



# COMPLIANCE ALERT<sup>®</sup>

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## DUE DILIGENCE IN PRACTICE ACQUISITIONS AND PHYSICIAN EMPLOYMENT

As the United States moves toward some system of healthcare reform, many hospitals and healthcare organizations are being approached by private practice physicians and physician groups seeking refuge from the unstable state of the economy and what lies ahead. While many healthcare organizations are employing physicians in order to solidify their market position, others (particularly in rural areas) find this method of physician recruitment most effective in terms of their overall medical staff development plans.

Regardless of the reasons why hospitals and/or physicians are seeking to affiliate with one another, one of the most critical components to ensure that a successful transition occurs is performing a Due Diligence Analysis of prospective medical practices. Some of the most critical due diligence components which are a part of any medical practice acquisition are as follows:

1. **Rights to Payment** – a printout of accounts receivable, copies of any notes in favor of PC or Physician, and any other evidence of rights to payment held by PC or Physician; includes a list of any debts or claims of the PC or Physician(s)
2. **Accounts Payable; Capital Expenditures** – a list/copies of invoices or statements of the PC's expenses and accounts payable; a list of capital expenditures exceeding \$1,000 or aggregate capital expenditures exceeding \$10,000 within the last six months
3. **Indebtedness and Security** – copies of all evidence of debt or other liabilities owing by PC; a list of and copies of all security interests, liens, pledges, mortgages, licenses, restrictions and any related documentation affecting title to any assets of the PC
4. **Contracts, Agreements, Other Documentation** – a list of and copies of all contracts and agreements relating to operation of the PC, including, without limitation, managed care contracts, contracts with employees or independent contractors, leases (including equipment and space leases), computer, maintenance and waste disposal contracts, and software licenses, and including

**copies of any benefit-related plans (pension, retirement or welfare) for PC employees and copies of any applicable insurance policies, as well as a list of any insurance coverages cancelled or discontinued during the past six months**

5. **Permits and Licenses – a list of and copies of all permits, licenses, certificates, governmental authorizations, and related applications and certifications, including medical equipment necessary for the operation of the PC**
6. **Provider Numbers – a list of and copies of all Physician and PC provider number applications with governmental payors, including without limitation Medicare and Medicaid, and a list identifying all of Physician’s and PC’s provider numbers and NPIs; copies of all correspondence with any payor and any contractor related thereto discussing billing and coding of claims**
7. **Insurance Claims – a list of all claims for any insured loss in excess of \$5,000 per occurrence filed by the PC during the past three years, including workers’ compensation, general liability, environmental liability and professional malpractice liability**
8. **Property – a list of all equipment, furniture, office furnishing, tools and like, indicating location (in PC’s office or otherwise) and whether each is leased or owned; a list of any damage, destruction or loss to any assets of the PC**
9. **Inventory – types and approximation of quantities of medical supplies and drugs and office supplies and other disposables and consumables of PC**
10. **Software and Processing – a list of all data processing programs, software, hardware, and related items used in conduct of the PC, including accounting, invoices, auditing, and medical records**
11. **Litigation – a detailed list of any pending or threatened litigation against the PC or Physician and copies of any judgments and settlement agreements involving the Physician and/or PC**
12. **Excluded Assets – a list of any assets of the PC or the Physician to be excluded from sale**
13. **Organizational Materials – copies of any and all formation documents of PC, such as articles of incorporation or organization, bylaws or operating agreement, and shareholder agreements**

14. **Financial Information** - Copies of state and federal tax returns, balance sheets and financial statements of PC for past three (3) years, including any auditor's correspondence
15. **Other Activities** - List of other healthcare facilities where Physician has privileges and confirmation that Physician's medical staff membership in good standing at each
16. **Patients** – the number of patient charts of PC

#### **Documents Needed at Closing**

17. **Billing** - a list of charges for services rendered to PC patients prior to closing date but not billed prior to closing date

One of the most often overlooked aspects of any due diligence process involves obtaining a comprehensive background report on both the medical practice and each individual physician in terms of any pending litigation, previous civil or criminal history or any historical behavior patterns that may be unacceptable or undesirable. Additionally, it is strongly recommended that the hospital acquire a credit report on both the medical practice and the individual physicians as well as performing background checks through both the OIG Website and the National Practitioner Databank (NPDB). Often times, physician recruiters or hospital CEOs have learned derogatory information after the acquisition has been completed and this, of course, is problematic for the healthcare organization who has acquired the medical practice.

While the due diligence process involves a systematic review of both financial, operational and clinical data of the practice, this approach should be more "consultative" in nature in order to not only uncover any deficiencies of the medical practice but, more importantly, focus on performance improvement opportunities for future practice enhancement.

The due diligence process is imperative when hospitals and healthcare organizations are contemplating the acquisition of a medical practice and/or employment of physicians. Indeed, your legal counsel is of paramount importance to ensure that these relationships meet all of the regulatory requirements as contained within the Stark laws and the AntiKickback Statutes. Most commonly, hospitals employ physicians after they have acquired their medical practices and there are regulatory implications of a practice acquisition in which the acquirer also employs the physician seller, since there is an unquantifiable regulatory risk, particularly if the price paid is calculated based on income generated by the practice. While most medical practice valuations are performed using the Asset Methodology (based upon fair market value of assets), oftentimes hospitals will use the Discounted Net Present Value Methodology, whereby future cash flows of the practice are projected and discounted at today's rate. Payment for hard assets of the practice minimizes the risk of non compliance with legal requirements. Under any valuation methodology,

the physician remuneration must be at fair market value and must be commercially reasonable. Failure to fall within a Safe Harbor is not fatal to the arrangement, but creates an unquantifiable risk that the arrangement may violate the law.

The value of outside legal and business counsel cannot be overstated with respect to practice acquisitions and physician employment arrangements in order to ensure that regulatory requirements have been met and that the practice transition is successful.

For further information regarding Physician Practice Acquisition and Physician Employment Issues, please contact John W. McDaniel, President and Chief Executive Officer, at 800.279.0614.

Products and services related to this topic on website [www.practicesupport.com](http://www.practicesupport.com) include:

[Medical Practice Valuation and Workbook Appraisal Guidelines](#)

[Adding a New Physician: A Guide for Managers, Doctors and Recruiters](#)

[Practice Management Tools for Physician Retention](#)

[Physician Recruitment & Employment: A Complete Reference Guide](#)

[Practice Valuation Services](#)

