

The Due Diligence Imperative

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Healthcare Reimbursement Environment, Part II of VI

In the January/February 2018 issue of *The Value Examiner*, the author provides readers with an overview of the U.S. healthcare reimbursement system and details the due diligence process as it relates to reimbursement. This brief article is an excerpt, which is part of the series on healthcare reimbursement, where the author provides more in-depth explanation of the due diligence process.



Resources:

[Trending Matters in Business Valuation and Healthcare Valuation](#)

[Forms of Physician Practice Reimbursement](#)

[The Imperative of Considering the Concept of Highest and Best Use in Healthcare Valuation](#)

[Healthcare Industry—Trends, Analysis, and its Impact on Valuations](#)

The first 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. Look for the more detailed version in the January/February 2018 issue of *The Value Examiner*.

In part one of this series, the authors also provided a definition of due diligence and the two classes of information generally required for due diligence related to a healthcare valuation engagement. To sum up, 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 to support the purchase price of the business.”^[1]

The two classes of information generally required for due diligence related to a healthcare valuation engagement are as follows:

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]

This second installment will review the due diligence process as it relates to healthcare reimbursement.

Healthcare Reimbursement

Healthcare reimbursement may be defined as the payment received by providers for the services that they render to patients, most of which reimbursement is received from third party payors, e.g., public (government) and private (commercial) payors.^[3] The U.S. government is the largest payor of medical costs, primarily through the Medicare and Medicaid programs; this significant market share allows the U.S. government to exert a strong influence on the healthcare reimbursement environment.^[4] In 2015, Medicare and Medicaid accounted for an estimated \$646.2 billion and \$545.1 billion in healthcare spending, respectively, combining for approximately thirty-seven percent of all healthcare expenditures.^[5] The prevalence of these public payors in the healthcare marketplace often results in their acting as a price setter, i.e., being used as a benchmark for private reimbursement rates.^[6] The healthcare reimbursement environment is currently undergoing a paradigm shift, from reimbursement based on the volume of services provided, to reimbursement based on the value of services provided, which shift was recently manifested in the move away from the sustainable growth rate (SGR), and the passage of the Medicare Access and CHIP Reauthorization Act of 2015 (MACRA). This volatility requires the analyst to conduct a thorough and robust due diligence exercise, as the reimbursement trends of the past may not hold true in the future.

Conducting General Research

In conducting the general research related to the subject interest being appraised, the analyst should first develop knowledge base related to the healthcare reimbursement environment, obtain the data required to benchmark the reimbursement at issue in the engagement, and, based on that, reach an adequate understanding of the pertinent reimbursement trends in the marketplace, all of which will allow the analyst to develop their observations, findings, conclusions, and opinion, and determine any necessary assumptions to be made regarding these future trends related to the subject property interest being appraised. One of the principal valuation techniques for which the general research is used, is reimbursement benchmarking.

Specific Research Resources

Specific research is typically collected from the subject entity, and specifically from the client, or the appropriate contact designated by the client, e.g., chief information officer (CIO), chief financial officer (CFO), or legal counsel, when pertinent. As the requested documents and information are gathered, an engagement-specific database may be useful to appropriately account for the data in a manner that adequately identifies, classifies, and stores it, so that it may be timely and efficiently retrieved for use.

Conclusion

The paradigm shift in the healthcare reimbursement environment is changing the scope and nature of due diligence requests going forward. The due diligence requests have necessarily expanded to include both trends in the subject entity's historical financial performance and financial condition, as well as, more recently, the quality metrics that influence reimbursement rates. The dynamic evolution of the reimbursement environment has already resulted (at least in part) in healthcare transactions becoming increasingly complex and subject to emboldened regulatory review, requiring that the analyst seek and obtain robust general and specific research data in conducting a complete and thorough due diligence process (that will withstand scrutiny) related to the subject property interest being appraised, whether an enterprise, asset, or service.

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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](#) *The Value Examiner*, NACVA (November/December 2017).

[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. 85.

[4] "How the Government as a Payer Shapes the Health Care Marketplace" By Tevi D. Troy, *American Health Policy Institute (AHPI)*, December 1, 2015, http://www.americanhealthpolicy.org/Content/documents/resources/Government_as_Payer_12012015.pdf (Accessed 8/14/2017), p. 1.

[5] "National Health Expenditure Projections 2016–2025—Tables" *Center for Medicare and Medicaid Services*, March 21, 2017, <https://www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/nationalhealthexpenddata/nationalhealthaccountsprojected.html> (Accessed 8/14/17), Table 3.

[6] "Medicare's Role in Determining Prices Throughout the Health Care System: *Mercatus*

Working Paper” By Roger Feldman et al., Mercatus Center, George Mason University, October 2015, <http://mercatus.org/sites/default/files/Feldman-Medicare-Role-Prices-oct.pdf> (Accessed 8/14/2017), p. 3–5.

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