

# Valued News



**TRINITY**  
Valuation Consulting Group, PLC

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## *Considerations of a Physician Practice Valuation*

By



E. Wayne Kirk,  
CPA, CVA

Mr. Kirk has 40 years of experience in the healthcare industry and has been actively involved with the valuation of companies since 1990. He is often sought after to assist businesses, including medical practices and other healthcare entities, during ownership transitions.

Physician practices are valued for a number of reasons, but most commonly they are valued for buy-ins and buy-outs of physician owners, divorce, or hospital acquisitions. Generally, physician practices are valued at fair market value which is defined as “the price at which the property or service would change hands between a willing buyer and a willing sell, neither being under a compulsion to buy or sell and both having reasonable knowledge of the facts.”

The Stark Laws which are applicable in most hospital acquisitions more broadly refines the definition of fair market value as “the price that an asset would bring as the result of bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party, or the compensation that would be included in a service agreement as the result of bona fide bargaining between well informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement.”

Valuing any type of business can be a difficult task that takes a breadth of knowledge and industry expertise. However, in order to successfully value a physician practice, one must be fluent in the language of healthcare. There are a myriad of differences between a physician practice valuation and the valuation of any other type of professional practice. Selecting an experienced healthcare appraiser helps to ensure an appropriate conclusion of value. The healthcare industry is currently undergoing unprecedented changes as a result of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. These changes further necessitate the need for an experienced healthcare appraiser that stays abreast with ever changing regulation. Otherwise, a transaction relying upon an inappropriate conclusion of value could result in regulatory violations such as the federal Physician Self-Referral Law (Stark Law) , the Anti-Kickback Statute , or the private inurement restrictions imposed by the IRS.

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## Trinity's Other Principals Also Have Extensive Healthcare Experience

### Jason Fleming, CPA/ABV/CFF

Before joining Trinity, Mr. Fleming worked as a consultant for a large regional healthcare consulting firm. In addition to valuing healthcare entities such as physician practices, diagnostic imaging centers, and ambulatory surgery centers, he valued and assessed the fair market value of physician compensation and other physician hospital alignment strategies such as medical directorships, physician consultants, joint venture arrangements, co-management agreements, and equipment and facilities leasing between physicians and hospitals.



### Travis McMurray, CPA/ABV/CFF, CMA/CFM, MBA

Mr. McMurray has been with BCS since 1992 and has worked with numerous clients in the healthcare industry ranging from small medical offices with one physician to small hospitals. His experience includes tax, valuation and management consulting. Mr. McMurray has worked with many different specialties as well as multi-specialty practices.



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Instrumental in any business valuation is the process of analyzing the financial statements and other financial data. This process includes but is certainly not limited to evaluating the following components. Understanding these components and how they work can help you add value to your practice.

- **Revenue** - most physician practice financial statements are prepared on the cash basis of accounting. Accordingly, patient revenue is typically representative of collections and is net of contractual allowances. This must be ascertained and not assumed.
- **Reimbursement rates** - commercial rates are typically tied in some manner to Medicare rates; Medicare rates are subject to the legislation and political process.
- **Physician productivity** - this can be determined or benchmarked using a number of measures including gross charges, collections, visits, procedures, etc. However, one of the more effective measures of physician productivity is work relative value units ("wRVUs") which provides an indication of the time, patient acuity, and efficiency of a particular procedure. Many physician practices do not have software that tracks wRVUs so it becomes necessary for the healthcare appraiser to calculate this important measure of productivity. This can be done by using the physician's current procedural terminology (CPT) codes, code modifiers, and the number or frequency of the CPT codes performed for a given period.
- **Payor mix** - practices with a high percentage of commercial payors as opposed to self-pay and Medicare, typically generate higher collections.
- **Utilization of physician extenders** - practices that employ physician assistants or nurse practitioners are generating value added revenue; that is revenue that does not have to be produced by the physician. All things equal, these practices tend to have a higher value.
- **Ancillary diagnostic services** - practices that have laboratory facilities or testing equipment, again, generate value added revenue that does not have to be generated as a result of the physician's time with the patient. As stated, these practices tend to have a higher value.

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- **Practice collections** - just because a physician bills for visits or procedures does not mean those billed amounts will be collected. Practices that actively manage their collections reap the benefits of higher collections which equates to higher revenue when on a cash basis of accounting. Under the premise of fair market value, it is important for the appraiser to review how well the practice manages its collections. If it is being done poorly, resulting in low revenue, adjustments may have to be made under the assumption that a hypothetical buyer, under the definition of Fair Market Value (FMV), would manage the receivables at least at an industry median benchmark level.
- **Physician compensation** - this is typically the largest expense item on a practice's income statement. It is important for the appraiser to benchmark the physician's productivity to ensure that the compensation being paid is consistent with the physician's productivity.
- **Rent expense** - the facilities of many physician practices are owned by a related party. The appraiser must ensure that these transactions are occurring at fair market value.
- **Accounts receivable** - if the practice is on a cash basis, the appraiser will need to make an adjustment to add net collectible receivables to the balance sheet. In order to do so one must determine whether the amounts are presented at gross or net of contractual allowances. Then the collectability of the receivables must also be considered.
- **Medical and office supplies** - for a cash basis practice, these amounts are typically expensed when purchased instead of being recorded on the balance sheet and expensed as used. These amounts are not always nominal and must be considered as part of the balance sheet analysis.
- **Fixed assets** - depending upon the specialty, the business appraiser should consider whether an equipment appraiser is needed to ascertain the value of the equipment used in the practice. Electronic medical records (EMR) - the appraiser must assess the practice's timeline of 1) implementation and 2) regulatory compliance and also the practice's capital commitment.
- **Accounts payable** - again, for a cash basis tax payer, this amount will have to be determined as part of the balance sheet analysis.

We have just given a brief overview of just a few of the financial or quantitative items that must be considered in a physician valuation. Non-financial considerations must also be assessed. These include but are certainly not limited to, assessing local patient demographics (i.e. the needs of the community), demand for the particular physician specialty under consideration and whether the community's needs are being met, the number of competing practices and how the subject practice differentiates itself, and hospital recruiting strategies.

There are three general approaches for determining the value of any business: 1) market approach, 2) asset approach, and 3) income approach. There are also a number of acceptable methodologies within each of these approaches. Although the details of these approaches are outside of the scope of this article, it is essential that the appraiser understand that not all methods or approaches are suitable for a physician practice. An experienced healthcare appraiser will employ the approach and methodology that provides the most appropriate conclusion of value for the practice given the current facts and circumstances.

## **Trinity Partner Appointed to Leadership Role**

Jason Fleming has been appointed to serve on the Business Valuation, Forensic & Litigation Committee for the Tennessee Society of Certified Public Accountants (TSCPA) beginning in June 2011.

# Trinity Is Making Its Mark

It has been just a few short months after our inception, and Trinity has been well received as measured by both the feedback from business owners and their financial and legal advisors and even more telling by the number of projects we have worked on over the last few months. Our work load has consisted of business valuations for a variety of reasons, business transaction consulting, exit planning, and the calculation of economic damages.

## *Getting the Word Out About Trinity*

Despite the positive reception and numerous projects with which we have been blessed, we concede that there is still a significant amount of work to be done in getting the message out about Trinity which includes:

- solidifying our commitment to being a resource center for the financial and legal community,
- reiterating our dedication to serve our professional peers and not be in competition for their services,
- demonstrating our independence and providing assurance to advisors that their client relationships are safe with us regardless of any affiliations we may have with other financial service providers, and
- demonstrating the breadth of services and depth of expertise we provide.

## Resource Center

We continue to strive to be a resource center for the financial and legal community and the clients they serve. Since Trinity's inception, we've met with countless attorneys, CPAs, and financial advisors to help us better assess their needs and the needs of their clients so that we can fulfill our commitment to being a resource center for them. We have truly enjoyed meeting with the numerous individuals and firms and are grateful for their time and feedback. We welcome the opportunity to meet with others. Please accept our open lunch invitation by giving us a call or sending us an email. Your thoughts are important to us and we look forward to meeting with you.

## Commitment to Serve Our Peers

Although our professionals are CPAs, Trinity does not provide traditional accounting services such as audit, tax, or bookkeeping. We seek to serve our professional peers and are not in competition for the services they are providing. Our exclusive focus is business valuations, litigation support, business transactions, and other non-traditional consulting services.



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## Independent Service Provider

One of the most important messages that Trinity can convey is that we value the trust that an attorney, CPA, or financial advisor places in us when they refer their client to us. It is our obligation to provide exemplary service and respect the relationship between that professional and their client. We look forward to illustrating this commitment by example.

## Breadth of Services & Expertise

**Business Valuation Services** - Business valuations are performed for a variety of reasons including estate/gift tax planning, divorce, and shareholder disputes. Whatever the reason, it is important to select a valuation firm that has the experience necessary to develop an appropriate conclusion of value. At Trinity, our valuation professionals have performed hundreds of business valuations that have been accepted by mediators, the courts, and the IRS. In addition to being Certified Public Accountants (CPAs), our professionals hold professional valuation credentials such as the Certified Valuation Analyst (CVA) credential from the National Association of Certified Valuation Analysts (NACVA) and the Accredited in Business Valuation (ABV) designation from the American Society of Certified Public Accountants (AICPA).

**Litigation Support Services** - When preparing for litigation, it is important to select an expert witness that is experienced and respected. The professionals at Trinity are well respected for their many years of experience in providing independent analyses and expert witness testimony. Our professionals have served in matters of mediation and arbitration. We also have been retained jointly by opposing attorneys and have served as court appointed experts. Our credentials, expe-

rience, and integrity have been utilized for many litigation cases including loss profits, shareholder disputes, and marital dissolution.

**Business Transaction Services** - Our merger and acquisition specialists at Trinity have been involved in a variety of business transactions. Without professional expertise, many businesses do not sell. We work with business owners to make changes that will help ensure a successful outcome. We can assist in the negotiation process. We also assist buyers with performing their due diligence so that they know they are getting what they are paying for. There are many advantages to having a professional represent your business during a transaction. Our experience helps to ensure you receive the price that your business is worth. We also serve to take the business owner out of the often emotional process of dealing with potential buyers.

**Other Consulting Services** - Our professionals have a breadth of experience to offer. We can assist clients with exit planning strategies, building company value, structuring buy-sell agreements, and ensuring an optimal capital structure. Exit planning is a crucial but often over looked component of a business plan. Even if you plan on leaving the business to your children or other family, this transaction needs to be properly structured. Trinity can help you identify potential successors and can help structure the transaction to meet your needs. Many owners dedicate their entire lives to building a business but few truly focus on building the value of the business. Growing the business does not necessarily translate to increasing value. Trinity can put you on track to maximize the value of your business.

*Striving to Be the  
Resource Center for  
Attorneys and CPAs.*

# Case Law

## **King v. King**

**Court of Appeals of Kentucky**

### **Physician Practice / Divorce**

The primary issue before the Kentucky Supreme Court was the value of the husband's OB/GYN practice. At trial, the wife's expert estimated the value of the practice using the capitalization of excess earnings method and relying on data published by the Medical Group Management Association ("MGMA"). The wife's expert calculated a value for the practice, as well as a value of the practice's goodwill. The husband's expert did not rely on MGMA data; instead relying on data provided by a local OB/GYN. The expert noted that there was a shortage of OB/GYNs in the area and noted that the husband worked about 15.4 percent more hours than the peer doctor. The trial court accepted the wife's valuation of the practice, to which the husband appealed, claiming his expert's valuation was better because it recognized his excess hours and the shortage of doctors.

The appellate court agreed, stating that the new rule from the *Gaskill v. Robbins*, 282 S.w.3d 306, court required consideration of the distinction between personal and enterprise goodwill. Neither expert distinguished between personal and enterprise goodwill. Both experts also testified that the husband's higher compensation resulted from his own work ethic and dedication, "personal assets that are neither transferrable, nor have value to others." The appellate court noted that any value of the practice attributable to personal goodwill, including his work hours, "in excess of the norm of the profession" must be excluded when valuing the husband's practice. The case was remanded back to the trial court for re-determination of the value of the husband's practice. The court noted that the trial court was not foreclosed from relying on the methodology utilized by the wife's expert. The court noted that the capitalization of excess earnings method was widely used and that the MGMA survey was approved by a prior Kentucky court in *Clark v. Clark*, 782 S.W.2d 56.

*No. 2007-CA-002149-MR and NO. 2007-CA-002199-MR August 14, 2009, rendered*

## **Blackburn v. TKT and Associates, Inc.**

**Supreme Court of South Carolina**

### **Application of Valuation Standards**

The following dissenting shareholder case was brought by two shareholders who claimed that the other two shareholders were draining profits by paying themselves excessive salaries. The trial court found in favor of the plaintiffs and permitted the defendants to purchase their interests in the medical equipment company at statutory fair value. The parties agreed on an appraiser and a valuation method (selecting an income method). The appraiser's engagement letter specifically stated that his analysis would conform to the Statement of Standards for Valuation Purposes as well as the professional standards of the National Association of Certified Valuation Analysts. The appraiser did not normalize the defendants' salaries. Failure to make the adjustments contradicted the trial court's specific findings, effectively rewarding the defendant owners for their misconduct. Further, both the AICPA and NACVA professional standards require normalization adjustments as a "key step" in the income approach. The Supreme Court of South Carolina agreed with the plaintiffs' argument that some normalization adjustment was warranted. In reaching their decision, the Supreme Court judge reviewed the appraiser's report, as well as both NACVA and AICPA valuation standards.

*387 S.C. 589; 693 S.E.2d 919 May 24, 2010, filed*

Visit our website at [www.TrinityVal.com](http://www.TrinityVal.com) to view additional cases.

# We Would Love to Hear From You!

Have a specific topic you would like to see in a future newsletter? Send us an email and let us know.

Also, go to our website to sign up to receive emerging business valuation news and case law related to estate/gift tax, divorce, economic damages, lost profits and business transactions.

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Follow Trinity on LinkedIn - Send Wayne, Jason or Travis an invite

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## COST OF CAPITAL

Treasury Yields <sup>1</sup>	4-Week: 0.01%	<sup>1</sup> Federal Reserve Board - Economic Research and Data , as of May 13, 2011
	5-Year: 1.86%	
	20-Year: 4.03%	
Prime Lending Rate <sup>2</sup> (U.S. Effective Date: 12/16/2008)	3.25%	<sup>2</sup> Federal Reserve Board - Economic Research and Data , as of May 13, 2011
Dow Jones Industrial Average <sup>3</sup>	12,595.75	<sup>3</sup> The Wall Street Journal - Stock Indexes: Closing Data Bank, as of May 13, 2011
LIBOR (US) <sup>4</sup>	1-Month: 0.20%	<sup>4</sup> The Wall Street Journal, as of May 13, 2011
	6 Month: 0.42%	
	1-Year: 0.74%	
S & P 500 P/E Ratio <sup>5</sup>	16.58	<sup>5</sup> The Wall Street Journal - Market Data Center - P/E Ratios on Major Indexes , as of May 20, 2011
Tax Exempt Municipal Bonds <sup>6</sup> (AAA Insured)	10-Year: 3.30%	<sup>6</sup> FMS Bonds, Inc. - Municipal Bond Specialists - Bond Market Yields, as of May 20, 2011
	20-Year: 4.50%	
	30-Year: 4.80%	
CPI Annual Growth Rate <sup>7</sup>	3.20%	<sup>7</sup> Bureau of Labor Statistics - Economic News Release - CPI - April 2011, as of May 13, 2011

# Recent Successful Engagements



Acquired By



Trinity facilitated the sale of Kingsport based Integra-Seal Industries, LLC to Portola Packaging, Inc. in March 2011. Integra-Seal and Portola both manufacture tamper-evident closures and packaging, among other products. Portola is an international company with locations throughout the world. Trinity partner, Wayne Kirk assisted Integra-Seal with positioning the company for sale and structuring the transaction. Mr. Kirk has been providing business transaction services for over 25 years and helping guide companies to the point that a desired exit strategy can be executed.

[All information above was presented with permission of all parties]

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## Independent Pharmacy Changes Ownership

Trinity facilitated the sale of an independent pharmacy in the Greater Tri-Cities region in early 2011. Trinity partner, Travis McMurray valued the company and assisted with the negotiations and deal structure. Furthermore, in preparing the purchase price allocation, McMurray relied upon his tax and valuation of intangible assets expertise to distinguish between personal goodwill and company goodwill thus minimizing the seller's tax burden from the transaction. Mr. McMurray has extensive experience in business tax and the structuring of transactions in relation to allocation of purchase price.

[Confidentiality was requested by the parties of this transaction]



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## *Considerations of a Physician Practice Valuation*

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