

The Due Diligence Imperative: Regulatory Environment (Part Three of a Six Part Series)

As discussed in the first installment of this six-part series, *due diligence* may be generally 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”; and,
- (2) “an investigation in order to support the purchase price of the business.”¹

There are two distinct classes of information generally required in completing the requisite *due diligence* related to a healthcare valuation engagement:

- (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.²

The first part 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*,³ and the second installment discussed due diligence in the context of the *reimbursement environment*.⁴ This third installment will review the due diligence process as it relates to the *healthcare regulatory environment*.

With the passage of the 2010 *Patient Protection and Affordable Care Act (ACA)*, i.e., “*Obamacare*,” providers are facing even more extensive regulatory scrutiny, much of which attention is focused on the increasing number of rules and the strict prosecution of *fraud and abuse* violations.⁵ Although significant efforts have been expended attempting to “*repeal and replace*” the ACA,⁶ the landmark legislation remains standing, and the sweeping nature of the ACA will continue to drive ongoing changes in the structure and financial operation of many healthcare provider enterprises, likely resulting in an even further increase in the pace of hospital/physician practice integration/transactional activities, as well as an increase in the number of U.S.

physicians who are currently employed by hospitals.⁷ These increases have, in the past, served as a catalyst for enhanced regulatory scrutiny from the *Office of Inspector General (OIG)*, the *Internal Revenue Service (IRS)*, and the *Department of Justice (DOJ)*, through the development of such initiatives as the *Fraud Enforcement and Recovery Act (FERA)* and the *Healthcare Enforcement Action Team (HEAT)*.

Among the valuation issues arising from these regulatory concerns are:

- (1) The need to establish the *very existence of tangible and intangible assets* within a healthcare enterprise;
- (2) The determination of whether (and under which circumstances) it is *legally permissible* for those assets to be acquired; and,
- (3) The need to take care in the selection of the applicable *valuation methodologies, approaches, and techniques* related to establishing the *Fair Market Value (FMV)* of healthcare *enterprises, assets, and services*.⁸

This increased scrutiny of the healthcare industry, at both the federal and state level,⁹ requires the analyst to conduct a thorough and robust due diligence exercise, due to the significant inherent risk in the industry.

In conducting the *general research* related to the subject interest being appraised, the analyst should first develop an understanding of the controlling laws and regulations pertinent to the engagement, which may change depending on factors such as the state in which the enterprise, asset, or service is located; whether the provider(s) receive(s) reimbursement from Medicare, Medicaid, or other government payors; and/or, whether any of the enterprise(s) involved in the engagement is tax exempt. In addition, the analyst should be conversant with federal fraud and abuse laws such as the *Stark Law (Stark)*, the *Anti-Kickback Statute (AKS)*, and the *False Claims Act (FCA)*, that, in general, state that physician compensation, for example, cannot be tied to the *volume or value of referrals*,¹⁰ and that a provider may not submit any requests for reimbursement to the government when the provider is materially noncompliant with the program regulations.¹¹ Some of the (publicly available) laws and regulations that the analyst may want to review, both to bolster their knowledge and determine the applicability

and relevance of the regulations to the subject engagement, include, but are not limited to:

- (1) Federal and state fraud and abuse laws;
- (2) OIG advisory opinions,¹² special fraud alerts,¹³ and work plans,¹⁴ which set forth guidance related to the relevant fraud and abuse laws;
- (3) Federal and state antitrust laws;
- (4) The applicable provisions of current healthcare legislation, such as the *2010 Patient Protection and Affordable Care Act* (ACA);
- (5) Proposed U.S. healthcare reform legislation;
- (6) Federal and state licensure, certification, and accreditation regulations;
- (7) State *Certificate of Need* (CON) laws;
- (8) State *Corporate Practice of Medicine* (CPM) laws;¹⁵
- (9) Relevant state case law; and,
- (10) State provider taxes.

As part of the requisite due diligence in conducting *general research* related to proposed legislation, the valuation analyst should consult government websites, such as www.regulations.gov, which includes information on proposed bills, as well as current legislation.¹⁶ State laws should also be researched for any CPM or CON issues, as these regulations may have a significant effect on the subject interest's competitive position, by acting as a barrier to entry for new healthcare providers.¹⁷ It is vital to the due diligence exercise that the analyst determines the pertinent current laws and proposed legislation that may have an impact upon the ultimate value of the healthcare *enterprise, asset, or service*.

Specific to the subject interest, the valuation analyst should search the Secretary of State (SOS) office of the state(s) in which the subject interest operates to ensure that the enterprise is in good standing and that there are no liens against the subject interest. To conduct these searches, the analyst should visit: (1) the *Business Services* section of the SOS office website, and search the business to determine that the business entity is active and in good standing; and, (2) the *Uniform Commercial Code* (UCC) section of the SOS office website, to determine who (if anyone) has an interest in the personal property of the subject interest. The analyst should also consult federal legal databases, such as *Public Access to Court Electronic Records* (PACER),¹⁸ and state court databases, such as Missouri's CaseNet,¹⁹ to ascertain any past or pending litigation against the subject interest. Additionally, the analyst should conduct a search of national and regional news services related to the subject interest and related parties in order to gather further (and potentially pertinent) information.

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 also may have a deleterious effect on the value indication for the subject property, must, according to professional standards, be disclosed within the valuation report to the client. However, these *subsequent events* will not have an impact on the valuation opinion reported, 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.

Specific research is information and data that is directly related to, or obtained from, the *subject enterprise, asset, or service* being valued. As the name suggests, specific research is client specific and changes depending on the specific facts and circumstances related to that engagement. In most cases, the valuation analyst will compile a preliminary documents and information request for the client, which documents and information may include, but are not limited to:

- (1) Any documents (or drafts of documents) that set forth the terms of transaction, such as *physician employment agreements* (PEA) and *professional service agreements* (PSA), term sheets, and *asset purchase agreements*;
- (2) Financial statements representing the financial operation and economic position of the subject entity for, at least, three annual periods ending on the valuation date. Fully audited financial statements are preferred, but so long as it is disclosed within the report, an accountant's compilation or management drafts of financial statements may also be relied upon;
- (3) Copies of all licenses, certifications, accreditations, permits, and other regulatory approvals including, if applicable, CONs;
- (4) The tax status of the entity;
- (5) Tax returns for the entity;
- (6) A summary and copies of documents related to any pending litigation in which the subject entity is currently involved;
- (7) Membership structure of the entity, including relative membership percentages, of all individuals, entities, and physicians in the entity; and,
- (8) Any business performance reports prepared by or for the enterprise related to regulatory position.

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, which has already resulted (at least in part) in healthcare transactions becoming increasingly complex and subject to emboldened regulatory review, requiring that the risk averse analyst seek out 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 a subject property interest being appraised, regardless of whether it is an *enterprise, asset, or service*.

- 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 *Ibid.*
- 3 "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; Health Capital Consultants, "The Due Diligence Imperative – For the Valuation of Healthcare Enterprises, Assets, and Services", September 2017.
- 4 For more information, see the second installment of this six part series: "The Due Diligence Imperative: Healthcare Reimbursement Environment" Health Capital Consultants, Vol. 10, Issue 10, October 2017, https://www.healthcapital.com/hcc/newsletter/10_17/PDF/DILIGENCE.pdf (Accessed 11/20/17).
- 5 "Patient Protection and Affordable Care Act," Public Law 111-148, 124 Stat 119 (March 23, 2010), as amended by "Health Care and Education Reconciliation Act," Public Law 111-152, 124 Stat 1029 (March 30, 2010).
- 6 For more information about the efforts to repeal and replace Obamacare, reference "Obamacare Repeal and Replace – In the Heat of the Night: Now You See it, Now You Don't" Health Capital Consultants, Vol. 10, Issue 7, July 2017, https://www.healthcapital.com/hcc/newsletter/07_17/PDF/ACA.pdf (Accessed 11/20/17).
- 7 "Hospitals' Race to Employ Physicians – The Logic behind a Money-Losing Proposition" By Robert Kocher and Nikhil R. Sahni, New England Journal of Medicine, Vol. 364, No. 19 (May 12, 2011), p. 1790–1791.
- 8 Cimasi, 2014, p. 263.
- 9 "Laws Against Health Care Fraud Resource Guide" Centers for Medicare and Medicaid Services, (September 2015) p. 1.
- 10 "Limitation on Certain Physician Referrals" 42 U.S.C. § 1395nn (2010); "Criminal Penalties for Acts Involving Federal Health Care Programs" 42 U.S.C. § 1320a-7b (2015).
- 11 "False Claims Act" 31 U.S.C. § 3729 (2009).
- 12 "Advisory Opinions" Office of Inspector General, U.S. Department of Health & Human Services, <https://oig.hhs.gov/compliance/advisory-opinions/index.asp> (Accessed 11/21/17).
- 13 "Special Fraud Alerts" Office of Inspector General, U.S. Department of Health & Human Services, <https://oig.hhs.gov/compliance/alerts/index.asp> (Accessed 11/21/17).
- 14 "Work Plan" Office of Inspector General, U.S. Department of Health & Human Services, <https://oig.hhs.gov/reports-and-publications/workplan/index.asp> (Accessed 11/21/17).
- 15 Almost all states have provisions against the Corporate Practice of Medicine (CPM). Although the regulated content of CPM provisions vary across states, these laws generally prohibit unlicensed individuals or corporations from engaging in the practice of medicine by employing licensed physicians. "Corporate Practice of Medicine Doctrine 50 State Survey Summary" By Mary H. Michal, J.D., et al., National Hospice and Palliative Care Organization, September 2006, <https://www.nhpco.org/sites/default/files/public/palliativecare/corporate-practice-of-medicine-50-state-summary.pdf> (Accessed 11/27/17), p. 2.
- 16 "General Information" Regulations.gov, <https://www.regulations.gov/faqs> (Accessed 11/10/17).
- 17 A useful source for tracking state legislation is the *National Conference of State Legislatures*, <http://www.ncsl.org> (Accessed 11/21/17).
- 18 "Public Access to Court Electronic Records" United States Courts, www.pacer.gov (Accessed 11/21/17).
- 19 "Missouri Case.net" Missouri Courts, <https://www.courts.mo.gov/casenet/base/welcome.do> (Accessed 11/21/17).




HEALTHCARE VALUATION

THE FINANCIAL APPRAISAL OF ENTERPRISES, ASSETS, AND SERVICES

Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA – CEO, HEALTH CAPITAL CONSULTANTS
Foreword by Shannon P. Pratt

“...the definitive treatise for the complexities of valuation in the healthcare industry.”
– Chris M. Mellen, President - Delphi Valuation Advisors, Inc.



The Adviser's Guide to Health Care


Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA – CEO, HEALTH CAPITAL CONSULTANTS
Todd A. Zigrang, MBA, MHA, FACHE, ASA – President, HEALTH CAPITAL CONSULTANTS

Keep Up With the Changes in Health Care Services and Consulting Practices
Includes Foreword by Leading National Health Care Attorney

David W. Grauer, Esq.
Partner, Jones Day

TWO-VOLUME SET ➤
• Consulting Services
• An Era of Reform - The Four Pillars

To purchase, visit AICPAStore.com/AGHC




ACOs: Balancing Quality and Costs in Healthcare

Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA – CEO, HEALTH CAPITAL CONSULTANTS
Foreword by Peter A. Pavarini, Esq. – Squire Sanders LLP

“A must read and resource for any healthcare industry executive”
—Roger W. Logan, MS, CPA/ABV, ASA, Senior Vice President of Phoenix Children's Hospital

Learn more at  CRCPress.com



(800)FYI - VALU

*Providing Solutions
in the Era of
Healthcare Reform*

Founded in 1993, HCC is a
nationally recognized healthcare
economic financial consulting firm

- [HCC Home](#)
- [Firm Profile](#)
- [HCC Services](#)
- [HCC Experts](#)
- [Clients & Projects](#)
- [HCC News](#)
- [Upcoming Events](#)
- [Contact Us](#)
- [Email Us](#)

HCC Services

- [Valuation Consulting](#)
- [Commercial Reasonableness Opinions](#)
- [Commercial Payer Reimbursement Benchmarking](#)
- [Litigation Support & Expert Witness](#)
- [Financial Feasibility Analysis & Modeling](#)
- [Intermediary Services](#)
- [Certificate of Need](#)
- [ACO Value Metrics & Capital Formation](#)
- [Strategic Consulting](#)
- [Industry Research Services](#)



Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA, serves as Chief Executive Officer of **HEALTH CAPITAL CONSULTANTS (HCC)**, a nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, MO, serving clients in 49 states since 1993. Mr. Cimasi has over thirty years of experience in serving clients, with a professional focus on the financial and economic aspects of healthcare service sector entities including: valuation consulting and capital formation services; healthcare industry transactions including joint ventures, mergers, acquisitions, and divestitures; litigation support & expert testimony; and, certificate-of-need and other regulatory and policy planning consulting.

Mr. Cimasi holds a Master in Health Administration from the University of Maryland, as well as several professional designations: Accredited Senior Appraiser (ASA – American Society of Appraisers); Fellow Royal Institution of Chartered Surveyors (FRICS – Royal Institution of Chartered Surveyors); Master Certified Business Appraiser (MCBA – Institute of Business Appraisers); Certified Valuation Analyst (CVA – National Association of Certified Valuators and Analysts); and, Certified Merger & Acquisition Advisor (CM&AA – Alliance of Merger & Acquisition Advisors). He has served as an expert witness on cases in numerous courts, and has provided testimony before federal and state legislative committees. He is a nationally known speaker on healthcare industry topics, and is the author of several books, the latest of which include: *“The Adviser’s Guide to Healthcare – 2nd Edition”* [2015 – AICPA]; *“Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services”* [2014 – John Wiley & Sons]; *“Accountable Care Organizations: Value Metrics and Capital Formation”* [2013 – Taylor & Francis, a division of CRC Press]; and, *“The U.S. Healthcare Certificate of Need Sourcebook”* [2005 – Beard Books].

Mr. Cimasi is the author of numerous additional chapters in anthologies; books, and legal treatises; published articles in peer reviewed and industry trade journals; research papers and case studies; and, is often quoted by healthcare industry press. In 2006, Mr. Cimasi was honored with the prestigious *“Shannon Pratt Award in Business Valuation”* conferred by the Institute of Business Appraisers. Mr. Cimasi serves on the Editorial Board of the Business Appraisals Practice of the Institute of Business Appraisers, of which he is a member of the College of Fellows. In 2011, he was named a Fellow of the Royal Institution of Chartered Surveyors (RICS). In 2016, Mr. Cimasi was named a *“Pioneer of the Profession”* as part of the recognition of the *National Association of Certified Valuators and Analysts (NACVA)* *“Industry Titans”* awards, which distinguishes those whom have had the greatest impact on the valuation profession.



Todd A. Zigrang, MBA, MHA, ASA, FACHE, is the President of **HEALTH CAPITAL CONSULTANTS (HCC)**, where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 20 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 1,000 transactions and joint ventures. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.

Mr. Zigrang is the co-author of *“The Adviser’s Guide to Healthcare – 2nd Edition”* [2015 – AICPA], numerous chapters in legal treatises and anthologies, and peer-reviewed and industry articles such as: *The Accountant’s Business Manual* (AICPA); *Valuing Professional Practices and Licenses* (Aspen Publishers); *Valuation Strategies; Business Appraisal Practice*; and, *NACVA QuickRead*. In addition to his contributions as an author, Mr. Zigrang has served as faculty before professional and trade associations such as the American Society of Appraisers (ASA); the National Association of Certified Valuators and Analysts (NACVA); Physician Hospitals of America (PHA); the Institute of Business Appraisers (IBA); the Healthcare Financial Management Association (HFMA); and, the CPA Leadership Institute.

Mr. Zigrang holds a Master of Science in Health Administration (MHA) and a Master of Business Administration (MBA) from the University of Missouri at Columbia. He is a Fellow of the American College of Healthcare Executives (FACHE) and holds the Accredited Senior Appraiser (ASA) designation from the American Society of Appraisers, where he has served as President of the St. Louis Chapter, and is current Chair of the ASA Healthcare Special Interest Group (HSIG).



John R. Chwarzinski, MSF, MAE, is Senior Vice President of **HEALTH CAPITAL CONSULTANTS (HCC)**. Mr. Chwarzinski’s areas of expertise include advanced statistical analysis, econometric modeling, as well as, economic and financial analysis. Mr. Chwarzinski is the co-author of peer-reviewed and industry articles published in *Business Valuation Review* and *NACVA QuickRead*, and he has spoken before the Virginia Medical Group Management Association (VMGMA) and the Midwest Accountable Care Organization Expo.

Mr. Chwarzinski holds a Master’s Degree in Economics from the University of Missouri – St. Louis, as well as, a Master’s Degree in Finance from the John M. Olin School of Business at Washington University in St. Louis. He is a member of the St. Louis Chapter of the American Society of Appraisers, as well as a candidate for the Accredited Senior Appraiser designation from the American Society of Appraisers.



Jessica L. Bailey-Wheaton, Esq., is Vice President and General Counsel of **HEALTH CAPITAL CONSULTANTS (HCC)**, where she conducts project management and consulting services related to the impact of both federal and state regulations on healthcare exempt organization transactions and provides research services necessary to support certified opinions of value related to the Fair Market Value and Commercial Reasonableness of transactions related to healthcare enterprises, assets, and services. Ms. Bailey-Wheaton is a member of the Missouri and Illinois Bars and holds a J.D., with a concentration in Health Law, from Saint Louis University School of Law, where she served as Fall Managing Editor for the *Journal of Health Law & Policy*.



Daniel J. Chen, MSF, is a Senior Financial Analyst at **HEALTH CAPITAL CONSULTANTS (HCC)**, where he develops fair market value and commercial reasonableness opinions related to healthcare enterprises, assets, and services. In addition he prepares, reviews and analyzes forecasted and pro forma financial statements to determine the most probable future net economic benefit related to healthcare enterprises, assets, and services and applies utilization demand and reimbursement trends to project professional medical revenue streams and ancillary services and technical component (ASTC) revenue streams. Mr. Chen has a M.S. in Finance from Washington University St. Louis.