs: Electronic Health Record (EHR) Strategic Plan (in progress)

General Format of the Pro Forma for Healthcare Services

Like the income statement, the pro forma measures revenue sources minus business expenses for a given period resulting in a Profit/Loss. The components of a pro forma for health care services would include:

- **Gross Revenues:** This is the gross revenues generated from the services provided to patients.
- **Less Contractual Allowances:** These are the portion of the service fees that are written off as a result of the payer mix, resulting from the contracts the provider has signed with insurance companies.
- **Gross profit (aka Net Income):** The gross profit represents the amount of direct profit associated with the services performed, e.g., the Gross Revenues minus the Contractual Allowances.
- **Operating expenses:** These are the general and administrative expenses that are necessary to run the business and provide the services, such as cost of the physical plant, salaries, advertising, and all other operating costs.
- **Depreciation:** Depreciation is usually included in operating expenses. It is the result of fixed asset expensing over the entire period of its planned use. The IRS requires certain depreciation schedules to be followed for tax reasons. Depreciation is a noncash expense in that the cash flows out when the asset is purchased, but the cost is taken over a period of years depending on the type of asset (IRS, 2013). Depreciation is listed with operating expenses if the cost is associated with fixed assets used for providing services or administrative purposes. Examples include building costs, computer systems, medical equipment, and other capitalized expenses.
- **Net income before taxes:** This represents the amount of income earned by the business before paying taxes.
- **Income taxes:** This is the total amount of state and federal income taxes paid.
- **Net profit/loss after taxes:** This is the "bottom line" earnings of the business. It is computed by subtracting taxes paid from net income before taxes.

Illustration 1: PRO FORMA (Forecast) INCOME STATEMENT

PRO FORMA INCOME STATEMENT REVENUES:					
	Year 1	Year 2	Year 3	Year 4	Year 5
Gross revenue	\$ 3,000,000	\$ 3,300,000	\$ 3,465,000	\$ 3,638,250	\$ 3,820,163
Less contractual allowances	\$ (925,132)	\$ (1,063,902)	\$ (1,223,488)	\$ (1,407,011)	\$ (1,618,062)
Net patient revenue	\$ 2,074,868	\$ 2,386,098	\$ 2,744,012	\$ 3,155,614	\$ 3,628,956
EXPENSES:					
Salaries	\$ 388,080	\$ 446,292	\$ 513,236	\$ 590,221	\$ 678,754
Benefits	\$ 93,139	\$ 107,110	\$ 123,177	\$ 141,653	\$ 162,901
Medical supplies	\$ 36,000	\$ 41,400	\$ 47,610	\$ 54,752	\$ 62,964
Radiopharmaceuticals	\$ 456,000	\$ 524,400	\$ 603,060	\$ 693,519	\$ 797,547
Nuclear license	\$ 425	\$ 489	\$ 562	\$ 646	\$ 743
Radiation safety consultant	\$ 3,500	\$ 4,025	\$ 4,629	\$ 5,323	\$ 6,122
Radiation exposure monitoring	\$ 13,200	\$ 15,180	\$ 17,457	\$ 20,076	\$ 23,087
First-year marketing expense	\$ 20,000	\$ 21,000	\$ 22,050	\$ 23,153	\$ 24,310
Clinician education (one-time)	\$ 40,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000
Equipment insurance coverage	\$ 800	\$ 920	\$ 1,058	\$ 1,217	\$ 1,399
Liability insurance coverage	\$ 24,000	\$ 27,600	\$ 31,740	\$ 36,501	\$ 41,976
Patient education materials	\$ 800	\$ 920	\$ 1,058	\$ 1,217	\$ 1,399
Interest expense	\$ 100,000	\$ 115,000	\$ 132,250	\$ 152,088	\$ 174,901
Depreciation expense	\$ 127,000	\$ 146,050	\$ 167,958	\$ 193,151	\$ 222,124
Bad debt expense	\$ (150,142)	\$ (172,664)	\$ (198,563)	\$ (228,348)	\$ (262,600)
Total Expenses	\$ 1,152,802	\$ 1,325,722	\$ 1,524,580	\$ 1,753,268	\$ 2,016,258
Net Income Before Taxes	\$ 922,066	\$ 1,060,376	\$ 1,219,432	\$ 1,402,347	\$ 1,612,699
INCOME TAXES:					
Federal	\$ 304,282	\$ 349,924	\$ 402,413	\$ 462,774	\$ 532,191
State	\$ 46,103	\$ 53,019	\$ 60,972	\$ 70,117	\$ 80,635
Local	\$ 18,441	\$ 21,208	\$ 24,389	\$ 28,047	\$ 32,254
Total Taxes	\$ 368,826	\$ 424,150	\$ 487,773	\$ 560,939	\$ 645,079
Net Income After Taxes	\$ 553,239	\$ 636,225	\$ 731,659	\$ 841,408	\$ 967,619

To see what is behind the income summary, see the spreadsheet relating to your team project.

References:

Federal Accounting Standards Advisory Board (FASAB). (2012). *FASAB Handbook*, Version 11 (06/12). Accessed January 19, 2012 from: http://www.fasab.gov/pdf/files/2012_fasab_handbook.pdf

Internal Revenue Service (IRS). (2012). Form 4562, Depreciation and Amortization. Accessed January 19, 2012 from: <http://www.irs.gov/uac/Form-4562,-Depreciation-and-Amortization>

Illustration 2: Team ACO Pro Forma

What do you need in place to implement an Accountable Care Organization (ACO) Risk Management Plan to control utilization of health services, control costs, and promote quality? How will you get your providers all on the same page? What kind of incentive system will you propose to motivate your providers of care?

These are the questions that you will explore and answer in your strategic plan.

How much will your strategic plan implementation cost? (That has been provided for you in the pro forma, i.e., \$190k). What and how will your strategic plan contribute to the bottom line of your ACO? The pro forma must show some type of a return on investment (ROI).

The top portion of the ACO’s financial data has been provided to you. You do not have to change any of the numbers in the top portion of the pro forma in the gray areas. You only need to add what you believe the reasonable cost savings will be from the implementation of your team’s plan, which has been given an annual budget (revenue allocation) of \$190,000 out of the total ACO annual revenue of \$60 million.

Do you think your plan for managing ACO risk will cover the cost of your plan \$190,000 (breakeven), or will it actually bring more value (cost savings, reduce utilization, increase quality) to the organization (i.e., profitable results) projected over a 3-year period? The C-Suite Management Team is expecting your team to have a reasonable ROI of 4-5 times in value than the cost of your program, i.e., a cost savings of \$800,000 to \$1million.

After completing your pro forma cost savings, do you feel the budget allocations of \$190k are sufficient enough to achieve your strategic plan objectives? If more dollars are allocated to your plan, would you be able to get a higher ROI?

These are things you should think about when you are filling in the bottom half of the pro forma. The Excel spreadsheet has been programmed to do the math. You need only to add dollars to the **“Capitated: Cost Savings Benefit Value due to Risk Management Plan”** section.

ACO Data	
Required rate of return (Investment - cost savings/value)	10%
Tax Rate	30%
Number of Assigned Patients to ACO is 10,000 @\$500 Per Member Per Month	\$ 5,000,000
Number of Assigned Patients to ACO is 10,000 @\$500 Per Member Per Month	\$ 60,000,000
Initial Investment in Plan	YEAR
Hardware (e.g., integration between providers-hospital servers)	\$25,000.00
Software (e.g., risk management software)	\$15,000.00
Development (e.g., add position of ACO Risk Manager and ACO Trainer)	\$150,000.00
Total Initial Investments	\$190,000.00

The pro forma template you should use can be found as a download link on the [Team Assignment document](#) for this module. You may hand in the pro forma separately with your plan, or paste it “special”, as an excel spreadsheet in your Team Project Term Paper.

[ACO, Company Name]

Risk Management Plan Pro Forma

[Date]

Gray cells contain calculations that should not be altered.

ACO Data

Look for red triangles in the corners for notes

Required rate of return (Investment - cost savings/value)		10%	
Tax Rate		30%	
Number of Assigned Patients to ACO is 10,000 @\$500 Per Member Per Month	\$	5,000,000	Monthly Medicare ACO Capitation Revenue (For All ACO Provider Types)
Number of Assigned Patients to ACO is 10,000 @\$500 Per Member Per Month	\$	60,000,000	Annual Medicare ACO Capitation Revenue (For All ACO Provider Types)

Initial Investment in Plan

YEAR	1	2	3
Hardware (e.g., integration between providers-hospital servers)	\$25,000.00		
Software (e.g., risk management software)	\$15,000.00		
Development (e.g., Add position of ACO Risk Manager and ACO Trainer)	\$150,000.00		
Total Initial Investments	\$190,000.00		

Capitated: Cost Savings Benefit Value due to Risk Management Plan

YEAR	1	2	3
Direct Value (Estimated Savings per Unnecessary Hospital Admission).		\$1.00	\$1.00
Direct Value (Estimated Savings per Reduced Duplication of Services).		\$1.00	\$1.00
Direct Value (Estimated Savings for Disease Prevention).		\$1.00	\$1.00
[Other benefits]		\$1.00	\$1.00
[Other benefits]		\$1.00	\$1.00
[Other benefits]		\$1.00	\$1.00
[Other benefits]		\$0.00	\$1.00
[Other benefits]		\$0.00	\$1.00
[Other benefits]		\$0.00	\$1.00
Total Benefits		\$6.00	\$9.00

Costs (Excluding Initial Capital Investments)

YEAR	1	2	3
Develop Training Material with Risk Management Objectives		\$1.00	\$1.00
Set up software with Risk Management Objectives for Providers of Care		\$1.00	\$1.00
		\$1.00	\$1.00
Office Supplies		\$1.00	\$1.00
Depreciation on capital expenditures (calculation uses three-year period)		\$63,333.33	\$63,333.33
Hosting, domain-name registration for shared Risk Management Software		\$150.00	\$150.00
Train 5 additional PT trainers for provider education in Risk Management		\$1.00	\$10,000.00
[Other costs]		\$1.00	\$1.00
[Other costs]		\$1.00	\$1.00
[Other costs]		\$1.00	\$0.00
Total Costs		\$63,491.33	\$73,490.33

Totals

YEAR	1	2	3
Net Benefits (Costs)		(\$63,485.33)	(\$73,481.33)
Tax		(\$19,045.60)	(\$22,044.40)
Value after tax		(\$44,439.73)	(\$51,436.93)
Depreciation added back		\$63,333.33	\$63,333.33
Cash flow	-\$190,000.00	\$18,893.60	\$11,896.40
Cumulative cash flow	-\$190,000.00	(\$171,106.40)	(\$159,210.00)

Evaluation Metrics

Net present value (NPV)	(\$154,052.75)
Internal rate of return (IRR)	#NUM!
Payback period (in years)	Exceeds 3 years