



Accounting for VAT

a professional fee method
for optometrists who run their own practice

Association
of Optometrists





Professional fee accounting for optometrists

Introduction

AOP exists to provide assistance to our members in all aspects of their professional lives. Of all the matters on which members consult the association from time to time, it is clear by the number of calls to our office that VAT is the issue on which most practitioners consistently require assistance and support.

The reasons that this particular tax provokes so much anxiety is possibly because it must appear to some practitioners that the situation is constantly in a state of flux. This may derive from new initiatives from H.M. Customs challenging the basis under which optical goods are supplied or at local level when anecdotal evidence suggests that local VAT officers in certain circumstances are unwilling to agree properly drawn up proposals for apportionment.

The most recent "strategic" challenge came in February 2001 when the Policy Division of H.M. Customs gave notice that in the light of the outcome of an important House of Lords judgement (the "Card Protection Plan" case) the supply of optical goods would henceforth be treated as a single supply and that this supply would be taxable. AOP and ABDO's prompt response which started with persuading Customs to defer the imposition of VAT, ended with a resounding victory before a VAT tribunal which upheld the 1995 House of Lords decision in the case of Leightons and Eye-Tech that **there were two supplies - one of goods (taxable) and one of professional services (exempt)**.

In the wake of the latest tribunal decision, Customs issued a business brief referring to the supply of optical goods and services which on first reading appeared to presage an attack on agreed apportionments, referring as it does to "manipulation of values" and "challenging apportionments". AOP have been assured that so far as the Policy Division is concerned there will be no change in approach to the profession. The problem is that local VAT officers do not always appear to be in step and may see this as a message to renew efforts to overturn agreed apportionment bases.

The problem referred to above can be traced back to Customs' decision, in January 1998, to rescind the previous agreement which was in place providing a prescriptive method designed to overcome the practical difficulties in applying the partial exemption regulations to arrive at a fair and reasonable basis for accounting for VAT. With no possibility of a globally agreed basis for apportionment, the AOP developed a separate system of accounting, Professional Fee Accounting, (PFA), guidelines for which were issued in 1999. We are now republishing this document, which we believe provides the most practical basis for determining the components of the supply of optical goods. Those optometrists who have recently started their own practice, as well as those who have faced challenges to their apportionment method, will be able to account for VAT without challenge by using PFA secure in the knowledge that it has the backing of their professional body, has been thoroughly reviewed by Customs and in particular has been circulated by Customs to all its local VAT offices.

Optometrists are trained professionals who provide a clinical and dispensing service to their patients. This service is based on training, experience and continuing education. The Opticians Act 1989 requires the General Optical Council (GOC) to maintain a register of optometrists engaged in carrying out eye examinations and the fitting and supply of optical appliances. They

must satisfy the GOC that they hold the appropriate university degree followed by one-year postgraduate training with a qualified practitioner, during which time the College of Optometrists' professional qualifying examinations must be passed.

The College is the examining body for the profession; it also sets standards and issues professional guidance. This guidance is accepted as the peer view by the GOC. College guidance stated - "it is the overriding and continuing responsibility of all optometrists to place the welfare of their patients before all other considerations and to apply to each patient the full extent of their knowledge and skills". Professional integrity is the foundation of the College's guidance on ethical practice. This is based on professional skill and continuing education applied to give patients a clinically appropriate service.

As the profession is well aware, good vision and healthy eyes are essential to the quality of life and the ability to earn a living. Optometrists are trained to detect eye disease and injury and to refer a patient to their general medical practitioner or ophthalmologist (1989 Eye Examination Regulations). In addition, primary eyecare is now being provided by optometrists to health authorities and general medical practitioners in the detection and monitoring of diabetic retinopathy, glaucoma, cataracts, macular degeneration and anterior segment diseases.

It is not possible to split the professional service into two elements. The results of the eye examination are used to determine the choice, parameters, type and power of the appliance supplied. The responsibility for the prescription, which makes up the appliance prescribed, rests with the prescribing optometrist - even when a different person dispenses the appliance.

This is NOT retailing

The optometrist is not a retailer selling optical appliances. He is a trained health professional providing a clinical eye examination, including a refraction. This includes action to establish whether an optical appliance is required and the level of correction needed. The AOP considers that the need to account for the professional services of optometrists is desirable.

This is not only because the proposals represent the true measure of the optometrist's clinical and dispensing expertise, but also because they are a direct consequence of the decision of the European Court of Justice in the EC Commission v UK case in 1988. **It was this case that determined that there were two elements to the supplies being made, and that professional services were exempt from VAT.**

Need for a fair system

In the Association's opinion a combination of charges for professional fees and for specifically identified sales of goods, ideally achieved by point of charge analysis, is the most suitable method of accounting to be used by optometrists who run their own practices. Customs have indicated that they may initially seek to reject this method of accounting for VAT. We could not disagree more strongly with their approach or their rationale. Accounting systems designed to identify, charge and record the correct quantum and measure of professional activity are the only true and fair systems that can be used. This is the thrust of the professional regulations of the General Optical Council and the College of Optometrists.

Professional fee accounting for optometrists

Establishing charging criteria

The basic principle of this system is that the exempt professional service of a practitioner represents the bulk of his income. Any standard rated supplies are supplemental to his professional service and should be supplied at a figure based on cost. This figure may include the addition of a handling charge and may take into account any other discounts the practitioner receives. In essence, though, the key point to grasp is that the professional services of the optometrist are correctly chargeable in their own right. They do not bestow a hugely inflated value on the spectacles or lenses being supplied. Those objects are only of use when supplied within the context of a professional consultation and examination.

In order to account correctly for professional fees, practitioners must ensure that true and accurate records are maintained of the use of their time split between specific professional heads such as consultation, examination, dispensing, record maintenance, post-qualification training, and practice management. (see later in this booklet for more detail on how to do this)

Practitioners need to establish charging criteria in order to compute the rate or rates to be applied in the calculation of fees, the potential cost of running the NHS element of practices, the balance of income against the needs of the public good and the fees to be rendered exclusively for consultations.

The criteria to be used will depend very much on the type of practice operated, its location, its patient catchment area, the experience of the practitioner, the competition, the perceived level of reward for the exercise of the professional practice.

Other factors will be the number of hours available, the overheads that need to be met regardless of the level of activity - the fixed overheads - and those that fluctuate depending on usage. Consideration of all of these will lead to the development of a range of charges, based on time, which can then be subsumed into a costing matrix appropriate to the practice.

This matrix may use the projected costs to achieve an equalised flat rate charging system or to produce a varied menu of charges related to the level of service supplied. On the other hand, the practitioner may decide that charging patients strictly in accordance with time consumed would be appropriate for their practice.

On the expense side, the accounting system must be capable of sufficiently clear analysis to enable the identification of the precise purchase cost of goods. Where there is a supply of lenses, frames, cases or other peripheral items, such as lens-cloths or saline solution, it is of the essence that the costs, discounts and attributable handling charges are properly costed. This is an essential prerequisite to the correct accounting for VAT as it is on this part of the supply that VAT must be charged.

The adoption of a precise point of charge analysis, which is capable of identifying the component parts of the composite whole, is needed. Those parts are the professional fee (which is exempt), the sale price of the goods and the VAT chargeable on those goods. There may be circumstances where goods supplied may be zero rated, but by using a point of charge system these can easily be picked up. This is similar to the point of sale systems used in many retail outlets, but there are critical distinctions between those and the professional charging systems of optometrists.

Many small practices, when they apply the correct system

of accounting for their professional fees, will discover that the level of their taxable supplies is below the registration threshold. This will mean that they could de-register for VAT with the result that they would have to absorb the input VAT on their purchases, but they would not have to account for it on their sales of goods. Those who are required to remain registered may obtain some benefits from the application of the partial exemption rules and, in particular the *de minimis* threshold. The rules for this are complex and it is not the purpose of this booklet to explain them in detail.

Correctly accounting for professional fees makes life simpler for the practitioner. It also provides Customs with a system and procedures which are easier to monitor and check. It requires good record keeping backed by a system, which complies both with recognised accounting standards and Customs stipulated detail. In essence, charging correctly for professional fees imposes a disciplined approach on practitioners to accounting for VAT and will save Customs some of the resources they are currently spending on independent practices.

For example, a practitioner who has no in-house glazing facilities will have an easy task because he should be able to identify each element of the supply - lenses, frames and case. On the other hand, if he has an in-house glazing facility he will need to consider the component elements of that supply and will have to make a charge for that which will be included in the amounts comprised in the point of charge bill. Other areas that will require particular attention are special offers and the sale of accessories. There is no difficulty though, provided that the proper records are maintained and there is a clear adherence to the principles of charging for professional fees in accordance with determined systems.

Practitioners must maintain good records of time spent, professional records, purchases made, fees rendered and sales made. This will mean extra record keeping. But the benefit of increased control of time, costs and selling prices will be an increase in cost effectiveness and profitability.

The essence of a Professional Fee Accounting (PFA) VAT system.

- 1) The first requirement is to accept that the prime constituent of the practitioner's activity is the consumption of professional time in pursuit of his practice. This time is made up of his own input, plus that of his partners and any professional employees he may have. The sum of this time is effectively the total of the time spent working on and in the business by those professional persons (see later).
- 2) Having identified this time, it is then necessary to determine how that time is spent. It is easy to work out how long each professional spends dealing with patients. That information is probably available already in the record cards of each visit and the practice diary. What is not so easy is identifying the amount of time taken on ancillary professional tasks such as writing up the records of visits, corresponding with medical practitioners in relation to a patient's health, or doing the behind the scenes work following up a specific patient's needs. Further, there is the work undertaken in respect of continuing professional education, essential to keep abreast of developments to ensure that service to patients is maintained at the necessary level required by the duty of care.
- 3) The purpose of the overall analysis is to work out how much time can be properly charged to patients as

against that which relates to the maintenance of a professional practice. In calculating the rate of charge, the various factors mentioned above will all come into play and assist in producing a figure, which at one end could be based on salary levels (inclusive of NI etc), and at the other on projected annual income. There is not one fixed method, but practices must develop a precise method. Stab in the dark guesses may produce a resultant income in due course, but they will not have any weight with Customs and they do not demonstrate professional management. Once the method is set, it will be tested by time and, over a two to three year period, will be capable of fine-tuning to produce a very precise result.

- 4) The rate of charge will be multi-faceted. The method permits there to be different rates for different professional activities. In all instances, the fee charged is based upon the rate. Adjustments to it will be for demonstrable economic reasons made as an essential part of running a professional practice.
- 5) To identify the sales price of ancillary goods and accessories sold, the cost of the components which make-up the standard-rated supply elements must be known. This will be available from a simple accounting system recording the cost of purchases and discounts available.
- 6) When the appliance is fitted or collected, a simple receipt with the practitioner's VAT registration number is sufficient unless the patient requests a full VAT invoice. In these circumstances the invoice supplied must comply with Customs regulations and, amongst other things, should identify the exempt element in respect of the professional fees.
- 7) In-house glazing must be charged realistically. Where the appliance is ordered as a complete job from a prescription house (lenses and frame supplied as a unit), a minimum handling charge will suffice.

- 8) It will be necessary to keep a daily record of fees and sales (normally a fees and sales daybook for point of charge analysis). The analysis should include the following:
 - a) Exempt professional fee
 - b) Purchase cost of lenses (excluding VAT)
 - c) Purchase cost of frames (excluding VAT)
 - d) Purchase cost of case (excluding VAT)
 - e) Handling charge
 - f) VAT on total of (b) to (e)
 - g) Standard rated supply/total (b) to (f)
 - h) Total receipt (including VAT)

The above analysis can be kept manually or on a computer spreadsheet. But the audit trail to accounting records must be self-evident. If a till-roll is used, it must be able to provide a breakdown of the daily receipts to support the point of charge analysis.

You must discuss the implementation of this method with your accountant or VAT adviser. In particular, the specific system used for accounting for VAT must comply fully with Customs stated requirements for records and returns.

Contact lenses

Currently, some practitioners who fit and supply contact lenses may use an apportionment method to separate the supplies of services and goods. This can continue in conjunction with a calculation of professional fees for other supplies. However, practitioners should consider the application of professional fee charging in respect of their practice as a whole.

By so doing, the accounting system covers the supplies of both spectacles and contact lenses. This will simplify point of charge analysis and facilitate simpler accounting records. Practitioners who have only a small number of contact lens patients will certainly find it easier to amalgamate them into the Professional Fee Accounting system. Each practitioner should make any decision in this respect after consulting his accountant or VAT adviser.

Table 1.1

Hypothetical practice - point of charge example

Note: the calculation of the rates of professional charge have not been shown in this example

One Proprietor	Turnover £200,000	Eye tests per annum @ £30	2,500
<u>Locums</u>		Spectacles supplied	1,800
One Optometrist		Handling charge	5
One Dispensing Optician		Mark up on accessories - 25%	
One Receptionist		Cost of services excluding proprietor's salary	
		Salaries	60,000
Opening Stock	5,000	Cars	2,000
Purchases	20,000	Subscriptions/education	2,000
Closing Stock	7,000	Office expenses	21,000
Cost of Supplies	<u>18,000</u>	Premises	16,000
			<u>101,000</u>

	Professional Service Fees	Cost of	Handling	VAT	Standard	Patients
	Eye tests	Goods	Charge		Rated	Paid
Aggregated charges	75,000	18,000	9,000	4,725	31,725	200,000

The above would require individual point of charge analysis. Optometrists who use PFA for VAT purposes are recommended to use one system for all supplies including contact lenses. Good accounting records are essential to make this system work efficiently.

Professional fee accounting for optometrists

Table 1.2

Hypothetical practice - point of charge example (continued)

These are notional examples per unit/patient

PRACTICE HAS NO INHOUSE GLAZING AND NO CONTACT LENSES							
	Professional Eye Tests	Service Fees Dispensing	Cost of Goods	Handling Charge	VAT	Standard Rated	Patients Paid
Eye examination and spectacles	30	45	15	5	4	24	99
Eye examination only (no appliance needed)	30	0	0	0	0	0	30
Spectacles only (from prescription - see note)	0	60	15	5	4	24	84
PRACTICE WITH INHOUSE GLAZING							
	Fees	Cost of Goods	Inhouse glazing	Handling Charge	VAT	Standard Rated	Patients Paid
Eye examination and spectacles	75	10	5	5	4	24	99
PRACTICE WITH CONTACT LENS SUPPLY							
	Fees	Cost of Goods	Handling Charge	VAT	Standard Rated	Patients Paid	
Eye examination, fitting & supply	79	16	10	5	31	110	Note: Professional fees have been shown at different rates. This reflects the commercial and practical considerations applicable to the charging of Professional fees.
Fitting and supply	49	16	10	5	31	80	
ACCESSORIES							
	Fees	Cost of Goods	Mark up 0.25	VAT	Standard Rated	Patients Paid	
Standard rated supplies	0	15	4	3	22	22	
Zero rated visual aids	0	30	8	0	38	38	

Accounting for time

The first part of this article addressed the context in which Professional Fee Accounting has emerged and details of the VAT method. **We now go on to look in some detail at how to record time spent on professional activities and how to apply those results to your fee structure.**

The essence of Professional Fee Accounting is that **the major supply made by an optometrist is his time and expertise.** In VAT terms, **this is a separate supply and distinct from the supply of spectacles or contact lenses.** If this supply is correctly accounted for, it cannot be confused with the supply of either of those items.

In all of the guidance notes issued by Customs & Excise prior to their withdrawal of the agreed bases, one fact remained constant. This was, if there was a single supply of spectacles, a portion of the sales proceeds was attributable to the exempt professional service of dispensing. All accounting methods devised, therefore, did two things. Firstly, they identified the eye examination performed by an optometrist, as a separate and VAT exempt charge. This Customs were more than happy to do because, historically, the eye examination fee has been set at an inappropriate rate which represents currently about half the true cost. Secondly, they sought to apportion the proceeds of the sale of spectacles. Various methods used to calculate the VAT portion of the supply of spectacles could, therefore, be applied to the balance.

Since most accounting records were deficient in recording or calculating the professional fee side of the supply, Customs could place far more emphasis upon the supply of the spectacles; the amount of VAT attributable thereto was higher than it should be. But for the Leightons and Eyeteck cases, Customs would have succeeded in requiring VAT to be charged on the entirety of the cost of the supply of spectacles.

A true and fair view

Practitioners need to note carefully that the Inland Revenue have changed the law with regard to accounts submitted for tax purposes for the year 2000/2001 and thereafter. This change sees the withdrawal of the cash basis for computation of income tax liabilities and **requires that accounts for income tax purposes should show 'a true and fair view'.** They do not require an audit but, based upon consultations between the Faculty of Taxation at The Institute of Chartered Accountants in England and Wales and the Inland Revenue, guidance notes are being issued. These make it clear that recognised accounting practices must be followed in the preparation of accounts. It is these same accounting practices which will be applied in the introduction of Professional Fee Accounting.

How to account For time

Anyone engaged in professional practice will spend his or her working day doing many things: eye examinations, other professional procedures such as in shared care, dispensing spectacles, fitting contact lenses, after care, writing up notes, reading professional journals, attending lectures and courses, speaking on the telephone to professional colleagues to take advice, or give it. Time is also spent on considering the many issues arising as a result of managing the practice, administrative matters, accounting, dealing with the VAT office, and the Inland Revenue both for personal tax liabilities and, if you have staff, PAYE.

If you are a professional who earns a living based on charging for your time, it is important that a detailed and reconciled record is maintained of how your time is spent. This is an important requirement. There are simple diary based software programs which are adequate for this purpose. The reason for this is to enable a record to be maintained of how time is being spent and to relate that

record to charges made or to be made and to give consideration to the relationship between the charge rate per hour and the profitability of the practice.

Professionals don't just charge on a time basis. Solicitors, for example, have a set charge for wills and conveyancing, which does not relate to the amount of time consumed in drafting and finalising. Those factors may have been taken into account and been discounted but, essentially, the charge is not a time based charge. All that said, **a clear appreciation and understanding of how professional time is consumed in the practice is essential.** Either the information is used as the prime basis for charging patients or it is used in calculating fixed rate charges and we will come back to this later.

To summarise, a Professional Fee Accounting system will be either time based or service based but, in both instances, it will be necessary to keep a record of how you spend your time.

The ingredients of a time charge

Where the practice is set up as a company, a salary and benefits of some kind or other will remunerate the professional staff. These benefits could be a car, a pension scheme, a mobile phone, private health insurance - the list is substantial. For the practice there is a cost associated with each staff member directly related to the cost of employing them. This cost includes the employer's National Insurance Contributions. **We have, therefore, the first identifiable factor in establishing a chargeable rate - the total cost of the employee. The second is the overhead attributable to the employee.** This will be either employee specific, for example protective clothing, or general, namely the cost of the working space occupied by the employee and the heating and lighting provided within it.

Lastly, **there are directly attributable costs** associated with specific items like fixed assets which are to be depreciated and which may form an essential ingredient within the cost calculation.

There are specific costs which need to be recovered if a practice is to survive and thrive. These costs are directly related to the activity of the practice and, therefore, can be used as the basis of calculating the charge rate to be applied per hour for a given employee. Conversely, the same information can be used in calculating a fixed fee service basis since in either event the amount is critical to the generation of profit.

Sole practitioners & partnerships

In a company set-up, all participants in the enterprise are employees or directors and are remunerated with a salary and benefits. This is not the case for the self employed and, in many instances, all that can be said is that earnings equate to what is left after all expenses have been paid.

This is far from scientific and exposes the practice owner to significant risk in terms of error and competition. At the very least, **an amount should be calculated which represents the return each practice owner expects to receive from their participation in the enterprise.** These words are chosen carefully, since to return to the company example, the employees/directors receive a salary and, possibly, a profit related bonus. The shareholders, who may be the same people, receive a dividend based upon the profitability of the enterprise.

For the self-employed there is a dual role - participant and investor. For the purpose of this exercise, what is being sought is the return expected as participant, called

the *'return for endeavour'*, which must be distinguished from the *'return as investor.'* This may equate to the total salary costs which would be payable to a replacement professional taking into account qualifications, training and experience or, indeed, may be some other figure. In any event, once the amount has been identified, it should be used in much the same way as if the person were an employee and the amount were the total cost of his employment by the enterprise.

Calculating the charge rate per hour

There are several ways in which this can be done and the tables on pages 6-11 show one method. Whether or not this is appropriate for your practice will depend upon discussions that you will have with your accountant and whether you consider that the basis, when taken in the context of the entirety of your practice accounts, produces a fair and reasonable result. No matter how sophisticated an accounting system is made, it does not alter the market conditions within which a practice operates.

Market forces may well dictate that the levels of charges which can be made are not sufficient to meet the budgeted projections drawn up. In these circumstances, reduction of costs, acceptance of a loss or lower profit, or a change in operating methods, are all commercial decisions which need to be taken. But it is impossible to deal with these variations in a report of this nature.

Overheads

In calculating the charge rate per hour, the question of including or excluding some or all of the overheads must be addressed. There are two reasons for this; the first is that some of the overhead costs will relate specifically to the sale of standard rated vatable goods such as spectacles and contact lenses. It would be inappropriate to include them in a charge rate to be applied to the supply of professional services. The second is more a matter of choice in that, if overheads are included, their recovery is dependent upon the level of activity and an increase in this beyond that budgeted would result in a significant increase in profitability. If they are not included, then they can be viewed as the first tranche of profit which, once met, will leave the balance to meet and possibly exceed your budgeted target profit.

Adjustments to charge rate

If you have never used a charge rate system before and the available records on which the system has been based are not as thorough as might have been hoped, then it is conceivable that the first year's results will be different from those expected. One year's operation, however, will provide substantial detailed information that will enable you to examine the basis on which the charges were originally determined and, as a result, provide the tools to refine your system accordingly.

You will also be able to take account of variations to reflect quality of service. For example, you may consider that the professional services required in dealing with one patient draw upon a specialist expertise that you have which has not been taken into account in calculating your normal charge rates. This could mean that a higher charge is made for the time you spend in seeing them. If this happens, then clearly, the converse could also be true.

In all instances, however, the underlying principle must be adhered to, namely that the charge is based upon accounting principles which are true and fair and which reasonably reflect the commercial and clinical requirements of the practice and patient.

Professional fee accounting for optometrists

Service based charges

If one assumes that a sole practitioner calculated his hourly charge rate at £100, a simple professional service supplied to a patient consisting of an eye examination and the dispensing of a pair of spectacles would, if the time taken were one hour, cost £100 excluding the cost of the spectacle lenses and frames.

There are, of course, ranges of professional services which can be supplied including, for example:

- Eye examination for spectacles
- Screening procedures
- Diabetic retinopathy monitoring
- Eye examination for contact lenses
- Contact lens fitting and supply
- Contact lens aftercare
- Behavioural optometry
- Low vision work
- Advising on and dispensing spectacles.

On the assumptions,

- that there is a reasonable understanding of the number of each of the above services rendered during a known period
- that it is possible to identify the time cost associated therewith, the hourly charge rate of £100 in our example can be expressed as an average charge for each service.

In performing these calculations, any necessary weightings can be brought into the calculations and consideration given to the overall effect of the charges when viewed together with the costings relating to the supply of spectacles or contact lenses. Detailed calculations illustrating this are given in the tables later.

Table 2.1

Key economic data - costs (£s)

			Per Optom
Professional salary OO			40,000
Bonus			5,000
Pension contribution			2,500
Employers NI etc	say		4,500
Gross emoluments			52,000
Directly attributable charges	say		3,500
Overhead costs			25,000
Non professional staff member			17,500
Employers NI etc	say		2,250
Non attributed overheads			44,750
Professional allocation		80%	35,800
Product allocation		20%	8,950
			44,750
Proprietorial return	Endeavour		65,000
	Investment		20,000
			85,000
Average cost of frames			10
Average cost of lenses per pair			14
Glazing			6
Average cost contact lenses			25
Handling charge per patient			10

Without doubt, information is the key to the efficient control of a practice. The more information you have the more you will be able to understand the relationship between your charges and your profitability.

Point of charge

Charging on a realistic time basis highlights the painfully familiar anomaly of the difference between the amount currently charged by a number of practitioners for an eye examination and the true cost of that examination taking into account the time spent by the optometrist.

The consequence of adopting PFA will be that the true cost of the eye examination is identified and each practitioner will need to evaluate the budgetary reasons for continuing with current charges or changing them.

The amount a patient pays for an optometric consultation, and the provision of any necessary appliances, will not be materially different using PFA to that payable under any other basis of calculation. The difference lies in the makeup of the amounts paid which are identified at the point of charge and **which, under PFA, consist of two separate and distinct charges.**

The charge for professional services calculated under PFA is exempt from VAT.

The charge for goods supplied - contact lenses, spectacles or ancillary products - are standard rated for purposes of VAT and are sold at whatever price is agreed with the patient, which will include any handling charge made, inclusive of VAT.

The tables which follow set out a suggested series of steps, which can be followed to identify a professional fee system for your practice. They also include a worked example. Your accountant will be able to assist you in putting together an effective system.

Table 2.2

Key economic data - time (hrs)

Hours usage		Proprietor		Professional Staff	
		Number	Time	Number	Time
0.5	Eye examination	1,100	550	2,100	1,050
0.75	CL examination	500	375		
0.25	Dispensing spectacles	750	188	1,948	487
0.25	CL Fitting	480	120		
0.50	CL Aftercare	375	187.5		
	Chargeable hours		1,420		1,537
0.06	Clinical Records	3,205	192	4,048	243
	Administration		88		
	Accounts		20		
	VAT		30		
	Income Tax, inc PAYE		30		
	Continuing Education		60		60
			<u>1,840</u>		<u>1,840</u>

It is assumed that the year has 46 working weeks and that each week has 40 available hours per chargeable person. Eye examinations have been computed as taking 30 minutes on average and those for contact lenses have been calculated as requiring 45 minutes.

We assume the proprietor has an additional qualification in contact lens practice.

Table 3.1

Developing a cost unit per hour

	Proprietor		Professional Staff	
Chargeable hours		1420		1537
Target cost recovery				
Gross emoluments	0		52,000	
Endeavour	65,000		0	
Direct costs	<u>3,500</u>		<u>3,500</u>	
	68,500		55,500	
Overhead allocation				
35800	17,900		17,900	
Half allocated - 2 persons				
Total costs	86,400		73,400	
Expected return				
20000				
Half allocated - 2 persons				
	<u>10,000</u>		<u>10,000</u>	
Aggregate	<u>96,400</u>		<u>83,400</u>	
Charge per hour		67.88732		54.26155
Say		£68		£55
Rounding difference		0.11		0.74

Table 3.2

Costs per hour applied to activity

	Charge rate £68				Charge rate £55			
	Proprietor		Professional Staff		Proprietor		Professional Staff	
	Number	Hours	Income	Average Charge per Exam	Number	Hours	Income	Average Charge per Exam
Eye examination normal	1100	550	37,400	34	2,100	1,050	57,750	28
Eye examination CLs	500	375	25,500	51		0	0	
Dispensing spectacles	750	188	12,750	17	1,948	487	26,785	14
Fitting and adjusting CLs	480	120	8,160	17		0	0	
CL aftercare	375	<u>188</u>	<u>12,750</u>	<u>34</u>		<u>0</u>	<u>0</u>	
		<u>1420</u>	<u>96,560</u>			<u>1,537</u>	<u>84,535</u>	
Surplus on rounding		<u>160</u>				<u>1,135</u>		
Gross income on an hourly basis		<u>181,095</u>						

A simple method of charging by time would be to charge in 15 minute units. This would have the merit of ensuring that all your time is accounted for. Time records can be maintained alongside those required for every professional consultation.

Professional fee accounting for optometrists

Table 4.1

Developing a price menu - eye examinations

The following examples are based upon the assumptions stated and do not represent a categorical method. They are provided as illustrations not as specific guidance.

All figures are based upon those in the Tables 2.1 and 2.2

Eye Examination

This practice is budgeting to do 3,200 eye exams and based upon the costing exercise the allocated cost per exam is:

	Proprietor	34.00
	Professional Staff	<u>27.50</u>
		61.50
Using these figures, a straight average could be applied		30.75

Alternatively, the charge could be weighted to reflect the greater number performed by the staff professional

	Tests	Rate	Income	
Proprietor	1,100	34	37,400	
Staff	<u>2,100</u>	28	<u>57,750</u>	
Aggregate	3,200		95,150	29.73
				Fixed charge say
				<u>£30</u>

Eye-exam CLs

In the case of contact lens practice where there is an examination in order to identify the needs of the patient, the service is undertaken by the proprietor and, as such, the costings of a fixed charge can follow the figure on the analysis

	Tests	Income	Rate	
Proprietor	500	25,500	51	
				Fixed charge say
				<u>£50</u>

CL Check-up

As with the eye exam for contact lenses, the service is supplied by the proprietor and comes with the added abilities he has. The fixed charge can follow the analysis figure

	Exams	Income	Rate	
Proprietor	375	12,750	34	
				Fixed charge say
				<u>£35</u>

Table 4.2

Developing a price menu - dispensing

The following examples are based upon the assumptions stated and do not represent a categorical method. They are provided as illustrations not as specific guidance.

All figures are based upon those in Tables 2.1 and 2.2

Dispensing spectacles

This practice is budgeting to dispense 2,698 spectacles and based upon the costing exercise, the allocated cost per dispensing is:

	Proprietor	17.00
	Professional Staff	<u>13.75</u>
		30.75
Using these figures, a straight average could be applied		15.38

Alternatively, the charge could be weighted to reflect the greater number dispensed by the staff professional

	Dispensings	Rate	Income	
Proprietor	750	17	12,750	
Staff	<u>1948</u>	14	<u>26,785</u>	
Aggregate	2,698		39,535	14.65
				Fixed charge say
				<u>£15</u>

Fitting and adjusting CLs

In the case of contact lens practice where there is an examination in order to identify the needs of the patient, the service is undertaken by the proprietor and, as such, the costings of a fixed charge can follow the figure on the analysis

	Procedures	Income	Rate	
Proprietor	480	8,160	17.00	
				Fixed charge say
				<u>£17</u>



Professional fee accounting for optometrists

Table 5

Professional fees gross income summary

	Number	Charge	Income
Eye examinations	3,200	£30	96,000
Eye examination contacts	500	£50	25,000
Spectacle dispensing	2,698	£15	40,470
Fitting and adjusting CLs	480	£17	8,160
CL check-up	375	£35	13,125
			<u>£182,755</u>

This compares with the gross income solely on hours used of **£181,095**

The advantages of this system is that it is price menu driven. The patient can see what he is paying for. The disadvantages are that the calculation of the charges are based on time usage and, whilst greater throughput will increase profitability, variations in the mix of patients, difficulties and staff performance could result in lower than expected income.

Table 6

The supply of goods

Before we can complete a P&L Account, it is necessary to deal with the supply of spectacles, contact lenses and ancillary goods which are standard rated for VAT

Average cost of frames	10
Average cost of lenses per pair	14
Glazing	6
Cost of supply of spectacles	30
Average cost contact lenses	25
Handling charge per patient	10

Calculation of costs

	<u>Net</u>	<u>VAT</u>	<u>GROSS</u>
2698 spectacles dispensed	80,940	14,164	95,104
480 CLs dispensed	12,000	2,100	14,100
		<u>16,264</u>	

Calculation of supply of goods

2698 spectacles dispensed including handling charges	107,920	18,886	126,806
480 CLs dispensed including Handling charges	16,800	2,940	19,740
		<u>21,826</u>	

Note: The cost of frames, lenses and contacts may vary with different products. For the purposes of example only an average has been taken. There will also be the sale of ancillary products which have been ignored for the purposes of this example.

VAT will be due to Customs and Excise on the difference between the output and input VAT **£5,562**

Table 7

Proforma Profit and Loss Account based upon example PFA budget

Professional Income			
	Eye exams	96,000	
	Eye exams CLs	25,000	
	Dispense spectacles	40,470	
	Fitting and adjusting CLs	8,160	
	CL after care	<u>13,125</u>	
			182,755
Less	Direct costs		
	Professional staff	52,000	
	Directly attributable costs(*2)	<u>7,000</u>	
			<u>59,000</u>
	Net Professional Income		123,755
Sales of Goods			
	Spectacles	107,920	
	CLs	<u>16,800</u>	
			124,720
Less	Cost of goods		
	Spectacles	80,940	
	CLs	<u>12,000</u>	
			<u>92,940</u>
	Net sales income		<u>31,780</u>
	Gross profit		155,535
Operating costs			
	Staff wages and salaries		19,750
	Overhead costs		<u>25,000</u>
			<u>44,750</u>
	Net profit		<u>£110,785</u>
Reconciled to budgeted expectation			
	End return for endeavour		65,000
	Investment return on professional activities		20,000
	Surplus arising on menu conversion		1,660
	Surplus arising on rounding		1,295
	Handling charges	31,780	
	Less attributable overheads	<u>-8,950</u>	
	Profit on sale of goods		<u>22,830</u>
			<u>£110,785</u>

NOTES

- 1) This summary of the PFA method is only an outline and practitioners must tailor the actual method used to suit the particular needs of their own practice. Consultation with accountants and VAT advisors before finalising how the system will be used is essential, as is advising Customs of the new method, preferably before it is commenced. It is a requirement that if practices start using a computer to keep records for VAT, Customs must be given prior notification and must agree to its use.
- 2) We would like to emphasise that using the PFA method is not mandatory. There are other acceptable ways of dealing with practice accounts and, depending on the nature of your practice, PFA may not be appropriate. Even so PFA is a system of accounting which is recommended by the Association of Optometrists since we believe it most properly reflects the nature of practice supplies.

Professional fee accounting for optometrists

Questions and answers

1. Must I have a handling charge?

Yes. A handling charge has been included as a non-professional charge to pay for the costs involved in supplying the appliance. If no handling charge is made, there is a possible argument that the professional fees include a profit on the supply of the appliance. One of the reasons why it is essential to contract with the patient (by using the notices and receipts described on page 3) for the separate supplies is to counteract the possibility of this argument being applied.

2. Must the handling charge be fixed amount?

No. Customs and Excise have accepted the use of a fixed handling fee. In subsequent telephone conversations with C&E at their London headquarters, they indicated that they had no objection to a handling charge calculated as a percent of cost. However, we have had no written confirmation of this. In all cases, the cost of the appliance and the handling charge are subject to VAT.

3. Must a give a receipt?

Yes. A receipt (Appendix 1 on page 13) is needed as evidence that the supplies made to the patient are multiple and not composite. It is not a legal requirement but Customs have indicated that they consider this an essential part of PFA as evidence of the nature of the supply. But there is nothing that says that the profit margin on the sale of goods has to be disclosed on the receipt. There is no requirement to provide a VAT invoice unless the supplies are being made to a VAT registered trader for the purposes of his business.

4. What details must I put on a receipt?

A simple receipt which groups professional services as one item and goods, handling charges and VAT as another, may be an effective way to demonstrate the two supplies being made. It also indicates that the exempt supplies are a composite as are the standard rated supplies.

Best practice, therefore, should be to provide a receipt that minimises the risk of confusion and sets down precisely what is being supplied. The receipt must contain details of the eye exam and the dispensing fee, combined if desired, and the cost of the appliance, which will include the handling charge and the VAT. An essential ingredient of PFA is that the patient is aware of the nature of the supplies being made. (See Appendix 1) If the intent of the supplier is to hide the nature of those supplies in one figure, PFA will not work and an apportionment method must be applied.

5. Do I have to display my professional charges?

No, but we do advise you to do so. PFA requires an agreement with the patient for the supply of professional services separate from the supply of appliances. For Customs to accept that this is the case, evidence will be required which demonstrates that the patient has seen and agreed to those separate charges. As seen above, the receipt is an important element in achieving this. It is also highly desirable to display a notice, which sets out your professional charges for dispensing (as well as other professional procedures). This notice helps to establish to the VAT authorities that you are using the PFA method. If you choose not to display your professional charges they should be available on request.

6. Can I have a range of dispensing fees?

Yes. Dispensing fees can, and probably should, vary according to the time taken, the difficulty of the dispensing process or the technical know-how required. If dispensing fees fluctuate according to the sale price of

appliances, however, the argument that they are wholly professional charges will be flawed, probably fatally. It would then be open to C&E to require the use of an apportionment method.

7. Do I have to keep stock records?

Yes. PFA is primarily concerned with the calculation of professional fees and presumes that the records and information necessary for the supply of appliances is maintained at a level sufficiently detailed to enable reasonable pricing and costing to be undertaken.

8. Can I sell an appliance at less than cost?

Yes. But a practice system that routinely allows sales of appliances at less than cost would not be acceptable for PFA, although there is no reason why such sales should not take place in individual cases or for limited classes of goods for limited periods.

9. Do I have to give receipts to NHS patients?

Yes. Customs and Excise require that the supply be clearly established for the patient even though payment is being made by a National Health Service voucher. This would be achieved by the provision of a statement of supply (Appendix 2 on page 13) at the time of completion and signing of the voucher. This statement of supply would contain the same information as required to be shown on a receipt.

10. Do I have to price my display stock and does this have to include dispensing fees?

Yes. But the Price Marking Order 1991 requires prices to be marked on or near goods so that prospective purchasers can see clearly what is to be charged for them. Under article 10 of the Order, however, where an appliance is only for sale if the practitioner's professional services are used as well –which will usually be the case –the price marked may be inclusive of those services. This is to say that notwithstanding the need, for PFA purposes, to make it clear that the patient is receiving two distinct supplies, for the purposes of the Price Marking Order, a total price may be shown on the frame. Where this is done, a notice in the practice, clearly displayed, should explain that the price quoted is inclusive of professional services and VAT. For VAT purposes, there is no requirement for display stock to be priced. Customs and Excise do not regard optometrists as retailers. If a price is displayed, the law of contract would appear to apply, though, which indicates that the optometrist is prepared to consider selling at that price. Once the patient has selected the appliance, it is his offer that the optometrist accepts which creates the contract.

11. When stock is valued at the lower of cost or net realisable value, what cost figure is applicable.

How stock is costed is important since it determines the selling price of goods. PFA is concerned with the supply of professional services. Supply of goods ancillary to those services is a matter that requires consideration but which has been dealt with by the use of a handling charge. Beyond that, the question of record keeping, stock costing and stock valuation has, deliberately, been left on one side for the moment so that it does not detract from the main issue.

The need to include stock in one's accounts for income tax purposes at the lower of cost and net realisable value in order to show a "true and fair" position does not mean that the cost used for VAT purposes has to be the lowest used for that valuation. It may be prudent to reduce stock more than twelve months old to a lower

stock valuation yet still sell the item at cost should the opportunity arise. Conversely, if your anticipation selling costs of appliances have to be reduced because they are not capable of being sold at cost price, it is the selling values that need to be used in the stock valuation for income tax purposes.

12. Will Customs require copies of all receipts to be kept if it is not shown on till rolls?

Yes, unless they state otherwise in writing.

13. Will a daily analysis in a sales daybook suffice?

No. It will be useful in preparing the VAT returns, but will not be evidence of PFA.

Appendix 1 – example receipt

ICU Optometrists

Receipt

Date 21 November 2001

Professional Services (VAT Exempt) £49.50
Appliance supply (standard rate) £89.99
RECEIVED £139.49

Appendix 2 – a statement of supply for an NHS patient

ICU Optometrists

Supply

Date 21 November 2001

Professional Services (VAT Exempt)....£49.50
Appliance supply (Standard Rated)....£89.99

TOTAL £139.49
Voucher £139.49
Amount paid £0.00

This booklet is based on an article by

- Ian Hayes, VAT Partner Buzzacott, Chartered Accountants Co-founder of Fiscal Solutions Limited and VATAX Reclaim. Treasurer of the Tax Faculty of the Institute of Chartered Accountants of England and Wales. Author of 'Accounting for VAT' & 'The Audit of VAT' published by the Institute.

With the help of :

- Malachy Cornwell-Kelly (ex-partner Dechert) Former Chairman VAT & Duties Tribunal, Special Commissioner of Income Tax and sometime Secretary of the Tax Law Review Committee. Member of the VAT & Duties Committee of the Law Society.
- Learned Counsel
- Ian Hunter OBE, Chief Executive of the Association of Optometrists

If you have further questions or comments to make, please make them known to

Alan Lester
Head of Finance, AOP
Tel: 020-7787 1115
Fax: 020-7261 0228
e-mail: alanlester@assoc-optometrists.org
61 Southwark Street,
London SE1 0HL

Association of Optometrists, 61 Southwark Street, London SE1 0HL
tel 020-7261 9661 fax 020-7261 0228
email postbox@assoc-optometrists.org