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Prepayments: Avoiding Pitfalls

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The value of a practice is determined, in part, by calculating the available income for a purchaser after the practice expenses are considered. Usually, practice financial statements and tax returns are adequate to breakdown the financial condition of the business, providing a purchaser with a good representation of practice income and expenses. By examining the day sheets, deposit slips and bank statements, a purchaser should find a direct correlation between the services provided to patients and the actual practice income.

Recently, though, we have seen some new trends in practices, propagated by the use of health-care specific credit cards and financing plans for dental treatment. These credit vehicles have been welcomed by practices, since once the patient is approved, the entire estimated treatment cost is advanced and paid immediately to the practice (less a pre-arranged percentage withheld by the bank).

What's the problem? When a dentist deposits the money received as prepayment for future patient services into the practice's general bank account, that money becomes comingled with money deposited for services already performed.

While there is nothing illegal or wrong with this practice, if the money has gone into the general account, the due diligence review may not discover the credits. Without full disclosure by the seller, the purchaser may be walking into a practice where many of the returning patients expect their continuing treatment will be provided at no additional cost. Patients will expect that their money has been properly transferred to the new practice owner.

So how can the general practice adapt? An easy solution is to use a separate bank account solely for prepayments, much as escrow accounts are utilized by brokers and attorneys. As treatment is provided, money can then be transferred to the operating account. Keeping the prepayments separated allows the owner to more accurately track the practice collections and profitability. Further, this separation protects the practice in the event that a patient decides not to complete treatment and requests a refund; the money is readily available and has not been already spent or taken by the owner. Finally, maintaining this separation allows for easy accounting and transfer of the patient credits in the event of any practice transition.

We urge you to take a serious look at your accounting procedures for prepayment credits, whether or not you are considering a transition.

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