



Is the Hospital Knocking on Your Door?



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Imagine sitting in your office between patients during a busy set of office hours. You are trying to catch up on charts and return phone calls when the receptionist tells you that the president of the local hospital is on the phone. As a matter of courtesy, you take the call not knowing why he would be contacting you, other than asking for your annual donation to the hospital foundation. Much to your surprise, he tells you that he would like to meet to discuss your interest in having the hospital purchase your practice. While no one expected it, hospitals are once again in the business of purchasing primary care medical practices.

Historical Perspective

In the 1990's, hospital purchases of medical practices were in full-swing as they were experiencing a great deal of competition. The impetus for hospital systems all across the United States was the development of the integrated delivery system (IDS). The idea of the IDS was a multi-layered organization that included primary care physicians as the "gatekeepers." These doctors served as the entry point into the rest of the IDS. It was important for hospitals to have as many primary care physicians as possible in their organization. Hospitals went after their own primary care physicians, as well as physicians that historically referred to competing hospitals. Competition became fierce as hospitals looked at the potential revenue generated for the IDS by referrals from the primary care physicians and specialists.

Despite limitations due to federal and state anti-kickback statutes, hospitals overpaid for many practices. Some were underperforming and bleeding red ink. According to a survey by the Medical Group Management Association the median net loss per full-time equivalent (FTE)

physician was \$89,500 in 2000. Although hospitals planned to incur some losses, they far exceeded expectations even with income from ancillary studies and referrals. As hospitals began to feel the effect of decreasing reimbursement and the downturn in the economy, they looked to limit their financial exposure by divesting themselves of practices or changing to an incentive-based compensation formula. Hospitals also began to devote the management resources necessary to improve the performance of these hospital-owned practices.

The New Trend

Today, as hospital mergers and closures have increased the intensity of competition, hospitals have emerged again in the purchasing arena. Once one hospital purchases a primary care practice, competing hospitals begin to do so to protect their market share. The median net loss per FTE physician dropped to \$68,881 in 2006 according to Medical Group Management Association. This is an amount that hospitals can accept in light of the potential referrals and corresponding revenue.

So the cycle has started again. Hospitals are determined not to repeat the errors of the past. The impetus behind the new initiative in purchasing practices is the increasing competition between hospitals and inability for many primary care physicians to maintain a healthy bottom line. Hospital management learned from its mistakes and is now focused on making hospital-owned practices work.

The hospital's approach to purchasing physician practices and the framework of the potential transactions has changed dramatically:

- The price of the practice is based on the fair market value of the identifiable tangible and intangible assets.
- There is no longer a significant component of the purchase price associated with goodwill.
- Physician compensation is no longer set on a guaranteed salary, but rather based on productivity, usually relative value units (RVU).

Important Considerations for Physicians

Physicians that consider selling their practice to a hospital have a number of important factors, both financial and non-financial to consider.

Administrative control - Physicians in a hospital-owned practice are responsible to a member of the hospital management staff, typically the Vice President of Medical Affairs. They no longer have ultimate business authority in practice decisions.

Staffing - The employees in the practice become employees of the hospital (or another health system entity). Although the physicians may have input into personnel decisions, the ultimate responsibility lies with the Human Resources Department. Permission must be obtained from the hospital to make personnel changes.

Vendors - Practices owned by the hospital are usually required to use the vendors that it prescribes.

Referrals - One of the reasons that hospitals purchase practices is for the referrals for ancillary testing, as well as referrals to staff specialists. The hospital may suggest that you change existing referral patterns.

Financial control - Physicians in practices owned by hospitals are usually compensated on a productivity basis. This may be based on relative value units, revenue or some other mutually agreed upon measure. While physicians may have less opportunity on the high end, they are typically protected against major decreases in reimbursement.

Contracting - Hospitals may have contracts with the major insurance companies that can provide a higher level of reimbursement for physicians. Those hospitals with a large number of owned practices have significantly more clout in negotiations with payers.

Billing - Hospitals usually have billing services as part of the management services that they provide to the practice. Physicians must conform to the billing standards established by the hospital.

Evaluation Process

When a hospital considers purchasing a practice, they will obtain a fair market value analysis. This is done to determine the "worth" of the practice and ensure compliance with federal and state anti-kick back laws. Hospitals are not permitted to compensate physicians in relation to the volume or potential value of referrals. As stated above, many hospitals will base the value and corresponding purchase price of the practice on tangible and intangible assets.

Tangible assets include furniture, equipment and supplies. Furniture and equipment can be analyzed based on book value or replacement value. Supplies are typically inventoried and the value included in the purchase practice.

Most hospitals do not want to purchase the accounts receivable of the practice. They allow the physician(s) to collect the old accounts receivable and keep the revenue they receive.

One of the most common methods of valuing the intangible assets is the comparative sales model. The Goodwill Registry maintained by the Healthcare Group, Inc. in Plymouth Meeting, Pennsylvania is generally considered the authoritative source of comparative data. The Registry is a compendium of purchases and sales of medical practices. It is broken down by specialty and state. The Goodwill Registry is used to provide a close approximation of the value of the goodwill in the practice.

The hospital will also analyze the productivity of all the physicians and providers in the practice. They will ask for information about services rendered by CPT code to benchmark the providers by relative value units. This data will be used to model compensation under an employee scenario to determine if they can compensate you at a level that is commensurate with your prior income.

Be Prepared

As physicians have become increasingly frustrated by the administrative duties of running a practice, the thought of having someone else assume these responsibilities is an attractive alternative. If you are approached by a hospital or are considering approaching a local hospital, we strongly suggest that you are prepared with all the information that has been discussed above. You should have an understanding of your strategic value to the hospital with respect to the volume of patients you refer. Since hospitals are always looking to extend their geographic reach, your importance to their strategic plan may be more significant if your practice is located in an area that typically utilizes a competing hospital. It may be beneficial for you to obtain an analysis of your practice prior to beginning negotiations with the hospital so you are prepared to evaluate their offer.

Selling your practice could be one of the most important decisions of your career. Make sure you investigate the options thoroughly and obtain the advice of professionals who can guide you.

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