Merging Medical Practices: Look Before You Leap

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Current changes in health care are forcing many physicians to merge their medical practices. Because any successful merger requires careful planning, there are many critical issues that should be reviewed, discussed, and decided by physicians considering merging their medical practices. This article explores some of these issues and provides a useful practice merger checklist.

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Combining separate medical practices into a large group practice is becoming a common way to deal with physician reimbursement and government regulation.

Many prognosticators declare that the day of the physician in solo practice is dead because the market will force most physicians into large group practices. Without consideration of current market forces, the merging of medical practices offers many benefits: better overall management, centralized and efficient billing and collection, group purchasing discounts, reduced overhead, and the ability to better respond to departing owners.

In spite of these benefits, the process of merging can be fraught with problems if not executed properly. The Medical Practice Merger Checklist included with this article serves as a guide to help physicians facilitate a merger. Properly used, this checklist can ensure the success of a merger.

The checklist begins with a premerger assessment, during which the merging physicians should assess and compare their respective finances, including a history of production, collections, and adjustments, and analyze overhead and liabilities. The preassessment will identify assets and liabilities that can and should be contributed to the new group. One area of immediate importance is the Medicare participation decision. Which members now currently participate and which do not? Since the new group will need to have a single position, all of the physicians must agree on this issue.

The checklist addresses the often problematic issue of practice employees. It must first be determined which practices have a retirement plan and which ones do not. Then the new group will have to decide whether to set up a new plan. One of the problems that commonly occurs in this area of negotiation is that physicians who currently do not have a plan may not want to be forced into making future retirement plan contributions.

The next steps are to analyze each practice's employees and their salaries, to decide which employees will be needed in the new group, and to determine a salary structure. Finally, each practice's policies related to vacation, sick leave, and other such issues should be reviewed and an overall policy for the new group developed.

Issues related to facilities also must be discussed. If the practices intend to consolidate into one location, the physicians must decide which of the specific assets of each practice will be contributed to the new entity. Not all assets will be needed in the new location because many items, such as examination tables and computer systems, will be duplicated. Physicians whose assets are to be used generally want to be compensated, and those who have to dispose of or store assets are in a quandary. The solution to this predicament will vary depending on the circumstances of each merger; in any case, the important point is to compromise as needed for the ultimate good of the merger.

Although choosing a managing physician may appear to be a simple decision, there are many factors that

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should be considered. Not every physician is a qualified manager. The manager should be the physician who is willing to spend the time it takes to properly manage a practice, which includes responsibilities such as signing checks, interacting with the office manager or administrator, and ensuring that other matters such as filing tax returns and approving minor purchases are carried out properly.

The physicians in the new practice group also must decide if the managing physician will be compensated for his or her time. In practices of fewer than five physicians, the managing physician is rarely compensated. Finally, the merging physicians should decide on the managing physician's term. Generally, this position is rotated annually among the owners.

Merging physicians should decide up front how they will want to compensate one another once the new practice gets under way. Compensation arrangements should be based on each physician's current financial data and the goals of the practice. Examples of compensation formulas range from equally shared income to productivity-based pay. Once the physicians decide on a formula for compensation, a pro forma document should be prepared that describes each physician's pay, which should be calculated before the merger actually takes place. The physicians must see how they will fare individually under the new formula. Obviously, they would not want to join a merger if their take-home pay would be decreased.

Finally, the buyout issues indicated in the checklist require careful consideration. The four events for a buyout are (1) retirement, (2) death, (3) disability, and (4) voluntary or involuntary withdrawal. For each event, the physicians must decide when the buyout would occur, how the buyout amount would be calculated, and how the buyout would be paid. Issues related to temporary disability, which are the most problematic, should be discussed. For temporary disability situations, the issue is at exactly what point the buyout should occur. Depending on the type of disability, the time could range from 1 month to 1 year.

The merging physicians must agree on how the buyout amount would be valued. During the merger process, it is important to remember that any buyout calculated at "appraised value" is potentially grievous because the buyout amount remains a mystery until an appraisal is performed. If the appraised value ends up being too high, the owners that remain in the practice may refuse to pay such a high amount. Instead of an appraisal, it is preferable to create a formula approach so that the buyout figure can be calculated at any time.

When physicians decide to merge their practices, they must be aware of the important issues that should be dealt with before the consolidation. With the health care industry changing as rapidly as it is, physicians are rushing to react to it. The principal reaction is practice merger. Although many consolidations have worked perfectly, many others have failed. The chief reason for these failures can be traced directly to the failure to plan out the merger. Physicians who use the Medical Practice Merger Checklist and take sufficient time to decide all issues related to the practice merger should ensure a successful new group practice.

Medical Practice Merger Checklist

Areas to Assess Before Merger
- Each practice's finances
- Employee payroll and benefits for each practice
- Coding practices
- Fee schedules

Form of New Practice Entity
- Partnership of corporations or professional association?

Assets to Be Contributed to New Entity by Each Practice
- Hard assets (building, equipment, cash, stock)
- Accounts receivable
  - Amount to be contributed
  - Method of accounting for remainder of physician accounts receivable

Items to Review in Determining Whether New Practice Should Assume Debt of Each Practice
- Existing physician debts
- Accounts payable
- Notes and other payables
- Lease obligations

Elements to Be Considered in Formulation of Physician Compensation
- MD collections minus share of the overhead
- Fixed compensation plus bonus
- Bonus based on percentage of collections
- Bonus based on percentage of net production
- Equal compensation for all physicians
- Fixed compensation plus percentage of net production
- Percentage of net production

Personnel Issues
- Choice of a practice administrator
- Review of current compensation of employees
- Determination of which employees will be retained by the new practice group
- Establishment of new fringe benefits
- Establishment of job duties for each employee

Facility Issues to Be Considered
- Current lease obligations
  - Office leases
  - Equipment leases
- Consolidation of offices
- Use of equipment
- Building ownership vs lease

Managing Physician
- Election of managing physician
  - Vote of physicians
  - Annual rotation
- Duties of managing physician
  - Day-to-day operations
  - Employee supervision
  - Supervision of billing and collection activities
  - Overseeing payment and maintenance of group insurance
  - Acquisition of fixed assets for less than $_______
  - Authority to enter into contracts on behalf of the group not in excess of $_______
  - Maintenance of bank accounts
  - Supervision of preparation and filing of tax returns
  - Renewal of licenses
  - Payment of accounts payable
  - Implementation of business decisions of the group practice
  - Organizer/leader of regular meetings of physicians

continued

Other duties
Compensation of the managing physician

Operational Issues
Call schedule
Billing and collection policies
Purchase of new computer system
Appointment scheduling
Office forms
Medical charts
Superbill
Fee schedule
Notification of insurance carriers of new entity, if applicable
New group provider number
Banking
Insurance
Group health
Malpractice
Office contents
Other
Office hours
Telephone number
Purchasing
Professional assistance
Practice accountant
Practice attorney
Other

Assessment of Hidden Costs to Merge
Nonproductive time (lost patient billings)
Marketing costs
Professional fees
Moving costs, if applicable
Malpractice tail premium
Cost to equalize fringe benefits
Cost of developing common operational policies
Possible facility costs
Buyout of existing leases
Additional leasehold improvements
Other

Practice Retirement Plan
Choice between current and new plan
Determination of how to handle current plans
Retirement plan administrator to be chosen
Investment counselor to be chosen

Name for New Group Practice

Physician Issues
Voluntary withdrawal by an owner
Required notice time for owner withdrawal
Involuntary termination of an owner
Death
Suspension, revocation, or cancellation of owner's right to practice medicine in the state
Loss of owner privileges to any hospital where the practice regularly maintains admission privileges
Failure of owner to follow reasonable policies or directives established by the practice
Owner commits acts amounting to gross negligence or willful misconduct to the detriment of the practice or its patients
Owner conviction of a crime
Owner breach of the terms of employment agreement
Physician becomes uninsurable for medical malpractice coverage
Disability of an owner
Owner becomes and remains disabled for _____months

Continued compensation to a disabled owner
Length of compensation
Amount of compensation
Permanent vs temporary disability
Physician fringe benefits:
Vacation
Sick leave
Effect on compensation if physician chooses to take extra time off for vacation, CME study, etc
Expenses (CME, etc)
Malpractice tail-end premium
Who pays in event of owner withdrawal?
Events requiring buyout of an owner
Death
Disability
Retirement
Withdrawal from the practice
Valuation of ownership interest
Appraisal
Fixed formula
Requirement of goodwill calculation
Payout of ownership interest
Death
Insurance proceeds
Amount of insurance to obtain
Proper structure for "key man" insurance
Disability, retirement, withdrawal
Installment payments or lump sum
Interest rate for installment payments
Timeframe for installment payments
Admission of a new owner
Required vote
Valuation of buy-in amount
Appraisal
Fixed formula

Major Decisions of the Group
Majority or unanimous approval
Common decisions
Hiring and firing of personnel
Amendment of practice fee schedule
Purchase of fixed assets in excess of $________
Adoption or amendment of retirement plan
Expenditures in excess of $________
Designation or change in signatories on group bank accounts
Borrowing money
Entering into lease contracts
Offering ownership to a physician
Terminating a physician's association with the practice
Withdrawals from group bank accounts
Negotiation and settlement of claims against the group practice
Determination of which expenses of the individual physicians should be paid for by the group practice
Dissolution of the group practice
Required vote of current owners
Method of dissolution
Purchase of insurance
Sale of group practice assets
Other

Promotion of the New Practice Group
Marketing strategy
Costs of implementation