

Surviving Medical Practice Audits

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Disclosure

- Nothing to disclose

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Disclaimer

- Neither Mohamed Yassin nor Shannon Ficker is a financial or legal counselor
- In the last 18 years, our practice was audited by the IRS and the State of Minnesota 6 times (Sales Tax, Payroll tax, Fed Income tax, State tax)
- We are providing you with information to help you examine your office financial procedures to help you in creating an audit-proof business environment

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Learning Objectives

- Recognize audit triggers
- Explain legal rights
- Provide a roadmap for executing an audit

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What is an Audit?

- An audit (*noun*) is an official inspection of an individual's or organization's accounts
- An audit (*verb*) is to conduct an official financial examination of individual's or organization's accounts
- Some audits are named according to their purpose or scope
- An audit may also be classified as internal or external

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Types of Audits We Will Discuss

- Internal Financial and Practice Management Audits
- External Financial Audits
- IRS audits
- State and Sales Tax audits

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Internal Financial and Practice Management Audits

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Benefits of a Medical Practice Internal Financial Audit

- Internal financial audits are valuable when done correctly
- The benefits of the internal financial audit are:
 - To ensure all services are billed for
 - To ensure you are paid for what you billed for
 - To ensure the money collected is going to your business account (3 out of every 4 medical practices experience embezzlement)
 - To develop a check list and procedures that everyone follows regardless of employee turnover or employee cross coverage

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Medical Practice Internal Financial Audit, What to Do?

- Compare daily deposits to computer daily report of posted payments
- Compare month end collections per billing software report to actual money deposited per monthly bank reconciliation
- Review daily petty cash reconciliations
- Review weekly contractual adjustment posting
- Review access controls to the medical billing software
- Ensure that the person that posts payments to patients' accounts does not open the mail or prepare the deposits

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Medical Practice Internal Financial Audit, What to Do?

- Review accounts receivable procedures and related approval of vendor endorsement
- Review cancelled checks for appropriate vendor endorsement and match with invoice(s)
- Limit number of partners authorized to sign checks and no check(s) should be signed without attached invoice, write paid on invoice
- Ensure that all available vacation time has been taken by related billing, collection, and management personnel

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Medical Practice Internal Financial Audit, What to Do?

- Review payroll procedures including:
 - Time cards (electronic clocks or manual)
 - Review hours worked before issuing payroll checks
 - Don't allow the person doing the payroll to record her/his own vacation time or worked hours
 - External payroll services vs inhouse, which one is appropriate for your practice?
 - Consider who collects and verify payroll data?, who runs the payroll? expense?

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Medical Practice External Financial Audit, Pros and Cons?

- Pros:
 - Objectivity. Medical auditors employed by an external agency inherently provide an objective point of view
 - Independence is perceived as 'honest'. One presumes that employed staff is honest, but in-house staff members are not always in the best position to discover errors, or to bring them to light.
- Cons:
 - Most auditors are experienced in chart auditing and maybe billing but rarely experienced in financial auditing and medical offices fraud / embezzlement even most CPAs
 - Expensive

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Medical *Practice Management* Audit, What to Do? (Not a financial audit but it is important)

- Review office practice procedures including:
 - Proper phone answering protocol
 - Appropriate and timely patient scheduling specially consults
 - Review time checking in to seeing the provider, aim for “ten minutes rule”
 - Review provider’s schedule weekly and adjust accordingly till you achieve the appropriate number and type of new and established patients mix. The goal is to maximize provider’s productivity while providing the best patient care without over extending the provider.
 - Review patients’ complaints and make appropriate changes

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Medical Practice Management Audit, What to Do? (Not a financial audit but it is important)

- Review office practice procedures including:
 - Review staffing ratio; unlike inpatient care ambulatory care has no standards and all depends on the skill level and efficiency of the employees
 - Examine if employees are scheduled appropriately to avoid overstaffing or understaffing. (Example: recently we audited an allergy practice and one day there was one PA working who saw 11 patients with 2 RNs, 1 LPN, 1, MA, 3 receptionists, 1 billing personnel and the office manger.)
 - Review and establish new staff training procedures
 - Review and establish patient follow up, laboratory and imaging review and notification procedures

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IRS and State Audits

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Top IRS Tax Audit Triggers

- Discriminant Information Function or DIF computer system; DIF is designed to scan every tax return and look for duplicates, unusual deductions, it compares each return to those of other taxpayers who earned approximately the same income
- If you earn \$200,000 or more
- If you overlook income; the IRS gets copies of W2s and 1099s forms
- If you spend or deposit a lot of cash (\$10,000 deposit limits for bank reporting)

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Top IRS Tax Audit Triggers

- If you claim a lot of deductions; example claiming 50% or more of your income as donations for qualified charities (the IRS knows you are not Mother Teresa)
- If you withdraw from 401(K) or IRA and you are not near retirement age; the IRS reports that 40% of those taking early withdrawals also goofed when they reported the event on their tax returns (mistakes=additional tax revenue) (NOT paying the 10% penalty)

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Top IRS Tax Audit Triggers

- If you are self employed; self employed individuals are entitled to a host of tax deductions that most other taxpayers don't get to share (travel/car, home office,.....)
- If you own a cash medical practice (Concierge Medicine)
- If you have assets or cash in another country (medical missions)

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Why the IRS is Targeting Physicians?

- The IRS is stepping up their audit enforcement against doctors, based on their perception that doctors make easy targets due to poor record-keeping practices in addition to their high earning power
- The notorious lack of doctors' record keeping, resulting in office expense estimating ("guesstimating" as the IRS would call it)
- One of the areas that the IRS is focusing on is deductions related to business travel for physicians
- It is the belief of the IRS that doctors routinely over-deduct for education-related travel; staying at hotels that are beyond the level and price point of the hotel where a seminar is provided, meals,

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Why CPAs are Generally Not Effective in Preparing Medical Practices for Tax Audits?

- Many CPAs unfortunately take information from their doctor clients and put it on a tax return without enough "questioning"
- CPAs frequently complain that physicians do not make the time to meet and thoroughly discuss the material provided, or that the physician has dumped all their records on the CPA just before tax filing is due. "Being too busy" is sometimes just a disguised excuse for procrastination.
- Myth: "CPA prepared taxes are less likely to be audited" this is false

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Minimizing the Risks of Medical Practice Audits

• Beef Up Your Business Management Smarts

- Michael Gerber writes in "The E-Myth Physician: Why Most Medical Practices Don't Work and What to Do about It"
...every enterprise in the world that really matters is organized into 3 distinct work levels: (1) the work of the Entrepreneur, (2) the work of the Manager, and (3) the work of the Technician
- Most physicians would rather be left alone to be the Technician
- Face the truth: Your medical practice is a business, in serious need of leadership, business acumen, and managerial oversight in order to survive in the modern world

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Minimizing the Risks of Medical Practice Audits

• Beef Up Your Business Management Smarts

- If you are not willing to do managerial tasks, you need to ensure that you have someone else in place with the skills and passion to perform your business owner duties
- Hiring a good business manager who works hand-in-hand with physicians can assist in both the initial medical practice organizational phase and the execution phase

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Minimizing the Risks of Medical Practice Audits

- Draw up a risk management plan for your office
 - Do you have a plan to manage potential audit risk? If you don't, why not?
- Set your standards
 - Need clearly-articulated standards to help guide performance.
 - These standards might be policies, procedures, stated expectations, or simply "how we do things here"
 - Too often, assumptions, and "how it's always been done" rule, leading to confusion, sloppy work, and errors

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Minimizing the Risks of Medical Practice Audits

- Give authority, provide training, and then delegate
 - Since physicians are the highest per-hour earner in your practice, it does not make sense for a physician to be performing tasks that a lesser paid employee could do
 - As business owners, we know that it's often easier to just do the task yourself than to take the time to train someone else to do it for you (*poor parenting*)
 - BUT, every time you perform a task someone else could do, you are incurring an opportunity cost (you are missing the opportunity to perform the work that only you can do)
 - You owe it to your mental well-being and business success to authorize the right people, train them according to your practice vision and its policies and procedures, and then remember to delegate

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Minimizing the Risks of Medical Practice Audits

- Systemize, Systemize

- Be the pilot flying a commercial airliner largely governed by a routine, systemized series of checklists. Remember, that is the main reason airplanes don't often crash (pre-flight, in-flight, and landing checklists).
- Most medical practices have checklists in place to ensure a satisfying patient experience in your office, that no lab or imaging study reports fall between the cracks, or that your patient visit documentation is coded correctly. But only a few have financial checklists from front desk collections to filing taxes.

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Minimizing the Risks of Medical Practice Audits

- The Team Approach

- Know what you are good at and what you are not. You might be the best allergist in your state, but you may be very weak at running a medical practice and performing the day-to-day chores that are required to do so.
- An office manager is an integral part of that, but unfortunately, many office managers have almost no training in tax and record keeping, but instead mostly pay bills and book appointments. This is the failure of the business owner.
- Have your office manager get the needed training
- The AAAAI Practice Management Committee is committed to training your office managers, please ask your manger to join

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How Can I Avoid Having the IRS or the State Audit My Medical Practice?

- The IRS and the State audit businesses for a variety of reasons, and you may not be able to prevent an audit, but you can minimize problems resulting from an audit by incorporating sound business practices into your medical practice:
 - Use a business record keeping system that works
 - Keep personal and business accounts separate, your practice is not your ATM

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Use a Business Record Keeping System that Works

- First, CAPTURE the information
 - If it isn't there, it doesn't exist
 - Keep track of every amount you spend for your business and every amount you take in as income / DME sales
- Second, CHECK to make sure the information is complete and correct
 - At least monthly, spend an hour going through all invoices, billing & collections
 - Don't wait too long; the longer you wait to do this, the more difficult it will be to remember and collect and verify information

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Use a Business Record Keeping System that Works

- Third, RECORD the information and save it
 - Recording means putting your financial information into a useable form (financial software example QuickBooks or spread sheet)
 - Do this every month
- After your financial information has been recorded each month, print out three reports:
 - Balance sheet
 - Income statement (profit and loss)
 - Accounts payable report

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Use a Business Record Keeping System that Works

- At the end of the year, always organize all your receipts with your accompanying tax return and store them some place safe since it's likely you won't get an audit notification until 12 to 24 months later after you file
- Plan for an Audit, don't wait until you get audited

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Keep Personal and Business Accounts Separate

- Lack of separation shouts "Audit" to the IRS.
- Clearly designate your business deductions and income.
- Use separate credit cards and avoid dipping into petty cash
- Trying to sort through your personal records at tax time is a nightmare
- Make it easy for the IRS. The IRS is more likely to audit your business and deny deductions and businesses losses if you have no clear separation between business and personal expenses.

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The Four Types of IRS Audits

- **Correspondence Audit:** This is the most common type of audit if you earn <\$200,000 and is done by mail. The IRS will normally request specific documentation to support particular items on the tax return.
- **Office Audit:** This is when you are required to go to an IRS office to meet with an IRS auditor. The IRS will determine the time and the particular documents that it would like you to bring for support
- **Field Audit:** This is when the IRS wants to come to your home, place of business, or your tax professionals office to perform the audit. This is the commonest audit in medical practices, it is only used if the individual or business being audited earned well over \$200K.
- **Random Audits:** IRS agents aren't looking for anything in particular

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How to Prepare For a Tax Audit

- Contact your tax preparer or tax advisor before you respond
- You may choose your accountant or a tax attorney to represent you or your company, but you need to be actively involved
- Having an inexperienced secretary or assistant represent you can be disastrous; individuals have a tendency to say way too much, give away too much and admit too much
- Get your records in order. IRS auditors can impose penalties on your business for poor records.
- Organize records by year and by type (income, expenses, pension plans, etc.)

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How to Prepare For a Tax Audit

- Request bank or credit card records or information from vendors. If records aren't available, don't make them up (consider getting monthly cancelled checks with your monthly bank statements).
- Make every effort to reconstruct lost or destroyed records, and document your efforts
- Understand **intentional vs. unintentional failures**. If you can show that your issue (no records for a particular year, for example) was unintentional, the IRS tends to be more lenient. On the other hand, they are much quicker to impose fines and penalties for intentional actions or omissions.

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Sales and Use Tax Audit

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What is the Difference Between Sales and Use Taxes?

- The sales tax is imposed on retail transactions. It applies to all retail sales of tangible personal property, and in some states services, in the state.
- Consumer's use tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales
- The sales tax and the use tax are “mutually exclusive”, which means either sales tax or use tax applies to a single transaction, but not both

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Sales and Use Tax Audits: Why do States Audit the Sales and Use Tax?

- Collect revenue for the state
- Make sure businesses within the state are collecting sales tax (and in the right amounts)
- Generate future revenue for the state as businesses become compliant
- Find out-of-state businesses that may potentially have nexus in-state
- Find out what types of transactions are occurring in the marketplace in order to make new tax laws

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When Do You Owe Sales or Use Tax?

- When you buy an item from a vendor in your state who did not charge the correct tax
- When you buy an item exempt for resale and use the item in your office
- When you buy an item from an out of state vendor who did not charge sales and use tax. (This is the most common in medical practice.)

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How to Make Your Practice Sales and Use Tax Audit Proof?

- Your office should always be prepared for a sales tax audit
- Establish and periodically review the sales tax procedures and policies:
 - At the end of each month review all invoices for sales and use tax payments
 - In a spreadsheet, keep track of all unpaid sales and use tax
 - File the Sales and Use tax annually if owe less than \$100, quarterly if you owe \$100-\$500 and monthly if you owe more than \$500 (you can apply for Abatement to reduce or waive the penalty for filing late)

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What are the Sales and Use Taxable Items?

- What is taxable:
 - Medical equipment and components
 - Lab supplies, radiological supplies, and all other items used in providing medical services
 - Office supplies (example: toner)
 - PC software and licenses
 - Maintenance items, repair parts, non production assets
 - Payments for the office cleaning crew
 - Payments for IT consultants

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What are the Sales and Use Taxable Items?

- What is taxable:
 - Extracts; testing BUT not treatment (see separate report)
 - Diluent, HSA (varies by state, NON-TAXABLE in most)
 - Syringes (varies by state, taxable in most)
 - Greer picks (or other similar products), taxable in most states
 - Sterile empty vials (varies by state, taxable in most)
 - Boxes to mail vials (varies by state, taxable in most)
 - Spirometry supplies (filters, nose clips)
 - Patch tests
 - TeleVox appointment reminders and other similar products

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Common Medical Vendors Who Don't Charge Use Tax

- Allergy labs
- Greer for picks
- Moore medical
- Total pharmacy supply
- Drugs depot
- Smile makers
- Toner supply through Amazon

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Responding to Tax Audits

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Responding to Tax Audits

- Don't provide the auditor with items that they have not asked for
- What items do you need to have ready?
 - Federal and/or State income tax returns depending on the type of audit
 - Chart of accounts
 - Depreciation of fixed assets schedules and invoices for the items depreciated
 - General ledger
 - Purchase invoices (remember, internet purchases are not tax free)
 - Credit card statements with supporting invoices or canceled checks
 - 1099's if asked for

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What Do You Do When You Receive the Audit Report?

- You have 60 days after receiving the final report to:
 - Pay the amount you owe or
 - File an informal appeal (speak to the auditor) or
 - File a formal appeal with the state tax court
- Don't rush to pay the "amount owed", challenge the findings

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What Are Your Rights When Audited By IRS? (Local States Follow The Same Rules)

- IRS employees must explain your rights and protect them
- IRS employees cannot disclose information about you to anyone, unless the law authorizes disclosure
- When an IRS employee asks you for information you have the right to know (1) why the employee wants the information, (2) how the information will be used, and (3) what will happen if you don't provide the information.

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What are Your Rights When Audited by IRS?

- IRS employees must be polite, professional, and fair. If an employee is not acting properly, you have a right to talk to the employee's supervisor, and if the supervisor's response is unsatisfactory, you can write to the IRS Director in your area.
- You have the right to have somebody represent you if you don't want to represent yourself in dealing with the IRS
- You have a right to stop an interview conducted by an IRS employee to consult with your accountant / attorney. The employee must stop the interview and usually will reschedule it.

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What Are Your Rights When Audited by IRS?

- You can tape-record any meeting with the employee conducting your audit, hearing your appeal, or trying to collect a tax you owe. You must tell the employee of your plan in writing at least ten days before the meeting.
- You have to pay only as much as you owe. If you cannot pay it all, you can ask about paying the tax in monthly payments
- If you have paid too much, you are entitled to a refund, as long as you apply for one on time
- You have a right to appeal an audit agent's decision of how much tax you owe

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Dealing with the Auditor

- The auditor is not your friend but you must also treat them with some degree of professional respect and courtesy
- Your goal is to provide them with the information that will allow them to complete their work as quickly as possible
- Having a good professional relationship with auditors can go a long way when it comes to penalty abatement and the tax treatment of unclear transactions

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Dealing with the Auditor

- Be as brief as you can
 - Auditors are trained to listen to everything you say. Saying too much can lead to the auditor looking at other tax years that weren't covered with the initial audit.
- Do not lie or make misleading statements
 - The IRS may ask questions they already know the answers to in order to see how much they can trust you
- Don't offer other years tax information

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Dealing with the Auditor

- Have all required support
 - Going into the audit with all the required documents and having it organized can impress the auditor and make them realize that you are willing to cooperate and make things flow smoothly
 - If you are missing documents, you are allowed to reconstruct them
- Be yourself during an audit
 - It isn't just your taxes that are under review, you are being reviewed as well by the auditor
- Don't give original documents to an auditor
 - The IRS is known for losing documents
 - If IRS lose one of your documents, it is not an excuse for not having proper support

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Dealing with the Auditor

- Understand how the IRS feels about substantial compliance
 - If you can show the IRS that you have enough proof that you did follow IRS tax laws, but your documentation is lacking, they may allow the deduction to be taken
- Appeal the audit if you don't agree
 - It is your right to appeal an audit examination report
 - Start by calling the auditor that you don't agree with and make your argument
 - If you are having troubles making your point then you can choose to meet with their manager, appeal with the IRS, or go to tax court

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Dealing with a “Tough” Auditor “an auditor that is not acting appropriately”

- Delay the audit
 - Auditors do not like delays because many times their performance is based on cases that they close
 - To delay, you can ask for a recess and pick back up at a later time
 - If they won't allow a recess you can then say you want to talk with a tax professional before going any further with the audit. If you talk about wanting a professional, the auditor must legally grant your request (You don't actually need to get one, but the request will end the audit for the current session).

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Dealing with a “Tough” Auditor “an auditor that is not acting appropriately”

- Request a new auditor
 - If you feel like you are being treated unfairly or the auditor is not being respectful to you, request a new one
 - When speaking with the manager you should tell them that you feel you are not being treated with respect and you would like to work with someone else
 - Although your request may not be granted, you will see the tone of the auditor change
- Consider recording the audit
 - You are allowed to record your audit with the IRS as long as you let them know in writing ten days before. When the auditor knows all proceedings are being recorded, this can limit abuse and can create a more professional environment.

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Questions?



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