

**The Due Diligence Imperative: Conclusion
 (Part 6 of a 6 Part Series)**

As discussed in the first installment of this six-part series,¹ *due diligence* generally may be defined as:

- (1) “such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case”;² and,
- (2) “an investigation in order to support the purchase price of the business.”³

The requisite *due diligence* related to a healthcare valuation engagement is comprised of two distinct classes of information:

- (1) *General research* – Research that is not specifically related to, or obtained from, the subject *enterprise, asset, or service* being appraised; and,
- (2) *Specific research* – Information specific to the subject *enterprise, asset, or service*, that is typically obtained from the client or the appropriate contact designated by the client.⁴

The first installment of this six-part series set forth an overview of the due diligence imperative for valuation professionals, in the context of the *Four Pillars of Healthcare Value*, i.e., *Reimbursement, Regulatory, Technology, and Competition*.⁵ The second through fifth installments reviewed the due diligence process related to the *reimbursement, regulatory, competitive and technological* environments, respectively. This series conclusion will review the due diligence process generally as it relates to the healthcare industry.

Each of the previous series installments set forth a detailed list of information and documents to be collected by the analyst specific to each of the *Four Pillars*. Obtaining and reviewing some general research items may be crucial before starting any project. For example, information related to current Medicare reimbursement rates (the date of which rates will be specific to the project), projected rates (for the next three to five years), and the Medicaid to Medicare fee index may be reviewed for use in *reimbursement benchmarking*.

Additionally, the analyst may be well-served to review the applicable provisions of current and pending

healthcare legislation, such as the *2010 Patient Protection and Affordable Care Act (ACA)*; *Medicare Access and CHIP Reauthorization Act of 2015 (MACRA)*; federal and state fraud and abuse laws; and, other laws, regulations, and case law as applicable to the specific facts, circumstances, and location of the engagement. Additionally, in some situations, such as when the client plans to start a new practice or business, the analyst may need to research federal and state licensure, certification, and accreditation regulations; and, state *Certificate of Need (CON)* laws, to determine their applicability to, and impact on, the project.

In conducting a competitive analysis related to the Subject Interest, the analyst must develop a working knowledge of the competitive environment in the Subject Interest’s market service area; obtain the data required to conduct a financial benchmarking study of the competitors in the geographic area proximate to the Subject Interest; and, review the financial profiles and financial statements of the competitors.

While the general research process provides the valuation analyst with an adequate grasp of the body of knowledge applicable to a particular property interest being appraised, it is the efficacy of the valuation analyst’s subsequent application of generally accepted accounting approaches and methods to that data that determines the successful outcome of the engagement.

In contrast to *general research*, *specific research* is information and data that is directly related to, or obtained from, the subject *enterprise, asset, or service* being valued. Additional subject-specific information may also be obtained through the site visit/management interview. In some situations, the analyst might find it difficult to obtain the requested information and documents. It is instrumental that the analyst be consistent and persistent in obtaining the relevant information and documents required to conduct the due diligence exercise within the valuation analysis. Some strategies to communicate with the client may include, but are not limited to, the following:

- (1) Determine the pertinent contact from whom to obtain the information, e.g., the chief financial officer (CFO), vice president of finance, accountant, billing manager, and contact them directly;

- (2) Arrange a phone call with the client, management or the designated contact, immediately after sending the document request, to review the list and answer any questions and discuss any potential problems with the availability or accessibility of said documents;
- (3) Send updated copies of document requests to the client to remind them of the outstanding documents and information; and,
- (4) In the event that the client encounters difficulty in procuring the requested documents, recommend alternative routes to obtain information or suggest substitute documents.

Clients often cannot provide the documents and information requested by the analyst, because the client does not possess the information in the format it has been requested. In the alternative to requesting and obtaining the data piecemeal from the Subject Interest, the analyst may request that the client (or the appropriate contact designated by the client), provide the analyst with a “*data dump*” from the software that stores the requested data, and convert the *data dump* into a usable format in which the analyst can sort/analyze the information. For example, a *data dump* may come from the patient billing system and may include (in the case of the subject interest being a hospital or a physician office) individual procedure data by: (1) Unique Transaction ID; (2) Current Procedural Terminology (CPT) Code; (4) Total Charges; (5) Total Collections; (6) Provider; (7) Site of Service; (8) Patient ID Number; (9) Patient Zip Code; (10) Payor Mix; and, (11) Referral Source. This information could further be used to analyze the reimbursement related to the Subject Interest. Note that, most revenue cycle software packages, e.g., Epic Systems and Meditech, allow this data to be exported to a Microsoft Excel or a data delimited (e.g., .csv) file.

Occasionally, the analyst may have to conduct independent research to construct the information or an adequate “*work around*,” in the event that the client has no documentation of the requested information. For instance, as discussed the fourth installment in this series, the analyst may request from the client patient location zip code distribution report or any market service area analyses for the Subject Interest, including any documents and information which may address the origin (e.g., zip codes) of the Subject Interest’s patients.⁶ This information is used to determine the Market Service Area to be used for the valuation. Some clients will not have this information accessible and may not be able to provide it to the analyst. To conduct a successful competitor analysis without this information, the analyst can, in the alternative, equate the Market Service Area of the client with the Metropolitan Statistical Area, county (or group of counties), or state, and find providers of similar services within the selected region. This process should be conducted with the cooperation of the management of the subject entity to insure that the

selected geographical area conforms to the perceived footprint of the subject entity.

As part of the requisite due diligence associated with a specific engagement, the valuation analyst should conduct independent research, specific to the subject enterprise, to supplement any information provided by the subject entity, in line with the old Russian proverb, “*Trust but Verify*.” For example, the valuation analyst may conduct a *Uniform Commercial Code* (UCC) search to determine if the subject enterprise has any undisclosed outstanding liabilities or whether the subject enterprise leases, rather than owns, their tangible personal property, i.e., *furniture, fixtures, and equipment*. Similarly, a search for filings related to the subject enterprise with the Office of the Secretary of State in which the subject enterprise operates should be performed to identify pertinent information related to the actual legal organization of the subject enterprise, as well as performing a brief search of online legal databases, such as the Public Access to Court Electronic Records (PACER) database⁷ for federal litigation, and state litigation databases, such as Case.net⁸ in Missouri, to reveal any past and ongoing litigation involving the subject property interest, including shareholder disputes, commercial damages and liabilities, and malpractice cases. Further information related to the subject property interest, which might not have been disclosed, may be gleaned from state licensing and certifying agencies and disciplinary boards, and may have an impact on the reputation, as well as the clinical and operational performance and financial status, of the subject enterprise. It should be noted that subsequent events, i.e., events that would not have been known or knowable as of the valuation date, but which may also have a deleterious effect on the value indication for the subject property, must be disclosed, within the valuation report, to the client. However, these subsequent events do not have an impact on the valuation opinion, as of the valuation date, and may require a decision by the client as to whether an updated valuation report, i.e., with a valuation date after the subsequent events, should be undertaken.⁹

The due diligence process of a healthcare transaction is a critical exercise for the valuation analyst. There has been a paradigm shift in the healthcare industry over the past several years, most notably manifested in the various provisions of the ACA, as healthcare transactions are increasing in both size and complexity, resulting in emboldened efforts at regulatory review, requiring that the analyst seek and obtain robust general and specific research data and information in conducting a complete and thorough due diligence process (that will withstand scrutiny) related to the subject property interest being appraised. This due diligence process is especially important in consideration of the *Four Pillars of Healthcare Valuation*, i.e., *regulatory, reimbursement, competition, and technology*, which are unique areas of risk that shape the market forces within the U.S. healthcare industry, in the valuation of healthcare *enterprises, assets, and services*.

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- 1 For more information, see the first installment of this six part series: “The Due Diligence Imperative – For the Valuation of Healthcare Enterprises, Assets, and Services” Health Capital Consultants, Vol. 10, Issue 9, September 2017, https://www.healthcapital.com/hcc/newsletter/09_17/PDF/DILIGENCE.pdf (Accessed 10/26/17).
 - 2 “Black’s Law Dictionary” 5th Edition, By Henry Campbell Black, St. Paul, MN: West Publishing Company, 1979, p. 411.
 - 3 “Business Valuation Resource Guide” By Stephen K. Bethel, Glendale, CA: Mattatal Press, 2003, p. 283.
 - 4 For more information, see the first installment of this six part series: “The Due Diligence Imperative – For the Valuation of Healthcare Enterprises, Assets, and Services” Health Capital Consultants, Vol. 10, Issue 9, September 2017, https://www.healthcapital.com/hcc/newsletter/09_17/PDF/DILIGENCE.pdf (Accessed 10/26/17).
 - 5 “Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services” By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 1, Hoboken, NJ: John Wiley & Sons, Inc., 2014, p. 2.
 - 6 For more information, see the fourth installment of this six part series: “The Due Diligence Imperative – Competition” Health Capital Consultants, Vol. 10, Issue 12, December 2017, https://www.healthcapital.com/hcc/newsletter/12_17/PDF/DILIGENCE.pdf (Accessed 2/13/18).
 - 7 “Public Access to Court Electronic Records” United States Courts, www.pacer.gov (Accessed 8/29/17).
 - 8 “Missouri Case.net” Missouri Courts, <https://www.courts.mo.gov/casenet/base/welcome.do> (Accessed 8/29/17).
 - 9 Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, 246-247.



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