Understanding and evaluating deal considerations in the hospital outsourced services (clinical and non-clinical staffing) investing sector

This issue explores certain operational, financial, and tax issues that private equity investors should consider when making investments in hospital staffing companies.

Operational

Care coordination—Hospital systems have been moving to an employment model for certain types of physicians in an effort to drive greater coordination across the patient care continuum, enhance their ability to provide strategically important services, and protect referral sources. This trend may negatively impact the market for certain types of outsourced physician staffing. Conversely, clinical outsourcing for certain specialists, such as anesthesia and ED staffing, may increase as these services are critical to full-service acute care hospitals and are not dependent on long-term physician-patient relationships.

Health care reform impact—Declining trends in reimbursement from government programs resulting from health care reform has driven hospital systems to engage in cost containment initiatives. While cost cutting may lead to an increase in the market size for outsourced physician services, this trend may negatively impact pricing for staffing services. Pricing pressures may be partially offset as insurance coverage is expanded as a result of health care reform.

Financial accounting

Revenue estimates—The majority of revenues derived from outsourced physician services typically come from billing and collection for physician services. The revenue cycle associated with physician services is complex and physician practices frequently account for revenue on a cash basis. As a result, management's ability to estimate future cash collections and the value of accounts receivable may impact historical quality of earnings. Focused financial diligence should be performed on historical revenues to understand the impact of management's estimates on the financial statements.

Litigation exposure—Staffing companies are often subject to malpractice claims and other legal or investigative actions. In many cases, staffing companies are required to indemnify clients from such actions resulting in financial exposure to the staffing company. Broad financial, risk management, and legal due diligence should be performed to understand potential exposure to a buyer post-transaction.

Billing and coding

Billing and coding assessments—Improper billing of Medicare and Medicaid can result in significant fines and penalties. Additionally, if proper billing and coding requirements are not followed, revenue may be misstated, which can also impact the quality of earnings. Performing a billing and coding assessment is a critical step during diligence. This typically includes selecting a sample of patient records and their related billing documents to assess whether the company has documented evidence of services being performed and has billed correctly for those services.

Compliance program—It is also important to assess whether the company has a compliance program in place to manage risks related to the following areas:

- Clinical credentialing: Are all clinical personnel properly licensed and credentialed?
- Screening: Is there a process to ensure that all personnel are screened for exclusion using Office of Inspector General, General Services Administration, and state Medicaid databases?
- Compliance audits and monitoring: Are compliance audits, including billing and coding assessments, routinely conducted, and are risks routinely assessed, identified, and managed by personnel with appropriate skills?
- Contracting processes: Do contracting processes include evaluation of fair market value, Stark, and anti-kickback implications?
- Quality reporting: Are Medicare and other quality initiatives reported by the company, and are their reported quality scores within acceptable ranges? Are there initiatives to monitor and improve the quality of clinical services?
- HIPAA compliance: Are processes and systems in place to safeguard Protected Health Information and report violations?

Tax

Sales tax—Staffing companies need to closely monitor constantly changing sales tax laws in the state and local jurisdictions in which they operate. Depending on a staffing company's jurisdiction, services rendered may or may not be subject to sales tax. To complicate matters further, certain jurisdictions may have exceptions to their general laws and may not tax services that are specifically provided to non-profit organizations and hospitals. In this case, exemptions certificates may be required. Given the complexity of sales tax laws, it is important to understand historical sales tax exposures (including interest and penalties) and/or adjust the quality of earnings when evaluating a target company.

Independent contractors—Staffing companies may classify certain individuals as independent contractors. The proper classification of an individual as an independent contractor vs. an employee is highly dependent on the facts and circumstances. A company that misclassifies certain individuals as independent contractors may be subject to income tax withholding exposure and payroll tax exposure, which could be sizeable depending on the number of independent contractors and statutes of limitations. Underpayment of payroll taxes could also impact a target company's quality of earnings.

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