

Test Your Knowledge

By Jane Piotrowski

A Case Study: Capital Rationing

YOU ARE THE CAPITAL PROJECT MANAGER FOR SNOWBOUND PHYSICIAN PRACTICE ASSOCIATES; A 30 MEMBER GROUP PRACTICE SPECIALIZING IN DERMATOLOGY AND SKIN CARE.

YOU ARE ABOUT TO BEGIN THE FISCAL YEAR 2015 BUDGETING PROCESS AND THE GROUP IS CONSIDERING THE PURCHASE OF SEVERAL PIECES OF EQUIPMENT. YOUR JOB IS TO DETERMINE WHICH PIECE (S) OF EQUIPMENT CAN BE PURCHASED WITH A TOTAL BUDGET OF \$100,000.

THE INITIAL OUTLAY AND CASH FLOWS AT THE THE END OF YEAR ONE IS AS FOLLOWS:

| EQUIPT # | CASH | CASH INLAY |
|----------|----------|------------|
| A | \$20,000 | \$25,500 |
| B | \$20,000 | \$22,800 |
| C | \$20,000 | \$22,500 |
| D | \$40,000 | \$46,875 |
| E | \$40,000 | \$45,085 |
| F | \$60,000 | \$68,750 |
| G | \$80,000 | \$94,375 |

THE PRESENT VALUE OF 1 AT THE END OF ONE YEAR AT 10% IS .8945

TASKS:

1. COMPUTE NET PRESENT VALUE FOR EACH OF THE ITEMS.
2. ASSUMING THE ITEMS ARE NOT MUTUALLY EXCLUSIVE, WHICH COMBINATION OF ITEMS CAN THE PRACTICE PURCHASE?
3. ASSUMING ITEMS B, D AND G ARE MUTUALLY EXCLUSIVE, WHICH COMBINATION OF ITEMS SHOULD THE PRACTICE PURCHASE?

Answer found on page 20

ANSWER:

| 1. EQUIPT # | CASH | CASH INLAY | | NPV |
|-------------|----------|------------|----------|---------|
| A | \$20,000 | \$25,500 | \$22,810 | \$2,810 |
| B | \$20,000 | \$22,800 | \$20,395 | \$395 |
| C | \$20,000 | \$22,500 | \$20,126 | \$126 |
| D | \$40,000 | \$46,875 | \$41,930 | \$1,930 |
| E | \$40,000 | \$45,085 | \$40,329 | \$329 |
| F | \$60,000 | \$68,750 | \$61,497 | \$1,497 |
| G | \$80,000 | \$94,375 | \$84,418 | \$4,418 |

2. A, G = \$ 7,228

3. A, C, F = \$4,433

Test Your Knowledge

| | 2012 | 2011 |
|--|---------|---------|
| 1. CONTRACT DISCOUNT | | |
| NET PATIENT REVENUE | 44.38% | 42.82% |
| CONTRACTUAL ALLOWANCE | 55.62% | 57.18% |
| DECREASE IN CONTRACTUAL THIS MEANS A SHIFT IN PAYOR MIX. IS ORGANIZATION SEEING AN INCREASE IN SELF PAY OR ARE THEY GETTING BETTER RATES FROM THE INSURER? | | |
| 2. OPERATING MARGIN | | |
| TOTAL OPERATING REVENUE-OP EXPENSE | (2,834) | 942 |
| TOTAL OPERATING REVENUE | 102,228 | 98,267 |
| | -2.77% | 0.96% |
| THIS IS NOT GOOD. IT IS SHOWING THAT ABILITY TO GENERATE REVENUE FROM PATIENT CARE IS DETERIORATING. | | |
| 3. RETURN ON TOTAL ASSETS | | |
| NET INCOME | (1,259) | 3,292 |
| TOTAL ASSETS | 122,390 | 133,863 |
| | -1.03% | 2.46% |
| THIS IS NOT GOOD. IT IS SHOWING THAT THE ORGANIZATION'S ASSETS ARE NOT GENERATING INCOME. | | |
| 4. RETURN ON EQUITY | | |
| NET INCOME | (1,259) | 3,292 |
| NET ASSETS | 73,216 | 88,025 |
| | -1.72% | 3.74% |
| THIS IS NOT GOOD. IT IS SHOWING THAT THE ORGANIZATION IS NOT USING IT S EQUITY TO GENERATE INCOME. | | |
| 5. CURRENT RATIO | | |
| CURRENT ASSETS | 46,511 | 48,311 |
| CURRENT LIABILITIES | 10,457 | 9,188 |
| | 4.45 | 5.26 |
| OVERALL GOOD. ORGANIZATION CAN MEET SHORT-TERM OBLIGATIONS. | | |
| 6. QUICK RATIO | | |
| LIQUID ASSETS | 45,153 | 46,961 |
| CURRENT LIABILITIES | 10,457 | 9,188 |
| | 4.32 | 5.11 |
| OVERALL GOOD. ORGANIZATION CAN STILL MEET SHORT-TERM OBLIGATIONS. | | |
| 7. NET DAYS IN PATIENT AR | | |
| NET AR | 22,195 | 25,382 |
| NET REV-BD/365 | 213 | 207 |
| | 104 | 123 |
| BETTER...BRINGING AR DOWN | | |
| 8. AVERAGE PAYMENT PERIOD | | |
| CURRENT LIABILITIES | 10,457 | 9,188 |
| OP EXP-DER/365 | 270 | 252 |
| | 38.76 | 36.44 |
| BECAUSE THE REVENUE IS NOT BEING GENERATED, IT IS TAKING LONGER TO PAY THE BILLS. | | |
| 9. DAYS CASH ON HAND | | |
| OP EXP-DER/365 | 23,408 | 22,329 |
| | 270 | 252 |
| | 86.76 | 88.56 |
| CAN PAY BILLS BUT NEED TO BE ABLE TO GENERATE MORE CASH | | |

Test Your Knowledge

YOU ARE THE INVENTORY CONTROL MANAGER FOR PARADISE DME SALES AND SERVICE. YOU HAVE BEEN ASKED BY THE CFO TO CALCULATE THE COST OF YOUR WHEELCHAIR SALES FOR THE YEAR AS WELL AS VALUE YOUR INVENTORY AT THE CLOSE OF BUSINESS AS OF SEPTEMBER 30, 2012.

PARADISE USES THE LIFO METHOD FOR VALUING IT'S INVENTORY.

| | COUNT | UNIT COST | TOTAL COST |
|---------------------------------|-------|-----------|------------|
| SUPPLY ITEM: WHEELCHAIRS | | | |
| INVENTORY -OCTOBER 1, 2011 | 25 | \$175 | \$4,375 |
| ACTIVITY: | | | |
| PURCHASE 15-Nov-11 | 10 | \$165 | \$1,650 |
| SALE 01-Dec-11 | (8) | | |
| PURCHASE 31-Jan-12 | 15 | \$185 | \$2,775 |
| SALE 15-Mar-12 | (22) | | |
| PURCHASE 30-Jun-12 | 10 | \$203 | \$2,030 |
| SALE 31-Aug-12 | (12) | | |
| PURCHASE 15-Sep-12 | 5 | \$200 | \$1,000 |
| INVENTORY -SEPTEMBER 30, 2012 | 23 | | |

ANSWER:

| | COUNT | UNIT COST | TOTAL COST |
|---------------------------------|-------|-----------|--|
| SUPPLY ITEM: WHEELCHAIRS | | | |
| INVENTORY -OCTOBER 1, 2011 | 25 | \$175 | \$4,375 |
| ACTIVITY: | | | |
| PURCHASE 15-Nov-11 | 10 | \$165 | \$1,650 |
| SALE 01-Dec-11 | (8) | | -\$1,320 8 AT 165 |
| PURCHASE 31-Jan-12 | 15 | \$185 | \$2,775 |
| SALE 15-Mar-12 | (22) | | -\$3,980 15 AT 185; 2 AT 165; 5 AT 175 |
| PURCHASE 30-Jun-12 | 10 | \$203 | \$2,030 |
| SALE 31-Aug-12 | (12) | | -\$2,380 10 AT 203; 2 AT 175 |
| PURCHASE 15-Sep-12 | 5 | \$200 | \$1,000 |
| INVENTORY -SEPTEMBER 30, 2012 | 23 | | \$4,150 |
| | 18 | \$175 | \$3,150 |
| | 5 | \$200 | \$1,000 |
| | 23 | | \$4,150 |
| COST OF SALES | 42 | | \$7,680 |