



## CRITICAL CONCEPTS IN UNDERSTANDING FINANCIAL ISSUES WHEN SERVICING A HEALTHCARE PROVIDER



W. Thomas Fulton, CPA, Manager  
Litigation Services and Business Valuation Group  
Cowan, Guteski & Co., P.A.

**A**s with any profession, healthcare providers look for advice and counsel from attorneys for a number of reasons. They can vary from a partnership formation or dissolution, to a merger or acquisition, to estate and gift tax planning. At times legal services are engaged for reasons unrelated to their business itself – such as a matrimonial litigation matter of one of the partners in their practice.

Although each case involving a medical practice, physician or dentist is unique to its specific circumstances, many have common traits. Having a good understanding of the key financial issues or utilizing an accounting or valuation professional that understands these issues is critical to the successful outcome of your case. It is essential that you can explain the financial aspects of the case to all of the parties involved in a concise and understandable manner. You or other members of your firm must have the resources behind you to provide these services. This will help you to resolve the matter and enhance the relationship with your client. It may also increase the likelihood that your client will refer you to their co-workers and associates.

Valuations are required for multiple purposes including mergers, acquisitions, buy-sell agreements, the formation of a group practice from multiple smaller practices and matrimonial litigation. Additionally, knowing the total earnings, including salary, bonuses, benefits and perquisites, of each of the physician owners, can be critical to a merger, marital dissolution, and other matters. Another key component involves understanding a practice's assets and liabilities.

Most medical and dental practices report their income, expenses, assets and liabilities on a cash basis. This means that income is recognized when received not earned, and expenses are recorded when paid not incurred. This reporting standard frequently means that key assets and liabilities might be missed at first glance. Attorneys need to be aware of this. Compounding the problem that attorneys and their professional advisors often face is that the practice may have a poor accounting system which could impact income tax reporting. These factors must be addressed when the client is looking to you for answers.

One of the many typical issues involves assets and liabilities that are not reported on the balance sheet. Accounts receivable (A/R) is an example of an asset that is typically not included on a medical practice's balance sheet when prepared on a cash basis. Some physicians are not even required to prepare a balance sheet for income tax purposes. This is true of a sole practitioner who reports his/her income and expenses on Schedule C of their personal income tax returns.

A/R can be a medical practice's largest asset. In order to determine a practice's A/R you will need to obtain a current aged trial balance from the practice's billing system. From the aged trial balance, adjustments will need to be made to the total figures to factor in contractual adjustments imposed by insurance companies and uncollectible amounts.

Many medical practices do not "clean-up" their computerized billing systems by removing aged accounts receivables that will never be collected. Practices carry bad debt for numerous reasons. Frequently patients have moved or changed insurance companies and the debt will never be collected. Knowledge of when to write-off bad debt and its impact on the practice's true financial position will help to determine the actual value of this asset.

What about the other assets of a medical practice?

When providing advice in a merger or in most other matters, questions come up about the quantity and value of a practice's tangible fixed assets.

- Is the equipment old or new?
- What value does it have?
- Are the majority of a practice's assets leasehold improvements? If so, are these improvements usable and transferable?
- Do the leasehold improvements have value to the acquirer or a merging partner?
- How does the book value relate to depreciation that might have been taken?
- If a practice has substantial tangible equipment, such as radiology equipment, that asset might contribute value in a merger. You will need to obtain an understanding of the terms of the merger and contributions made. You will also need to determine how the equipment has been acquired. For example, has it been financed or leased?
- If leased is it an operating lease or a capital lease and will it be acquired at the end of the lease?
- Are there other items included in the operating lease like supplies or maintenance that will impact the practice's future expenses and net income?

Additionally, knowledge about a practice's operations, gross receipts and net income are key elements in providing sound legal advice during a merger or when providing projections – especially in matrimonial litigation. This can be the most significant and sensitive issue for an attorney and their client. Most medical professionals do not want or understand why their personal information needs to be quantified, disclosed, and understood by a spouse, merger partner, hospital venture partner or you. This is especially true if the cause of the litigation, such as the divorce of a partner, does not involve the other partners directly. How do you handle this issue?

As previously indicated, income and cash flow is possibly the most important component of valuing a practice, determining support in matrimonial action, and projecting future income streams. The legal professional needs to understand and/or be guided by an accountant who understands the complexities of all of the benefits a medical practice provides to its owners.

A medical practice's billings, collections from professional services, as well as billings and receipts from medical equipment must be understood when projecting future income/benefit streams. A working knowledge of billing codes (CPT Codes) is also advisable. Additionally, how partners share income and benefit from each other's services are very relevant. Questions that you might ask include:

- Does one partner perform all of the surgical procedures, while the other performs all the follow-up?
- How does each individual benefit from this?
- Do they share revenue equally?
- Are salaries calculated based upon productivity?
- What are the perquisites and how are they determined?
- Is there a formal system for calculating perquisites?

What should be obvious is that any one client can present a multitude of issues. How these issues are recognized, understood, worked through and finally resolved is up to you and the professionals you rely upon to help you obtain a fair and equitable agreement for your client.

#### About the Author

W. Thomas Fulton, CPA, is a Manager in the Litigation Services and Business Valuation Group at Cowan, Guteski & Co., P.A. Mr. Fulton provides business valuation services to clients in a variety of industries, specializing in healthcare, commercial and professional services entities. Working directly with attorneys, he has provided guidance and financial assistance in the resolution of numerous matrimonial and commercial litigation matters. He can be contacted at 732-349-6880 ext. 151 or [tfulton@cowanguteski.com](mailto:tfulton@cowanguteski.com).

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