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Revenue Less Expense Compensation Models

Presented by Integrated Healthcare Strategies
as Authored by Cathy Kibbe

As not-for-profit hospitals increasingly turn to physician employment, they are faced with selecting a physician compensation model that best addresses their objectives. These hospitals have several options including salary, compensation based on physician production (professional collections or wRVUs) and revenue less expense models.

Revenue less expense models are often chosen when hospitals wish to link physician compensation to practice financial performance. This model can be used on an individual physician or group basis, and it essentially works like a private practice model (i.e., physician revenue less expenses determines physician compensation). Physicians can “draw” against expected earnings or have their “salary” adjusted quarterly based on actual practice performance. The model typically only utilizes professional revenue and expense; however, ancillary revenues can be included if the model and the physician practice are properly structured to comply with state and federal regulations, which is discussed in more detail below.

There are a number of pros and cons related to the revenue less expense compensation model:

Pros

- Physician income tied to financial performance
- Rewards physicians for productivity and overhead management
- Easier to “control” practice expense increases (e.g., if physicians want another staff member to increase their productivity, they pay for this expense)

Cons

- Physicians may limit or close their practice to “poor payors”
- Model administratively more complex than other productivity models and can result in multiple “battles” with physicians about what, and how much, is included in “expenses”
- More difficult to develop a “group” culture and loyalty to the hospital
- Physician income can vary significantly across sites/specialties even though physicians may be “working as hard” (i.e., relative to wRVUs)

- Physicians' desire to have access to ancillary revenue which may result in additional capital expenditure and competition with the organization for these services
- More difficult to implement hospital initiatives such as EMR and Pay for Performance programs
- Physicians may perceive no "benefit" in being employed

As noted above, for a revenue less expense model to comply with government regulations related to Stark II, tax-exemption standards and the Medicare Anti-Kickback Statute, it and the physician practice structure must meet a number of criteria.

To comply with Stark II guidelines, a physician can be paid for the work he/she personally performs (i.e., excludes any ancillary revenue from services not personally performed by the physician). Thus, a revenue less expense model based solely on professional revenues and expenses would comply. An employing entity which provides variable compensation to employed physicians that includes revenues from services that are not personally performed by the physician (including ancillaries) must satisfy the definition of a "group practice" under Stark II. To qualify as a group practice, the entity must be a single legal entity organized primarily to be a group practice. As a group practice, the entity must look and feel like a group practice through characteristics such as common billing and administration, shared governance, etc. If the entity is a subsidiary or affiliate of a hospital, it must ensure that no physician directly or indirectly receives compensation based on the volume or value of that physician's referrals.

Furthermore, if the compensation model calls for site- or specialty-specific calculations of net income which include ancillary revenues, each site/specialty must consist of at least five physicians to qualify for the in-office ancillary exception under Stark II. In addition, the regulations provide that the share of ancillary contribution margin paid to physicians must not relate directly to the volume or value of referrals.

For the revenue less expense model to comply with tax exemption standards, total physician compensation derived from the model must be reasonable. In addition, all direct and indirect expenses must be allocated appropriately in the model.

Lastly, the employing entity should retain a portion of the surplus generated by the clinic within the organization to avoid characterization as a revenue sharing arrangement.

Revenue less expense physician compensation models can be very effective in linking physician compensation to practice financial performance. However, this model may make it more difficult to administer compensation and to integrate the physicians into the organization's mission and business strategy. Thus, organizations should consider all of the issues related to this model before selecting it.

About Integrated Healthcare Strategies

Integrated Healthcare Strategies provides not-for-profit healthcare organizations with direct access to a comprehensive array of healthcare-specific services, delivered by professionals from the industry who understand the rigors of running a healthcare organization – from the lunchroom to the Board Room. Its client list is a “who’s who” of healthcare organizations including over 1200 major healthcare providers, 1,800 hospitals and 700 independent and affiliated medical groups. Integrated Healthcare Strategies specializes in the areas of physician strategy and compensation, employee compensation, executive compensation, human capital solutions, labor relations, leadership transition planning, executive search, employee surveys, performance management and board governance solutions.

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