Pay Attention to Details When Selling Your Practice

Just a few improvements can result in a big payoff when it comes time to sell.

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The healthcare industry is in a state of confusion and has been for the past 16 years. Physicians are faced with dwindling reimbursement rates, demanding administrative tasks, and hanging federal and local rules and regulations. On the flip side, hospitals and healthcare networks are interested in purchasing physician practices. Should you consider keeping the status quo, turning over many of the administrative headaches, or just retiring all together? As a provider, should you take over or continue a solo practice, join a multispecialty group, or become an employee of a hospital?

Buying or selling a practice can be life-changing. The process is complex, and involves legal, tax, accounting, valuation, and psychological issues. It takes time and due diligence. It involves an entire team of professionals, which can and should include accountants, lawyers, and consultants, all of whom specialize in this area. The intent of this article is to establish a starting point on where and how to begin. It addresses major issues that should be considered in the beginning of this complex process. Whether you are a buyer or a seller, you will face many of the same processes and questions. A host of legal and practical issues will confront you, and this article explores your options.

Preparing to Sell

In the housing market, the old saying goes that the most important thing in pricing a house is location, location, location. In medical practices, location also is important, but because many practices tend to be rentals in the same medical office buildings near a hospital, the better mantra is patients, patients, patients. What you are really selling is access to your patients and the goodwill you have built up with them over the years. For the most part, buyers want to purchase a turnkey operation—a complete package of location, staff, operations, and patients.

It is critical that the practice is valued at a fair market value.

Determining the value of the practice is an important aspect of any sale or purchase. It is critical that the practice is valued at a fair market value. But what determines fair market value? Although "patients" are a key part of selling a practice, patient loyalty is not what it once was. All of that goodwill and the many patient charts you built up over years may not have as much value as you think. In many cases, insurance carriers

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determine which practice a patient uses, because most patients prefer to be in-network rather than pay a premium to keep their physician, especially if that physician will no longer be with the practice.

So, to increase the value of the practice, be sure it is in good shape. As with staging a house before putting it on the market, just a few improvements can result in a big payoff when it comes time to sell your practice. Low costs and efficient operations maximize revenues, and that is the key to selling your practice successfully.

With that in mind, take a close look at your practice operations. What can you do to bring down your overhead? Payroll can be a big expense, and overtime can add considerably to that expense. Do you have a lot of overtime? What can be done to eliminate it? Can staff scheduling be changed so that there is overlap only during the busiest hours of the practice? Perhaps if some staff start and end later than others, it will not be necessary to have staff on overtime when the inevitable emergencies cause the day to run late.

What can you do to trim supply costs? Do you participate in a buying group that will give you group volume discounts? Do suppliers offer discounts for bulk purchases or payments within a certain time? Have you compared suppliers' prices recently? Would longer equipment leases reduce monthly fees? If you are looking to sell, be sure those leases can transfer ownership and that they are included in the sale documents.

Now that your expenses have been trimmed, it's time to maximize your revenue. Most importantly, code accurately for everything you do. Include services that are not usually paid, in case the payer has changed its policy or allows you to bill the patient for non-covered services. Have patients sign waivers for non-covered services that they request, because most payers allow you to collect payment on services that are not covered by benefits, provided that patients have been fully informed and signed a waiver stating that they understand their liability for payment for those services.

Advertise early and as often as you can. Start at least a year ahead of your target date, and advertise everywhere a potential candidate would look.

Collect co-pays and coinsurance. Your agreement with payers requires that you do so. If you waive those fees, you are giving your patient the agreed-upon reduced payer fee and a further reduction of the copay/coinsurance fee. Collect co-pays at the time of service. Be prepared to accept credit and debit cards as well as checks and cash. Set up payment plans, preferably with automatic charges to a credit card on file or debit from a checking account. Finally, clean up your accounts receivables so you know exactly where your practice stands. A low accounts receivable number reveals a lot about yourself as a businessperson and how well your staff is trained at collecting your fees.

Advertise early and as often as you can. Start at least a year ahead of your target date, and advertise everywhere a potential candidate would look. Use the Internet to expand your search. Make sure that you pitch your community, the school systems, and professional associations so that your candidates are getting a full package. Remember, it is not only the buyer you have to impress but perhaps the buyer's spouse/partner as well.

Practice Valuation

With your practice in the best shape possible, hire a practice valuation expert to guide you through understanding the various buying models that exist today. An expert can help value the practice and advise you regarding what to ask for and why. Choose an appraiser who understands the managed healthcare industry. Beware of those with undefined "years" of experience.

Appropriate professionals may include those from the American Society of Appraisers, Institute of Business Appraisers, National CPA Healthcare Advisors Association, Institute of Medical Business Advisors, International Business Brokers Association, and the American College of Healthcare Executives.

Provide the appraiser with your consolidated financial statements for each of the past three to five years (i.e., practice balance sheet, statement of cash flow, net income statement, and statement of operations). Know the difference between tangible and intangible assets. Consider the depreciation of your tangible assets, especially if your specialty involves a good deal of expensive instruments or equipment. Your intangible assets include goodwill, restrictive covenants, and your staff.

Be sure to consider taxes, because it is the after-tax price that counts.

Purchase Price

The purchase price is the primary deal term. Be sure to consider taxes, because it is the after-tax price that counts. Payment terms are almost as important as the total purchase price. For professional practices, usually you use some combination of cash, promissory note, and earn-out (i.e., money that is paid over time based on the practice's post-closing performance). Sellers love cash, and buyers love earn-outs. Also consider who collects the accounts receivable that

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were booked before the closing date. Ask for everything you want, within reason, and negotiate.

Another deal term is legal structure—will it be a stock or asset sale? As a rule of thumb, buyers want to buy assets and sellers want to sell stock. With stock sales, the buyer takes the entire professional corporation, leaving all contracts, assets, and liabilities in place upon assuming ownership. The buyer gets a carryover basis, while the seller pays taxes on the appreciation in his or her shares (with no double-tax). This is why sellers love stock sales.

With asset sales, the buyer takes the assets of the practice but not the liabilities (unless specifically agreed upon). The buyer gets a stepped-up basis in the assets, which is why buyers love asset sales. The seller keeps the unassumed liabilities, and might incur the dreaded double tax (if he or she uses a C corporation)—that is, the corporation pays taxes on the asset sale, then the shareholders pay taxes again when the corporation dividends attribute the remaining purchase price to them.

As negotiations progress, both the buyer and the seller should conduct due diligence in a business-like manner.

Avoiding Stark Violations

If the physician is thinking about continuing to work for the buyer, and especially if the practice being sold is in a position to potentially refer services to the new owner, the Stark self-referral violations and Federal anti-kickback regulations must be looked at closely. Generally, the Stark statute and its regulations prohibit physician referrals of Medicare patients for certain designated healthcare services when there is a financial relationship with the practice to which that patient is being referred.

The federal anti-kickback statute prohibits soliciting, paying, offering, or receiving any remuneration in cash, in kind, directly or indirectly, overtly or covertly, in exchange for referrals of business, to induce referrals, or for ordering, leasing, furnishing, recommending, or arranging for the provision of any services, items, or goods payable by a federal healthcare program.

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The sale of a practice, when the physician remains in a position to send referrals to the purchasing entity, can, in itself, violate these regulations if the physician continues in an employment or independent contract relationship that creates a financial relationship. For anti-kickback purposes, the sale itself can be perceived as in exchange for referrals.

Both laws, however, permit sales and a continued employment or independent contract relationship provided they meet certain requirements, including that the transaction is at fair market value.

Due Diligence

As negotiations progress, both the buyer and the seller should conduct due diligence in a business-like manner. Most buyers of a professional practice have experience in the profession. For the buyer, at a minimum, the following should be reviewed:

- The seller's professional license, for any history of complaints or litigation;
- The practice's financial statements and tax returns for the past three years;
- Whether the seller's relationship with patients can realistically be transferred or if it is so intensely personal that it can't be separated from the seller;
- Any liens, unpaid back taxes (including sales taxes), unpaid workers' compensation, unpaid trust fund taxes, unpaid vacation liability, unpaid bills, and current and potential lawsuits;
- HIPAA and state licensure requirements/violations; and
- Any medical malpractice and federal false claims liabilities.

Deal Documents

Once the practice has been fairly valued and due diligence performed, it is time to get the paperwork completed.

Letter of Intent

The first document in a sale is a letter of intent, also known as a term sheet. A letter of intent can include a good-faith deposit placed into an escrow account until contractual matters are completed and the sale is brought to a close.

The letter of intent usually is not binding on the parties—except for such matters as due diligence procedures and, perhaps, a lock-up or exclusive period during which the seller may not field other offers—and is used to confirm basic deal terms.

The Purchase Agreement

Once the parties agree to the basic terms of the deal, they can move on to the binding deal documents. In the purchase agreement, the seller makes representations about the practice, such as providing some type of formal confirmation that the practice is not involved in any type of litigation.

Representations are not a substitute for due diligence, but they do provide additional security to the buyer by allowing the buyer to recover some of the purchase price if any of the representations are materially misleading, such as the seller not disclosing certain liabilities.

Non-Compete Agreement

The last important piece is the non-compete agreement, unless the seller will continue as an employee or part of the larger group purchasing the practice.

Disposition of Medical Records

A major part of the buyer's purchase is the transfer of the practice's medical records. With respect to HIPAA, it is generally permissible for a physician to transfer records from his or her practice to the purchasing physician or entity, since the new physician(s) will need these records to continue caring for the patients or for hospital care operations which include management and administration of the practice. For the purpose of federal law, physicians should plan to retain records for at least six years from the date of treatment to respond to false claims actions, malpractice, or any claims of overpayment. It is not unusual for a retiring physician to consign the records to a custodian on agreement to provide him or her with access as needed.

Patient Notification

When a practice is sold or taken over by a hospital or larger entity, patients need to be notified and given the opportunity to take their records elsewhere. A letter from the selling doctor to all the patients of record, introducing the new physician, can be much more valuable than the new doctor attempting to introduce himself or herself.

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Summary

Physicians must be cognizant of the requirements and hurdles they face regarding the sale of their practice and the mandatory steps needed in a sequential order. It is recommended that regardless of the arrangements with the buying physician or entity, they get the right team of professionals in place.

The value of anything is a relative concept, and, to some extent, a matter of perspective. The fact that you and your appraiser can demonstrate a particular value for your practice with hard calculations does not guarantee that you will find someone to pay you that much. Remember that the devil is in the details, so pay attention to all of the details and make sure that you retain a set of professionals to guide you through this process. **PM**

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