



Fair Market Value for Physician Compensation Arrangements

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Disclosure:

- Kirk A. Rebane is co-owner of Haverford Healthcare Advisors and part owner of Aurora Diagnostics, LLC.
- Kirk A. Rebane is a consultant to various imaging centers and radiology practices.



Learning Objectives:

Attendee should be able to:

- Know situations when you need to be concerned that physician and ancillary agreements are priced at fair market value
- Discover methods of determining whether existing compensation rates are within a reasonable range of fair market value
- Know factors that influence the fair market rate when determining the pricing of such physician and ancillary agreements.



Introduction

- In the 1980's, physician incomes felt additional negative pressure due to:
 - beginning of Medicare's reimbursement scrutiny
 - the rise of managed care
 - increase in the number of physicians
 - increased competition between specialties, including radiology



Introduction (Cont.)

- In the 1990's, there was a paradigm shift from an inpatient setting to an outpatient setting.
- Into the 21st century, there was an explosion of available information via the Internet.
- The passage in 2010 of the healthcare reform act led to further increased pressures on compensation.



Introduction (Cont.)

- There is a renewed trend toward hospitals employing physicians.
- Evolving patient care models, such as accountable care organizations, may lead to forms of physician compensation which focus on quality metrics, utilization goals, sharing cost-savings, etc.



Introduction (Cont.)

- All of these industry factors have increased the downward pressure on hospital profits and physician compensation.
- Economic interests can compromise a physician's professional judgment.



Introduction (Cont.)

- The increased concern with physician compensation and self-referrals has led to an increase in regulatory scrutiny of financial relationships between physicians and hospitals, and between physicians and physicians.



Regulatory Scrutiny

- Compensation, not payment for referrals
- Whenever a physician or a physician group receives compensation in exchange for providing professional services to or on behalf of a hospital, the physician is deemed to have a financial relationship with the hospital.



Regulatory Scrutiny (Cont.)

- Financial relationships and compensation arrangements are regulated by:
 - Stark laws
 - Anti-kickback regulations
 - False Claims Act
 - The IRS



Regulatory Scrutiny (Cont.)

- The regulatory efforts regarding compensation arrangements are increasingly focused on fair market value and commercial reasonableness.
- In financial relationships between hospitals and physicians, Stark laws and regulations require that compensation be consistent with fair market value.



FMV and Commercial Reasonability (Cont.)

- The IRS prohibits 501(c)(3) tax exempt entities from operating other than for charitable purposes. Hence, the IRS prohibits payments in excess of fair market value.
- Stark law defines fair market value as the “value in arm’s length transactions, consistent with the general market value.”



FMV and Commercial Reasonability (Cont.)

- For a service agreement, “general market value” is defined as “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” at the time of the service agreement.



FMV and Commercial Reasonability (Cont.)

- The fair market price is the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement, where the price or compensation has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals.



FMV and Commercial Reasonability (Cont.)

- CMS defines “commercially reasonable” as an arrangement that would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician of similar scope and specialty, even if there were no potential business referrals between the parties.



FMV and Commercial Reasonability (Cont.)

- To be commercially reasonable, both the services and the payment must be commercially reasonable.
- Reasonable compensation is the amount that would ordinarily be paid for like services by like enterprises under like circumstances (IRC Section 162).



FMV and Commercial Reasonability (Cont.)

- Fair market value is defined by the American Society of Appraisers in their Business Valuation Standards, which closely parallels the definition set forth by the IRS in their Revenue Ruling 59-60, as the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is acting under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.



FMV and Commercial Reasonability (Cont.)

- Financial arrangements can be set at fair market value but not be commercially reasonable, and vice versa.



Compensation Arrangements

- Administrative Services
- Admin, Supervisory, & Teaching Svcs (“AS&T”)
- Call-Coverage Services
- Employed Physician Comp Arrangements



Compensation Arrangements (Cont.)

- Lease Agreements (for equipment, space, or staffing)
- Management Services Agreements
- Medical Director Services
- Professional Services Agreements



Establishing Fair Market Value

- “Ultimately, fair market value is determined based on facts and circumstances. The appropriate method will depend on the nature of the transaction, its location, and other factors.” (Federal Register, Vol. 72, No. 171, CMS, 42 CFR Parts 411 and 424, September 5, 2007).



Establishing Fair Market Value (Cont.)

- Three basic approaches to valuation (of any type of asset, contract, or business):
 - the income approach
 - the market approach
 - the cost approach



Establishing FMV: The Income Approach

- The income approach projects future cash flows to be generated by an asset or contract, and then discounts those future cash flows back to present value in order to account for the time value of money and the risks associated with actually achieving those projections.
- Given that there are significant regulatory concerns regarding paying for future referrals, the use of an income approach is typically not appropriate in determining the FMV of compensation.



Establishing FMV: The Income Approach (Cont.)

- Do a final sanity check on the remaining profitability of the payor to make sure the remaining profits are within normal range (this goes toward supporting commercial reasonability and economic sense).



Establishing FMV: The Cost Approach

- The cost approach measures the investment that would be required to create a replica or replacement of the subject property or subject income-producing vehicle.
- The cost approach is based upon the Principle of Substitution – when several similar or commensurate services are available, the one with the lowest price will attract the greatest demand.



Establishing FMV: The Cost Approach (Cont.)

- The cost approach does not directly consider (a) the amount of economic benefits that can be achieved, (b) the time period over which they might continue, (c) the trend of the economic benefits, or (d) the risk associated with actually receiving the economic benefits.
- Estimate the cost to perform tasks by internally-employed personnel, using published compensation studies as well as client information.



Establishing FMV: The Cost Approach (Cont.)

- Estimate the time required to perform the exact range of tasks through the analysis of the physicians' work logs, or the review of RVU history.
- Adjust the comp data for inflation, specialties, benefits, region, etc.
- Do a final sanity check on the remaining profitability of the payor to make sure the remaining profits are within normal range (this goes toward supporting commercial reasonability and economic sense).



Establishing FMV: The Market Approach

- The market approach provides an indication of value by comparing the price at which similar property has exchanged between willing buyers and sellers.
- One looks at prices paid for comparable properties, and must make adjustments to reflect the degree of comparability.
- The market approach also is based upon the Principle of Substitution.



Establishing FMV: The Market Approach (Cont.)

- Collect information related to comparable agreements for similar services, either within the particular healthcare system in question or within the greater marketplace.
- Analyze the specific facts and circumstances of such comparable agreements.
- Adjust the market compensation data for inflation, specialties, benefits, and other factors in order to ensure comparability.



Establishing FMV: The Market Approach (Cont.)

- Beware of tainted market data.
- Do a final sanity check on the remaining profitability of the payor to make sure remaining profits are within the normal range (this goes toward supporting commercial reasonability and economic sense).



Establishing FMV: The Survey Approach

- Stark II, Phase II regulations added a safe harbor for fair market hourly compensation which to a large degree was based on comparable compensation market data contained in surveys, also called the Survey Approach.
- Stark II, Phase III eliminated FMV safe harbors, but noted “reference to multiple, objective, independently published salary surveys remains a prudent practice for evaluating fair market value”.



Establishing FMV: The Survey Approach (Cont.)

- Survey firms to use for survey data include, but are not limited to:
 - The Medical Group Management Association – www.MGMA.com
 - Sullivan Cotter and Associates, Inc. – www.SullivanCotter.com
 - Hospital & Healthcare Compensation Services – www.HHCSINC.com
 - Integrated Healthcare Strategies (f/k/a Clark Consulting) – www.IHStrategies.com



Establishing FMV: The Survey Approach (Cont.)

The Survey Approach (Cont.)

- Towers Watson (f/k/a ECS Watson Wyatt Data Services) – www.TowersWatson.com
- The Hay Group – www.HayGroup.com
- William M. Mercer – www.Mercer.com
- American Medical Group Association – www.AMGA.com



Establishing FMV: The Survey Approach (Cont.)

- Certain surveys break down their annual compensation and/or hourly rates by specialty, practice setting (such as group practice vs. academic vs. hospital employed), by position level, by region or state, and for different percentiles such as 25th, median, and 75th.
- Surveys may include total compensation from all sources, including ownership profits and ancillary profits, so care must be taken in the application of the data.



Establishing FMV: The Survey Approach (Cont.)

- The Stark law guidelines recommend determining an hourly compensation rate by using an average of compensation data at the 50th percentile level, on a national basis, for physicians in the same specialty from multiple surveys and dividing this average by 2,000 hours.



Establishing FMV: The Survey Approach (Cont.)

- There are limitations to the survey data, some of which are pointed out within the Stark law:
 - there is generally a lag of one and two years between the collection and reporting of compensation survey data –may not reflect current market conditions
 - the 50th percentile national compensation data may not be applicable depending on the skill level and experience of a particular physician



Establishing FMV: The Survey Approach (Cont.)

- many of the surveys are based on employment compensation data and, hence, do not reflect the higher costs incurred by independent contractors (e.g., taxes, benefits, insurance)
- survey data for a general region may not reflect higher or lower wage rates that may prevail in distinct parts of that region



Establishing FMV: The Survey Approach (Cont.)

- the Stark Law Safe Harbor Approach uses an average of the median data from multiple surveys to determine fair market value.
- the surveys reflect a view of the general market for physician services and may not reflect the unique facts and circumstances of a particular physician arrangement.
- in certain surveys, certain specialties will have too small sample sizes for reliance, especially on a regional basis.



Establishing FMV: The Survey Approach (Cont.)

- It is critical to understand how the various physician compensation surveys gather and report their financial information on compensation.
- Do not cherry-pick survey data.



Establishing FMV: The Survey Approach (Cont.)

- Apply the survey-derived hourly compensation rate to the estimated number of hours required to provide a particular service – work logs can provide a great deal of information and support.
- Note that the MGMA points out that there is an inverse relationship between physician compensation and compensation per wRVU.



Establishing Fair Market Value (Cont.)

Correlation and Conclusion

- If more than one approach is conducted, the results of each approach must be correlated into a single, justifiable conclusion.
- Once the total FMV is determined, then that opinion can be bifurcated, if need be, into the fixed component and the variable component.
- Verify that compensation components from separate fee arrangements do not overlap or provide duplicate payment for identical services.



FMV for Physician Compensation

- Physician compensation agreements have many components.
- Market and competitive factors must be considered.
- FMV can be estimated based on industry percentile rankings (market benchmarks) for compensation and productivity (wRVU).



FMV for Physician Compensation (Cont.)

- All sources of compensation, including benefits, should be aggregated in considering compliance.
- Compensation used to be a base salary – then it became base salary plus some wRVU productivity incentive. Now, compensation will be impacted by a quality incentive.



FMV for Physician Compensation (Cont.)

- Base salary is intended to provide stable and predictable income levels. Base salary is for the provision of clinical services.
- Incentive compensation plans are designed to recognize and reward for physician productivity for personally provided services, predetermined quality metrics, and patient satisfaction. Incentive plans are not intended to reward for future referrals.



FMV for Physician Compensation (Cont.)

- It must be remembered that adding performance-based quality compensation can not increase total compensation beyond FMV.
- Annual adjustments, including cost of living adjustments, may be included in contracts as long as the resulting compensation continues to be fair market value.
- Do a final sanity check on the remaining profitability of the payor to make sure remaining profits are within the normal range, i.e., is there a reasonable rate of return for the employer?



FMV Allocation of Global Billings

- Need to determine the fair market allocation of global reimbursement which is economically reasonable, satisfies applicable legal and regulatory criteria, and complies with national standards for the profession.
- The allocation can be set in aggregate (for administrative convenience) or by each type of procedure.
- The starting point is typically based on an analysis of the then-most recently available Medicare-established RVUs for each CPT code, as published by CMS.



FMV Allocation of Global Billings (Cont.)

- Utilize historical or projected procedure mix.
- Determine the weighted average technical component / professional component fee split.
- The analysis assumes that every other payor (other than Medicare) will make payments for a given CPT code with the same relative TC/PC allocation as Medicare.



FMV Allocation of Global Billings (Cont.)

- The “as-calculated” global allocation may need to be adjusted for:
 - medical director services and requirements
 - billing and collection fees
 - professional supervision services and requirements
- Allocation of global reimbursement could change over time due to:
 - change in procedure mix, volume, and modalities
 - change in CMS compensation schedules
 - incorrect assumptions in start-up business plans
 - other issues



FMV Allocation of Global Billings (Cont.)

- Prudent to have certain measurement dates for look-back provisions and to allow for adjustments to the allocation of global reimbursement.



FMV for Administrative Services

- Valuation of administrative services should take into consideration a number of factors, including:
 - the scope of services required, including the specific duties and responsibilities required for those services
 - time sheet records of time and work spent on each administrative function
 - the number of, and scope of, committees and meetings that require the physician's involvement



FMV for Administrative Services (Cont.)

- each task may involve the need for medical knowledge and experience and/or business and management knowledge and experience
- FMV for administrative services could be based on opportunity costs
- However, Stark's Phase III regulations recognize a distinction between clinical and administrative services with regard to physician compensation. Clinical services may very well warrant higher compensation.



FMV for Administrative Services (Cont.)

- FMV for administrative services could be based on what the hospital is typically paying to other qualified professionals for similar services.
- Annual adjustments, including cost of living adjustments, may be included in contracts as long as the resulting compensation continues to be fair market value.
- Do a final sanity check on the remaining profitability of the payor to make sure remaining profits are within the normal range, i.e., is there a reasonable rate of return?



FMV for Call-Coverage Services

- Over half of healthcare systems use call-coverage compensation of some form.
- Valuation of call-coverage services should take into consideration a number of factors, including:
 - the number of call-coverage hours per week
 - the frequency of call provided, and the manner in which physicians respond to call - via telephone or in person



FMV for Call-Coverage Services (Cont.)

- Valuation factors to be considered (Cont.)
 - the actual burden on the physicians, including whether call-coverage is on weekdays or weekends, and the likelihood of actually being called in when on call
 - the degree to which there is a legitimate need for call-coverage within a particular specialty
 - the level of trauma, or severity of the illness, when called in, and the frequency in which the physician will have to provide inpatient care to patients admitted from the emergency department



FMV for Call-Coverage Services (Cont.)

- Valuation factors to be considered (Cont.)
 - The payor mix of the patients, and the likelihood that care will have to be provided for an uninsured patient
 - The nature of the call: restricted call, or unrestricted
 - Does the arrangement include concurrent call-coverage for multiple hospitals?
 - All other agreements for other similar arrangements at the employer entity



FMV for Call-Coverage Services (Cont.)

- Benchmarks for call-coverage stipends are not readily available, although information is more available than previously.
- Call-coverage analyses must also take into account the difficulty which hospitals often face in securing coverage, as more and more physicians are focused on lifestyle balance.
- Make sure that the call-coverage payment system has not been structured in a way that compensates the on-call physician for professional services for which separate reimbursement from insurers or patients is received.



FMV for Call-Coverage Services (Cont.)

- Annual adjustments, including cost of living adjustments, may be included in contracts as long as the resulting compensation continues to be fair market value.
- Do a final sanity check on the remaining profitability of the payor to make sure remaining profits are within the normal range, i.e., is there a reasonable rate of return?



FMV for Medical Director Services

- Although the Stark safe harbor method of utilizing combined data from multiple surveys has now been eliminated, such a technique still provides useful information.
- Understand the nature and scope of the services required, the size and complexity of the department in question, and the type of specialty.
- Understand the qualifications and duties required.



FMV for Medical Director Services (Cont.)

- Estimate the number of work hours required to provide the necessary services.
- Analyze the surveys to determine the appropriate market rate of compensation, making sure such a rate is fully loaded and represents current rates.
- Medical directors tend to be leaders in their specialty and therefore are often more productive than the average physician.



FMV for Medical Director Services (Cont.)

- Physicians may be eligible for incentive compensation, based on predetermined metrics related to quality.
- Be aware of the impossible day.
- Annual adjustments, including cost of living adjustments, may be included in contracts as long as the resulting compensation continues to be fair market value.



FMV for Medical Director Services (Cont.)

- Do a final sanity check on the remaining profitability of the payor to make sure remaining profits are within the normal range, i.e., is there a reasonable rate of return?



FMV for Management Services

- Using a cost approach, the FMV of the management fee can be established by determining the estimated number of work hours needed to provide the management services, the various types of personnel required to provide such services, and the FMV hourly rate for each type of personnel.



FMV for Management Services (Cont.)

- Factors that can influence the FMV include:
 - size of the service being managed
 - complexity of the service being managed
 - scope of services being provided
 - number and type of personnel required to provide management services
- A market analysis should be conducted by job function.



FMV for Management Services (Cont.)

- A profit component should be included as if the management services were being provided by a third-party.
- The fixed versus variable nature of management services needs to be examined.
- Prudent to have a look-back provision to allow for periodic adjustments in management fees.



FMV for Management Services (Cont.)

- Annual adjustments, including cost of living adjustments, may be included in contracts as long as the resulting compensation continues to be fair market value.
- Do a final sanity check on the remaining profitability of the payor to make sure remaining profits are within the normal range, i.e., is there a reasonable rate of return?



Compliance Programs

- Lack of compliance with regulatory concerns by a healthcare organization can lead to:
 - large fines
 - disruption of the organization
 - lost jobs
 - imprisonment
 - lost goodwill in the marketplace
 - loss of tax-exempt status
 - exclusion from Medicare/Medicaid programs



Compliance Programs (Cont.)

- Therefore, it is important for the healthcare organization to conduct a compliance review, in which all payments made to physicians are identified, documented, categorized, and justified.
- Depending on which permitted exclusion or allowable exception you are pursuing in structuring a particular compensation arrangement, there are specific requirements which must be met – however, it might be simpler to meet those requirements for all financial arrangements.



Compliance Programs (Cont.)

In a compliance review, you should check for:

- expired or unsigned contracts
- contracts that do not specify the exact services to be covered by the arrangement
- contracts that are not correlated with any and all other arrangements between the hospital and the physician
- contracts which specify aggregate services to be provided by the physician which exceed those that are reasonable and necessary for legitimate business purposes



Compliance Programs (Cont.)

- lack of legal counsel or board approval
- lack of appropriate, or insufficient, FMV data or analysis
- contracts that have changed fees during the term of the contract, or in which the fee or fee formula has not been set in advance
- contracts that contain fees impacted by the volume or value of referrals, or other business generated by the physician for the hospital



Compliance Programs (Cont.)

- lack of time sheets or work logs, especially for non-clinical services
- lack of invoicing documentations
- payments made without a contract
- payments that do not match the contract terms
- payments that do not match the time sheet or invoice amounts



Compliance Programs (Cont.)

- Test all potential outcomes of an incentive plan for fair market value.
- Check total compensation for fair market value and reasonableness.
- As part of a thorough compliance plan, you should maintain active checklists, databases, and workpapers which allow for the continuous monitoring of all financial relationships with physicians.



Compliance Programs (Cont.)

- The healthcare organization should constantly seek to improve its controls and accountability.
- FMV justification does not necessarily require the use of a third-party appraiser. Instead, develop an internal policy as to when outside third-party FMV opinions should be obtained, as opposed to internal analyses.
- Having a third-party appraisal does not provide full protection from an investigation, but it demonstrates that the organization considered relevant facts and sought an expert opinion.



Compliance Programs (Cont.)

- It is important to note that the FMV opinion provided by a third-party appraiser:
 - will consist of a prospective analysis of the value of Services
 - will not address the FMV of past compensation for Services
 - will not address the appropriateness of the level of Services being furnished by the physicians
 - will not address the legal permissibility of the underlying relationship