Basic Models for Physician Compensation with Corresponding Contract Provisions

BY (ELIZABETH) LYNN GORDON, M.A., J.D.

The purpose of this article is to provide physicians and their employers with a basic overview of models of physician compensation for use in determining specific compensation arrangements.

Typically, one of four physician compensation models is used in establishing a physician's compensation arrangement with an employer: fixed compensation, base plus percentage of revenue, base plus performance factors, and relative value unit performance. These models are also often incorporated into partnership agreements among physicians to determine allocation of combined practice revenue.

Fixed Compensation Model

The most simple compensation arrangement is for the parties to agree upon a fixed salary. This is typically determined through one of two methods. In the first method, the parties may utilize the following formula: estimated gross revenues of the physician's practice, less expenses attributable to the physician, less (i) an allocation to amortize the practice purchase over a set period (e.g., five years), if applicable and/or (ii) a profit margin for the employer.

In the second method, preferred especially if practice revenues would be difficult to determine, the parties may base compensation upon objective data regarding average physician compensation for given specialities. Keep in mind, however, that the majority of surveys on physician compensation assume a full-time practice commitment. The American Medical Group Association publishes an annual Medical Group Compensation and Productivity Survey. The Medical Group Management Association annually publishes a Physician Compensation Survey in its Physician Advisory Newsletter. The GMENAC and AMA publish similar surveys. Other sources of information may include state or local medical societies, national trade associations, the "Big Six" accounting firms, health care consulting firms, and benefits and compensation firms.

Typical compensation language in an agreement incorporating the "Fixed Compensation Model" is as follows:

In consideration of Physician's professional and administrative services rendered hereunder, Corporation shall pay to Physician during each year of this Agreement an annual salary in an amount equal to $________. Physician's salary shall be paid on or before the __________ (____) day of each month for services rendered during the prior month, or at such other intervals as agreed to by the parties, subject to applicable federal, state, and local deductions and reporting requirements as required by law.

The amount would be determined through one of the two methods as described above.

However, as physicians vary widely in practice performance and the market continues to demand reductions in health care costs, employers are quickly moving towards a combination of a base
salary and a performance component in establishing physician compensation, as more fully addressed below.

**Base Plus Percentage of Revenue Compensation Model**

As physician compensation is becoming more closely linked to individual performance, a physician compensation model increasing in popularity is one that combines a lower base pay with a percentage of individual practice revenue. Under this model, the parties agree to a base pay that is lower than a typical fixed salary where no performance factors are considered. Then, the parties agree to a second component of compensation equal to a fixed percentage of physician net revenue. In calculating this second component of salary, “net revenue” typically means the total gross collections of the individual physician less adjustments due to practice-related expenses for the individual physician, bad debt, and contractual allowances (including base salary) attributable to services provided by the physician during the period for which the calculations are being made.

The percentage could be based simply on a portion of revenue (e.g., equal to 30 percent of all physician net revenues, as in Option One below). On the other hand, the percentage could be based on a portion of revenue which exceeds a certain threshold amount for the period under consideration (e.g., equal to 60 percent of all physician net revenues during the year that are in excess of $240,000, if any, as in Option Two below).

Typical compensation language in an agreement incorporating the “Base Plus Percentage of Revenue Compensation Model” is as follows:

**Option One**

(A) In consideration of Physician’s professional and administrative services rendered hereunder, Corporation shall pay to Physician during the first year of this Agreement a base annual salary in an amount equal to $________ (such salary as may hereinafter be adjusted shall be referred to as “Base Salary”). Physician’s Base Salary shall be paid on or before the ___ (th) day of each month for services rendered during the prior month, or at such other intervals as agreed to by the parties, subject to applicable federal, state, and local deductions and reporting requirements as required by law.

(B) During the first year of this Agreement, Corporation shall distribute to Physician an amount (the “Bonus”) equal to ___ percent (___%) of all Physician Revenues during the year that are in excess of $________, if any. Such Bonus shall be payable to Physician within forty-five (45) days after the anniversary date of the Initial Term or any subsequent renewal term. For purposes of this subsection “Physician Revenues” shall mean the total annual gross collections less adjustments due to practice-related expenses, all collections with respect to ancillary services (ancillary services shall mean laboratory services, diagnostic imaging services, and other ancillary services which are provided in-office), bad debt, and contractual allowances attributable to services provided by Physician during each one year period of this Agreement.

(C) Upon termination of Physician’s employment, Physician shall be entitled to a Bonus for that portion of the Bonus period that Physician was employed by the Corporation based on the formula set forth in subsection (B) above. Such Bonus shall be payable to Physician within forty-five (45) days after the date of Physician’s termination.

(D) On or before the last month of each year of this Agreement, Corporation shall evaluate the Base Salary paid to Physician and the incentive bonus formula set forth in subsection (B) above for the purpose of determining whether any increases should be granted. Corporation shall make such adjustments to Physician’s Base Salary and bonus formula as the parties may mutually agree.

**Option Two**

(A) In consideration of Physician’s professional and administrative services rendered hereunder, Corporation shall pay to Physician during the first year of this Agreement a base annual salary in an amount equal to $________ (such salary as may hereinafter be adjusted shall be referred to as “Base Salary”). Physician’s Base Salary shall be paid on or before the ___ (th) day of each month for services rendered during the prior month, or at such other intervals as agreed to by the parties, subject to applicable federal, state, and local deductions and reporting requirements as required by law.

(B) During the first year of this Agreement, Corporation shall distribute to Physician an amount (the “Bonus”) equal to ___ percent (___%) of all Physician Revenues during the year that are in excess of $________, if any. Such Bonus shall be payable to Physician within forty-five (45) days after the anniversary date of the Initial Term or any subsequent renewal term. For purposes of this subsection “Physician Revenues” shall mean the total annual gross collections less adjustments due to practice-related expenses, all collections with respect to ancillary services (ancillary services shall mean laboratory services, diagnostic imaging services, and other ancillary services which are provided in-office), bad debt, and contractual allowances attributable to services provided by Physician during each one year period of this Agreement.

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The phrase “during the first year of this Agreement” in paragraphs (A) and (B) and the language in paragraph (D) in each of these sample sections are optional, but would be included if the parties are less certain as to actual practice performance and would like the opportunity to revisit the compensation formula annually in order to adjust based on performance. Also, the exclusion of certain ancillary revenue from any bonus calculation is necessary to break the absolute connection between a physician’s volume or value of referrals for these services and such physician’s direct financial benefit from such referrals (in accordance with federal anti-kickback and self-referral laws).

**Base Plus Performance Factors Compensation Model**

One of the most highly individualized physician compensation arrangements is a model that combines a lower base fee with a combination of various performance factors which serve as the basis of calculating performance compensation. With this model, we find the most variance from agreement to agreement since the parties may consider any number of factors in calculating performance payments. In general, however, such compensation arrangements combine a lower base pay with additional payments calculated based on the physician’s meeting or exceeding certain performance factors (one of which may be a targeted amount of individual practice revenue). Under this model, the parties agree to a base pay which is lower than a typical fixed salary where no performance factors are considered. Then, the parties agree to a second component of compensation based on aggregate performance under an agreed upon set of performance factors, as specified in the agreement.

Any one or more of the following measurements may be found in a “Base Plus Performance Factors Compensation Model”:

1. Number of new patients seen
2. Volume of services Physician personally performs

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3. Cost efficiency
4. Aggregate collections (less all collections with respect to the following ancillary services: laboratory services, diagnostic imaging services and other ancillary services which are provided in-office)

5. Patient contact
6. Patient satisfaction
7. Capitation (utilization/cost of care)
8. Fee-for-service productivity
9. Contribution to the organization
10. Physician’s involvement in marketing the practice
11. Physician’s community involvement (promoting health and wellness)
12. Physician’s performance of administrative responsibilities
13. Group or specialty goals achieved

Whatever performance factors the parties agree on, such as patient volume, patient satisfaction, or physician contribution to marketing, the employed physician can concentrate on those items identified in the agreement as priorities that demand responsiveness. Therefore, the parties should give careful thought to what the priorities of the physician and the practice are. Performance factors should remain fixed for annual terms in order to have any true impact on performance. However, revisiting performance factors on an annual basis would not be unreasonable.

Once the parties have determined individual and practice goals and have come up with a suitable list of performance factors, they should allocate value points to each factor to allow for weighing such factors differently. Typically, this is achieved through weighing performance factors with an assigned percentage allotted to each. For example, the parties may agree on the following performance factors and assign comparative value percentages accordingly: Patient Volume, 30%; Physician Revenue, 30%; Patient Satisfaction, 10%; New Patients, 10% and Administrative Tasks, 10%.

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Keep in mind that which performance factors to consider and the comparative value of each is entirely up to the parties to the employment agreement.

Typical compensation language in an agreement incorporating the "Base Plus Performance Factors Compensation Model" is as follows:

(A) In consideration of Physician’s professional and administrative services rendered hereunder, Corporation shall pay to Physician during the first year of this Agreement a base annual salary in an amount equal to $________ (such salary as may hereinafter be adjusted shall be referred to as "Base Salary"). Physician’s Base Salary shall be paid on or before the __________ (___th) day of each month for services rendered during the prior month, or at such other intervals as agreed to by the parties, subject to applicable federal, state, and local deductions and reporting requirements as required by law.

(B) In addition to the Base Salary set forth above, Physician shall be eligible for "Performance Compensation" in an amount equal to ______ percent (___%) of Physician’s Base Salary. Physician’s eligibility for said Performance Compensation shall be based on meeting the objectives set forth in Exhibit A hereto and shall be weighed in accordance with the “Comparative Value Percentage” set forth for each objective.

Performance Compensation shall be calculated by Corporation on an annual basis, on the anniversary of the starting date of Physician.

(C) In the event that Physician’s employment terminates prior to completion of a one-year term, but after a minimum of one quarter, Corporation shall calculate Performance Compensation based on available data and pay Physician the percentage of Performance Compensation attributable to percentage of time completed. For example, if Physician completes six months of a one-year term he would be eligible for fifty percent (50%) of the Performance Compensation.

In the event that Physician has completed less than one quarter, no Performance Compensation shall be paid.

Both parties should agree in advance on performance expectations and the measurement standards for meeting these expectations, and include adequate descriptions of both the factors and the standards for measurement in Exhibit A. Otherwise, disputes may arise at the time of Performance Compensation evaluation.

The employment agreement should include an Exhibit A (tailored to the agreed-upon criteria) similar to the following example, which incorporates the earlier example of selected performance factors and weighted values (Patient Volume, 30%; Physician Revenue, 30%; Patient Satisfaction, 10%; New Patients, 20%; and Administrative Tasks, 10%).
Exhibit A

The following performance factors shall be measured in calculating Physician’s Performance Compensation, with the corresponding Comparative Value Percentage, for each one year term of this Agreement.

**Patient Volume**  
(Comparative Value Percentage = 30%)

Individual patient visits in excess of _______ meets 10%; of _______ meets 20%; or of _______ meets 30%.

**Physician Revenue**  
(Comparative Value Percentage = 40%)

Individual allowable gross collections in excess of $_________ meets 20%; or in excess of $_________ meets 40%.

**Patient Satisfaction**  
(Comparative Value Percentage: 10%)

Patient service survey results indicating that 75 percent or greater of the respondents rate the Physician’s services as “excellent” meets 10%; or that 50 to 75 percent of the respondents rate the Physician’s services as “excellent” meets 5%.

**New Patients**  
(Comparative Value Percentage: 20%)

Number of new patients seen is greater than _______ meets 10%; or greater than _______ meets 20%.

**Administrative Tasks**  
(Comparative Value Percentage: 10%)

Physician performs all administrative and nonpatient care responsibilities that may be assigned to Physician from time to time by the Corporation in a timely and satisfactory manner. Range is from 1 to 10%, based on Corporation’s independent assessment.

Initiated:  
Employer _______  
Physician _______

The parties may wish to include an example of how the Performance Compensation would be calculated. Table 1 should serve as a model for that example (the actual example referenced in the agreement should be based upon actual performance factors and comparative value percentages selected).

Table 1 is a table of calculations that would be made for an employment agreement where the Physician’s Base Salary is $100,000, and the Performance Compensation provisions states, “In addition to the Base Salary set forth above, Physician shall be eligible for ‘Performance Compensation’ in an amount equal to fifty percent (50%) of Physician’s Base Salary.” The table is based upon the performance factors and comparative value percentages of the previous example.
salary and a bonus component based on total RVUs.

Thus, pursuant to the RVU Compensation Model, the parties agree to a base pay which is lower than a typical fixed salary where no performance factors are considered. Then, the parties agree to a targeted RVU number and incorporate this number into a performance compensation component of the employment agreement.

As a quick overview, RVUs are derived from the Resource-Based Relative Value Scale (RBRVS) that Medicare initiated in 1992, and establish a value of one service compared with another delivered by the physician. For example, a patient office visit has a lower relative value than a complicated surgical procedure. While reimbursements for the two may vary significantly given the variety of reimbursements in the health care market, the extent of disparity can still be minimized. There are nationally uniform RVUs for more than 7,500 medical procedures referenced by codes, developed by the American Medical Association under contract with the Health Care Financing Administration. For each physician service, there are three relative values: an RVU for physician work (actual time and effort spent), an RVU for practice expense (operational expense), and an RVU for malpractice expense. Compensation arrangements may consider the total RVU for a service or focus on the value assigned to the work component.

Example compensation language in an agreement incorporating the "RVU Performance Compensation Model" is as follows:

(A) In consideration of Physician’s professional and administrative services rendered hereunder, Corporation shall pay to Physician during the first year of this Agreement a base annual salary in an amount equal to $_____. (such salary as may hereinafter be adjusted shall be referred to as "Base Salary"). Physician’s Base Salary shall be paid on or before the _____ (___th) day of each month for services rendered during the prior month, or at such other intervals as agreed to by the parties, subject to applicable federal, state, and local deductions and reporting requirements as required by law.

(B) In addition to the Base Salary set forth above, Physician shall be eligible for "RVU Performance Compensation" equal to ___% of Physician’s Base Salary. Physician’s eligibility for said Performance Compensation shall be based on the number of relative value units (RVUs) accounted for by Physician, as set forth in Exhibit A hereto. RVU Performance Compensation shall be calculated by Corporation on an annual basis, on the anniversary of the starting date of Physician.

(C) In the event that Physician’s employment terminates prior to completion of a one-year term, but after a minimum of one quarter, Corporation shall calculate RVU Performance Compensation based on available data and pay Physician the percentage of RVU Performance Compensation attributable to percentage of time completed. For example, if Physician completes six months of a one-year term he would be eligible for fifty percent (50%) of the RVU Performance Compensation. In the event that Physician has completed less than one quarter, no RVU Performance Compensation shall be paid.

Both parties should agree in advance on the RVU coding obligations to determine RVU Performance Compensation. Exhibit A should then detail the percentage of compensation to be allocated to each targeted number of RVUs (any number of thresholds may be utilized), and specify the physician’s coding obligations. This compensation arrangement, more than any other, calls for detailed and accurate record keeping. A practice utilizing this physician compensation method should have the requisite computer system capabilities and coding expertise. In this regard, either the physician or a coder who can code from

<table>
<thead>
<tr>
<th>Performance Factor</th>
<th>Comparative Value</th>
<th>Possible Points</th>
<th>Actual Points Earned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patient Volume</td>
<td>30%</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Physician Revenue</td>
<td>30%</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Patient Satisfaction</td>
<td>10%</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>New Patients</td>
<td>20%</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Administrative Tasks</td>
<td>10%</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td><strong>100%</strong></td>
<td><strong>100</strong></td>
<td><strong>62</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Payment Calculation</th>
<th>Actual Performance Percentage = 62%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>62% of $50,000 (Total Possible Performance Compensation) = $31,000 (Actual Performance Compensation)</td>
</tr>
</tbody>
</table>
the physician’s description of services provided, must correctly enter the RVU codes for each service performed. Otherwise, disputes may arise at the time of RVU Performance Compensation evaluation.

The employment agreement should include an Exhibit A similar to the following example:

**Exhibit A**

Physician shall, in addition to the Base Salary set forth in the Agreement, be eligible for an annual RVU Performance Compensation equal to ______ percent (___%) of Physician’s Base Salary. Physician’s Base Salary is $_______ . The maximum amount Physician shall be eligible is $_______ , based on meeting one of the following four RVU thresholds:

1. If Physician’s total annual RVU is greater than ______
but less than _______,
Physician shall receive ___% of ________.

2. If Physician’s total annual RVU is greater than ______
but less than _______,
Physician shall receive ___% of ________.

3. If Physician’s total annual RVU is greater than ______
but less than _______,
Physician shall receive ___% of ________.

4. If Physician’s total annual RVU is greater than ______
but less than _______,
Physician shall receive ___% of ________.

In order to properly account for total RVUs, Physician shall enter an RVU code for each service delivered, at the time of service, in addition to any other coding necessary for reimbursement.

Initiated: Employer ______
Physician ______

This final model often includes other performance compensation measurements and standards. Thus, combining the performance compensation elements of the Base Plus Performance Factors Compensation Model with the RVU Performance Compensation component of this final model results in a highly individualized compensation bonus which works for practices that include a substantial percentage of managed care payment.

**Conclusion**

These four models are intended to demonstrate the range of options available in determining a physician compensation package appropriate for an individual circumstance. The end result may be a combination of any of these four models. As health care reimbursement continues to evolve, physician compensation packages are continually being reassessed. This overview should facilitate both parties in reaching a mutually agreeable physician compensation arrangement.

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