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Health Care Valuations Present Unique Challenges

by David H. Glusman, CPA, CFF, FABFA | Sep 03, 2019

Health care expenditures in the United States will top \$3.5 trillion this year, which is about 18% of the gross domestic product. The provider sector is undergoing dramatic change in the form of mergers, consolidation, and new partnerships. All of these actions require business valuation services.

Quite a few CPAs have business valuation credentials, but it is important to understand the unique nature of valuation within the health care sector. Health care business transactions and financial arrangements – particularly those that could provide financial incentives for the referral of patients to services that are paid by federal health insurance programs – require compliance with three closely related laws: the Anti-Kickback Statute (AKS), the Physician Self-Referral law (commonly called the Stark Law), and the False Claims Act (FCA).

The AKS makes it a crime to offer or exchange anything of value in an effort to induce the referral of patients to services paid by Medicare, Medicaid, or any other federal payor. Violating the AKS is a felony, punishable by a fine of up to \$100,000 and up to 10 years imprisonment. AKS violators are also subject to civil penalties.

The Stark Law is somewhat narrower. It prohibits physicians from referring Medicare patients to providers with whom the doctor (or an immediate family member) has a financial relationship. The rationale is that a financial arrangement may interfere with the health professional's independent medical judgment. The banned referrals apply to a specific list of "designated health services."

The FCA was enacted in 1863 because Congress was concerned that suppliers of goods to the Union Army during the Civil War were defrauding the government by charging too much or providing unnecessary supplies. Most states have statutes essentially identical to the federal one that covers state programs, including medical assistance.

An example of an inducement or incentive for patient referrals would be a hospital paying a physician a monthly sum for patient referrals. This is an illegal kickback. Once a relationship is tainted by an illegal payment, the entity or entities receiving the referrals are prohibited from submitting any claims for medical services to federal health care programs, including Medicare or Medicaid.

The AKS and Stark Law have safe harbors that are exceptions to their prohibited acts. The safe harbors permit some financial arrangements and transactions, as long as specific criteria for each safe harbor are met. For example, one safe harbor allows the sale of physician practices to a hospital. In addition to other requirements, two key elements of this transaction are that the purchase price and any subsequent physician compensation arrangements must be fair market value. Fair market value in health care transactions is governed by traditional valuation principles and methodologies, but it is also governed by extensive federal regulations, guidance, and case-specific advisory opinions issued by the U.S. Department of Health and Human Services Office of Inspector General.

When performing an engagement in which a CPA is providing an opinion regarding fair market value, AKS and Stark Law compliance requires determining whether the consideration and other terms are “commercially reasonable.” When it comes to the AKS, a transaction is generally deemed to make commercial sense if entered into by a reasonable health care provider entity of similar type and size, or a reasonable physician (or group thereof) of similar scope and specialty, even if there were no potential business referrals between the parties.¹

To perform a fair value analysis, the CPA would need to gain an understanding of the reason for the transaction and any referral patterns, past or anticipated, as well as other financial issues between the parties. This review may require a need to engage other experts.

Consider a radiation oncology practice planning to rent space from a hospital system and contracting with a radiation oncologist to provide management services under a long-term contract. The CPA must be able to determine whether the arrangements made are of fair market value, without considering that the radiation oncology facility may give or receive referrals of patients from the hospital system and its affiliated entities. Thus, a real estate expert may be needed to determine the fair market value of the leased space. Separately, the CPA needs to determine the management services being rendered and calculate, by market reference, whether it and the underlying methodology is of fair market value and commercially reasonable. Only with these considerations is the CPA in a position to render an opinion.

CPAs who provide business valuation, due diligence, and investigative accounting services in the health care industry need to be aware of AKS and Stark Law compliance requirements.

1 See preamble to the Stark II, Phase II regulations at 69 F.R. 16093 (March 26, 2004) and OIG Supplemental Compliance Program Guidance for Hospitals at 70 F.R. 4866 (Jan. 31, 2005).

David H. Glusman, CPA, CFF, FABFA, is a partner with Marcum LLP in Philadelphia. He can be reached at david.glusman@marcumllp.com.