

# UPDATES FROM BARATZ & ASSOCIATES, P. A. FOR THE HEALTHCARE INDUSTRY

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## FAIR MARKET VALUE AND ITS IMPACT IN THE HEALTHCARE INDUSTRY

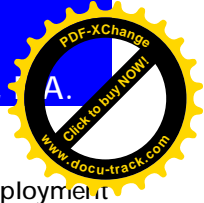
As a break from the everyday onslaught of what's new in the industry and what is the most recent legislative or regulatory event, I thought I would try a change of pace and give you some insight into the impact that "Fair Market Value" and valuations in general are having.

The term "Fair Market Value" ("FMV") pops up in numerous areas of consideration including federal and state Anti-Kickback Statutes, Stark Laws (or state counterparts), Internal Revenue Service Intermediate Sanctions (Private Investment/Benefit Transactions), etc. It has become a major area of concern for many healthcare providers because a lack of support for FMV in transactions between healthcare providers can result in very significant consequences. More and more case law is emerging related to financial transactions between parties not being in compliance with FMV, resulting in fines, repayments and penalties that can be staggering in comparison to the original FMV discrepancy. With this in mind, the following touches on areas of consideration where FMV is an important consideration:

- **Valuation of General Compensation Relationships** – This topic addresses the basic employment relationship between two parties who may have a patient referral relationship. From a FMV perspective, there is no clear guidance on how to establish whether or not FMV is being paid. There are several definitions of FMV in the regulatory literature but no specific guidance on how to approach support of an amount. However, a reasoned approach, taking into account historical compensation levels, multiple national, regional and/or local independent compensation studies, and a thorough review of the terms of the employment relationship, will go a long way to reduce the chance that mistakes are made. A common mistake is including in the employment arrangement of a physician, whose practice was

acquired, compensation that is derived from ancillary services/technical components of services of the practice which are not personally performed services by the physician. Stark does not allow this. Another mistake is using inappropriate levels of compensation from the national studies that is not necessarily supportable. (ex: using 90<sup>th</sup> percentile for a doctor just out of training.) Using a qualified and experienced independent third party for this task adds to the credibility of the final product. It is very helpful to have this done prior to finalizing an agreement.

- **Valuation of Physician On-Call and Coverage Arrangements** – Over the past several years, physicians in many specialties have begun to resent being required to be on-call without any commensurate compensation. This resentment is heightened due to growing malpractice insurance risks and costs, uncompensated care concerns, physician shortages and quality of life issues. Trauma center requirements and EMTALA laws have combined with physician concerns to create a need for economic support to be paid in many circumstances to meet the on-call needs. Valuing this is very difficult, as it is new, market information is difficult to obtain, and regulators are wary of the reasons for why payments are made and at what level. Two OIG advisory opinions have touched on this topic; OIG Adv. Opinion 07-10, 9/20/07 and OIG Adv. Opinion 09-05 5/14/09. Both of these should be considered in any valuation along with an analysis of the type of call needed, historical information on call activity, payor mix and uncompensated care, community need, physician availability, type of facility (trauma vs. non-trauma), time of the



week (weekday/weekend). With this analysis, traditional approaches (cost, income, market) can be applied to the facts and opinions on FMV developed. An independent and consistently applied approach is again prudent.

- **Valuation of Medical Director and Other Administrative Positions** – As is the case in all valuations, an understanding of legal and regulatory issues is needed. It is critical that in addition to identifying the services required, the qualifications of the candidate, and the time commitment expected, that the services be necessary and performed. Timely and comprehensive records must be consistently kept indicating that the work is done. An independent third party using the same national, regional and local studies discussed in bullet one above should be able to establish a reasonable FMV amount to use. It is important that consideration be given to the possibility that FMV for administrative services may differ from FMV for clinical services so this should be analyzed.
- **Business Valuations** – There are a number of considerations that impact the world of healthcare business valuations that we will touch on. It is very important than anyone doing valuation work in this area have a strong working knowledge of the healthcare regulatory environment. Simple things such as knowledge of IRS guidance and specific case law provides significant insight into how regulators may look at FMV in these instances and should be considered. If your methodology is too far removed from regulatory guidance, risks may be increased. Some classic issues you find are: the use of a physician compensation amount in a discounted cash flow model

that is not consistent with the employment arrangement you entered into with the same physician that you acquired the practice from; not income tax affecting the cash flows because the transaction is with a non-taxable entity; developing a value that is more synonymous with “strategic value” than “FMV”; not separately identifying ancillary service revenues and technical services accurately so that it is not in the employment compensation arrangement, therefore impacting on the business valuation; not drilling beneath the surface of the target practice to make sure that physician productivity in any historical information or projections is accurate and sustainable. (Are coding and documentation levels appropriate); relying on “rule of thumb” “multiples” as the core valuation method.

The above is just a brief commentary on issues we all face. It would take several volumes to fully discuss the areas of valuation and its relationship with the healthcare industry, but I hope this will generate some thought and consideration that whenever you enter into a financial transaction or relationship with a healthcare provider, FMV has to be considered. FMV will impact whether or not you are for-profit or not-for-profit and due to the heightened regulatory scrutiny and the increasingly severe financial consequences of getting it wrong, you should make sure that you have competent legal counsel and valuation experts that can analyze the situation and help you arrive at a solution that has the best opportunity to withstand any review.

If you have any questions or require any additional insight regarding this month’s topic, do not hesitate to contact this office.

NOTE: For additional information and resources make sure you check out our new website.

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