Spring 2021

Practice Management
ADVISOR

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www.dhc-cpas.com

3818 Bayou Rapides Road
Alexandria, Louisiana 71303

(318) 445-4585 ■ 1-800-738-6800 ■ FAX (318) 442-1138

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What you need to know about practice valuation

Although there's no direct tracking of medical practice closures, a survey by the Physicians Foundation estimated that about 8% of U.S. physician practices closed because of the COVID-19 pandemic — approximately 16,000. And even with the rollout of vaccines and the light at the end of the tunnel, more may close before the economy recovers.

In such volatile times, you may be considering buying a practice, merging with another practice or possibly selling your own. To do so, you'll first need to establish an estimated value of the practice you're buying, merging with or selling. Keep in mind that a practice valuation should be done by a professional appraiser who's accredited through any of several reputable associations, such as the American Institute of Certified Public Accountants.

What does the practice need to provide?

As owner of the practice, what's your role in the process? You'll typically need to provide a variety of items, including the practice's:

- Last three years' tax returns,
- Profit/loss (P/L) statements for the previous three years,
- End-of-year balance sheets for the previous three years,
- Depreciation report for anything that has been depreciated over time,
- Previous year's payroll report, and
- Production report (by provider if there's more than one provider, and it should be organized by the provider).

Understanding how the practice is being valued is a key step in getting the right price.

You'll also need to provide a list of equipment purchased in the past three years (and expenses), and a list of "discretionary items" to account for any business expenses that might not transfer to a new owner. In addition, a description of the practice is key: What does the practice focus on? What are its mission statement and vision statement? The description should include the practice's infrastructure; for example, the number of treatment rooms, square footage, and whether the seller

Ensure compliance with rules and laws

Buying or selling any business can be complicated, but medical practices have unique issues to be aware of. An experienced health care attorney can help perform both health care compliance and due diligence. Relevant issues include:

Health care compliance. Running a medical practice falls under many federal and state laws and regulations involving business referrals, how bills are submitted to private insurers and public health care programs, and privacy laws such as HIPAA. Part of what an attorney will evaluate will be the practice's current compliance plan, whether any current or future compliance complaints exist, and any other potential problems that need to be addressed.

License requirements. An attorney needs to review the current medical licensure required for the medical practice and the ongoing status of those licenses.

Patient notification. How and when patients are notified about a sale are governed by various rules and laws. The patients also should be informed of their rights to access and control their medical records after a sale, with a HIPAA-compliant authorization required to transfer medical records. The sale agreement needs to stipulate who owns the medical records after the sale and for how long.

Additional issues include evaluating any managed service organization agreements, open contracts with vendors and third parties; any open litigation; ongoing lease or rental agreements; and contracts with employees and independent contractors.

owns the building or is a tenant (and if a tenant, a copy of the lease agreement and a determination of whether it's transferable). You'll also need details such as how many new patients per month the practice has seen over the past 12 months, the total number of patient visits, the top 10 Current Procedural Terminology (CPT) codes used and the top five referral sources.

What are the possible valuation methods?

There are four fundamental approaches to a medical practice valuation:

1. Asset approach. This looks at the assets and liabilities of the practice. The essential question is: What would it cost to create another practice just like this, based on its assets and liabilities?

2. Market approach. Similar to a real estate appraisal, the market approach asks, "What will the market bear for this practice?" It will be compared to others in your area.

3. Income approach. This approach is the most common. It leverages a method of excess earnings, asking the question: What can I expect my return on investment to be? The key element is to determine the practice's ability to create profits above and beyond the owner's fair market salary (excess earnings).

4. Earnings before interest, taxes and amortization (EBITA) method. Not as common, but becoming more popular, EBITA takes the practice's net income with interest, taxes and amortization added back in. Doing so forms the foundation for how the practice is valued based on a multiple of EBITA.

Is the value reliable?

Buying or selling a practice is a big deal and shouldn't be taken lightly. Engage experienced professionals with proven practice valuation expertise to make sure the numbers are reliable. Understanding how the practice is being valued is a key step in getting the right price.

Is it a good time to buy a practice?

Consider these factors before you make the leap

Even in times of economic uncertainty, there may still be opportunities for growth. While some medical practices are struggling, others are doing well — and may want to expand their operations. If you're considering acquiring a practice, you'll first need to know its value. (See "What you need to know about practice valuation" on page 2.) In addition, a buyer needs to take several specific items into consideration when evaluating whether to make the leap.

Buyer beware

Here are some areas to research when considering buying a medical practice:

Trend of revenue. Over a two- or three-year period, has the practice's revenue been going up or down? Where did the revenue originate? Can the buyer replicate that revenue stream? (Note that this may be more difficult to evaluate in the age of COVID-19. The pandemic may have had effects on revenue you'll need to consider when projecting the practice's revenue going forward, including into a post-pandemic period.)

Goodwill. An important intangible aspect of a practice is goodwill, which falls broadly into corporate goodwill and personal goodwill. The biggest problem with goodwill is that nobody really has the same definition of it or knows how to value it.

If a hospital, for example, wanted to buy a medical practice, it generally wouldn't be willing to pay for goodwill — it would be more interested in acquiring the physician, with his or her experience, expertise and patient list. But if a younger physician wanted to buy a retiring physician's practice, he or she would not only be seeking the patient list (understanding there may be some attrition when the owner retires), but also be looking to preserve and build on the practice's well-established professional reputation and good standing in the community.

Corporate goodwill can easily transfer to a new owner, and includes practice location, setting, number of treatment rooms and other tangible characteristics. Personal goodwill is harder to transfer, because it's in large part based on the previous owner's personality and charisma, as well as the length of time he or she stays on in the practice.

Transition details. The concept of goodwill leads naturally into the transition and how to set it up. The best way to maximize goodwill, assuming the seller has personal goodwill, is for the seller to remain during the transition and introduce the buyer to the existing patient base. This will ensure both the corporate and some personal goodwill transfers to the new owner.

Revenue adjustments. Does the seller offer services that can't be duplicated? Perhaps the seller was a residency director or a sub-specialist, and the buyer is neither of those things. The seller might have specialized skills that the buyer doesn't (yet).

These factors must be taken into consideration before buying a practice.

Costs. Are the costs of the practice comparable to those of similar practices? A negative response may affect fair market value.

Referring sources. Another reason for the seller to stay on for some period of time is to provide an opportunity to introduce the new owner to the seller's current referring sources. As buyer, you would want the seller to help you continue the practice's revenue streams.

Payer mix. This has a direct impact on the revenue stream. If you, as buyer, can't replicate the revenue stream because you lack the necessary technical skills or aren't part of the current payer mix, this directly impacts the revenue stream. Can you participate with the existing insurance carriers?

Due diligence matters

Whether you should buy a practice depends on your ability to replicate (or improve) the seller's operation — ranging from unquantifiable factors, such as physician charisma and subjective good-will, to personnel costs, facility costs, patients, payers and referring sources. As the adage goes: Let the buyer beware! If you conduct proper due diligence, you'll more likely be rewarded with a practice that will succeed over the long term.

Co-management arrangements

Rewarding quality and efficiency can be a win-win

In difficult economic times, it's particularly important to assess any areas of your medical practice to locate systems that can be streamlined, simplified and improved. Making strategic changes will give your practice a boost that can help it survive an economic downturn and thrive going forward. Clinical co-management is one tool that can help you create incentives for improving service quality and efficiency while maintaining control. But it's not for every practice.

Two common structures

Co-management typically comes in two forms. In the first arrangement, a hospital contracts with a physician group or several groups to take responsibility for clinical and operational management of a hospital-related facility (such as a satellite primary care clinic) or service line (such as ophthalmology).

Any relationship with a hospital must achieve goals set by both the physicians and the hospital. If only one party benefits, the relationship will be short-lived. It's also important for the hospital to realize that every action in pursuit of market share and mission fulfillment has an economic impact on its physicians.

In the second arrangement, a separate legal entity is created to provide some of the same services that

the hospital itself provides. This entity can be owned by physicians or groups of physicians, or jointly by the physicians and the hospital.

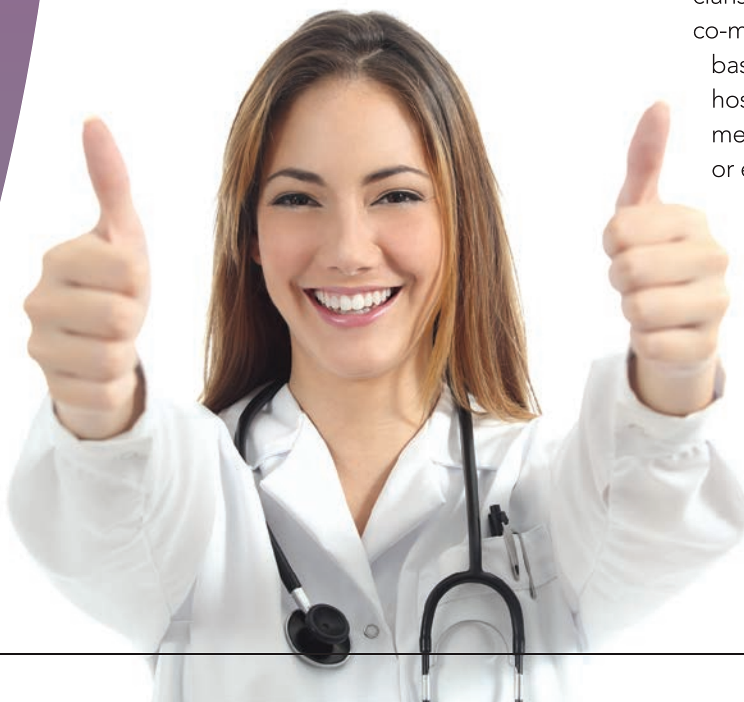
Typically, the parties create a compensation agreement that involves a base payment commensurate with the fair market value of the management services provided, plus an incentive fee tied to efficiency and quality objectives. Both parties should seek independent valuations by experienced appraisers to determine the fair market value of the two compensation components.

Trust to establish

Co-management may be attractive to physicians who want to integrate more closely with a hospital while maintaining their independent practices and not becoming employees of the hospital. With such a close-knit working relationship, the parties must trust each other completely.

The hospital must accept that it will surrender some control over its operations. The physicians, in turn, must understand that they'll take on substantial managerial and leadership responsibilities within the hospital.

In addition, governance of the separate organization or the operations management (whichever model is chosen) is critical to the success of the arrangement. If it's a true partnership of physicians and hospital, granting substantial authority to the doctors, their participation should equal or exceed the hospital's.



This will likely present no problem with for-profit hospitals. Tax-exempt hospitals, however, may insist on 50-50 equity arrangements and reserve powers to protect their charitable missions.

Legal questions to answer

When a hospital and a group of independent physicians collaborate, a number of legal questions emerge. For example, the antikickback law may be violated if the co-management agreement induces physicians to refer patients to the hospital. The Stark law requires that compensation in agreements between a hospital and physicians not be tied to the value or volume of referrals for "designated services."

Co-management may be attractive to physicians who want to integrate more closely with a hospital while maintaining their independent practices.

A co-management arrangement can take advantage of several available Stark exceptions, however. Ask your CPA and a health care attorney for more information.

Also consider the Civil Monetary Penalty statute. It prohibits a hospital from making payments to physicians as inducement to reduce or limit services. So, co-management deals should avoid incentive fees based on achieving cost reductions. Last, 501(c)(3) hospitals can't use a co-management arrangement to confer private inurement, private benefit or excess benefits to the physicians.

A possibility to explore

As you see, there are some complexities involved in the co-management structure. But if you can iron out the details with the help of qualified professionals, you might discover a way forward for your medical practice that ultimately will lead to the best results.

6 ways to improve your revenue cycle

Revenue cycle management (RCM) is one of the most complex medical office tasks. The various steps involve creating, processing and submitting claims, as well as collecting fees for services. Luckily, there are ways to apply the standard principles of professional RCM to improve your office's ability to get paid in a timely manner. Here are six ways to help evaluate your RCM:

1. Understand that every staff person is involved in your billing process. Everyone in the practice plays a vital role in the successful submission of insurance claims. From the moment a patient calls the office, the job of collecting correct patient information is fundamental to whether a claim is accepted or rejected.

2. Verify eligibility. About a third of claims are rejected over eligibility issues, but leveraging technology can minimize — and even eliminate — this particular problem. Your electronic health record (EHR) system should have this capability.

3. Communicate payment policies to patients. Most patients are unaware of the details of their own insurance coverage. It's important that the practice educate and inform patients of what patients owe and when. For example, many practices require that patients provide co-pays at the time of service. Communicate this early in the process.

4. Conduct internal billing audits. Revenue loss is often attributed to a failure to bill for all services provided. About every six months, examine the appointment list to evaluate whether each visit was charted appropriately. Ask:

- Are services being paid for appropriately and on time?
- Do the services match the patients' ledgers as reported on the explanation of benefits?
- Are the write-offs applied appropriately and the balances correctly transferred to patients?

5. Scrub appropriately. Scrubbing refers to assuring claims are reviewed for appropriate modifiers as well as International Classification of Diseases (ICD) and Current Procedural Terminology (CPT) codes. Improperly scrubbed claims can cost you money. Billing companies often use a scrubbing tool that automatically identifies conflicts and problems before the claim is submitted.

6. File claims on time. There are time limits on filing claims. Any delays can cost your practice revenue. Evaluate and monitor the time each step takes, from the time the patient attends the appointment to the moment the claim is submitted, posted and billed. Compare your office's timing with national standards to see how your practice measures up.

In addition, using pre-registration to detect problems early can prevent initial claim rejections — and implementing RCM software, often part of your EHR system, can ensure efficient reimbursement.

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3818 Bayou Rapides Road
Alexandria, Louisiana 71303