Transaction Due Diligence by David Kottak, dkottak@bkd.com

Webster provides a literal definition of “due diligence” as “appropriate attention.” We believe that it is critical to give proposed transactions the “appropriate attention.” A thorough understanding of business risks is critical as healthcare providers explore transactional relationships with other healthcare providers. Difficult questions should be asked early on during the transaction evaluation process. Is the transaction or venture beneficial to all parties? How does the transaction benefit each of the parties involved? More importantly, what can go wrong? In many cases these are difficult questions that key stakeholders don’t want to ask on the front end of a transaction because they feel they have no better option.

Transaction due diligence can be a helpful tool in providing an objective arms length perspective in the evaluation process by examining what everybody at the table is seeking. It can assist by outlining the practical business risks and issues of the transaction. Issues such as: required regulatory approvals, proposed federal and state program payment changes, income tax related matters (including tax exempt issues) in addition to operational synergies which could be gained subsequent to the transaction.

The scope, approach and timing taken by organizations in connection with transaction due diligence varies greatly and is typically dependent upon their individual “risk assessment” of the transaction. One size does not fit all when approaching transaction due diligence. It is critical for an organization to focus effort and attention on the areas identified with the highest degree of risk, while at the same time approaching the transaction objectively and providing an overall framework for managing risk. In other words, just because a particular area of a transaction doesn't appear to contain a high degree of risk doesn't necessarily mean that’s the case.

A thorough due diligence work list might include the procedures to obtain and evaluate the following types of documents:

1) Corporate Organizational Documents
   i) Articles of incorporation, partnership agreements, etc
   ii) Bylaws and operating agreements
   iii) Listing of officers, trustees and directors
   iv) Conflict of interest statement and disclosures
   v) Listing of loans with related parties
   vi) Board of director and committee minutes including annual reports

2) Regulatory and Compliance Issues
   i) Licensure documentation including Medicare/ Medicaid certification
   ii) Certificate of need applications and status of judicial proceeding
   iii) Engineer and safety reports concerning owned property
   iv) Accreditation letters including follow progress reports

For more news see the chapter website
www.hfmaky.org

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President’s Message  By David E. Tate

Spring is in the Air!

Spring marks some of the most exciting times in the year for the HFMA. The new officers are being nominated and elected. Plans are being set in motion to attend the Leadership Training Conference which will be held in San Antonio, Texas. The next president and the vice presidents begin to select the chairpersons and co-chairpersons for the various HFMA committees. Yes, it’s a new beginning for HFMA leadership. It’s a time for you to step up and Make a Difference!

The Chapter surveys always have several comments about not knowing how to volunteer or how to get more involved. This newsletter has contact information for all of the chapter officers as well as the chairpersons for each of the committees. If you desire to get more involved, or just want to learn more about the committees and responsibilities, please reach out to any of the HFMA leadership. I can remember being nervous myself about asking to get involved and 12 years later I ended up accepting the nomination to be president of the Chapter.

We have done a lot of great things this year for our Kentucky Chapter. One of the things I was told to do in advance about a serving year as President was to see your record now. By doing so, you will ensure that HFMA continues to provide you with valuable information and insights that further your success.

HFMA National’s On-line Membership Directory

Have you visited HFMA National’s On-line Membership Directory lately? Here’s the link: http://www.hfma.org/dual_login.cfm. When you select “HFMA Directory” not only can you search for members of our chapter, you can also search for all of your HFMA colleagues by name, company, and location — regardless of chapter! You may also view your current contact information and make edits to your profile, as well as view any products you have ordered, events you have registered for, your CPE credits, your Founders points, and more!

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Transaction Due Diligence…continued from page 1

v) Audit reports issued by regulatory agency inspecting the facility
vi) Listing of properties owned, leased or operated

3) Financial and Accounting
   i) Audited financial statements and related management letters
   ii) Interim period financial information including statistical information
   iii) IRS, state and local tax filings as well as audit results
   iv) Medicare/Medicaid cost report filings including audit results
   v) Significant financing agreements (notes, leases, bonds, etc)
   vi) Inventory listings including property, equipment and supplies
   vii) Details regarding intangible assets recorded

4) Employment Agreements
   i) Organizational chart covering all employees
   ii) Employee manuals and handbooks
   iii) Positions funded in whole or in part by grants or contracts
   iv) Information regarding union organization activity
   v) Insurance policies including deductibles and tail coverage options
   vi) Listing of matters resolved by compensation
   vii) Listing of matters referred to insurance carrier

5) Other Matters
   i) Detailed analysis of the information systems platforms
   ii) Summary of recent patient surveys, responses and follow up
   iii) Corporate ethics and compliance programs and policies
   iv) Description of any religious guidelines for patient care
   v) Description of charity care policy and community benefit reports
   vi) Copy of policy related to abortion, sterilization or other birth control matters
   vii) List of basic terms of gift and endowments

Transactions which have a perceived strategic value, a fear by management of slowing down or derailing the deal, or an inability to make adjustments to the purchase price or working capital reconciliation often times become a transaction team’s rationale for a lack of focused effort in this area. However; an effective due diligence process can add tremendous value in many other areas. It can assist in the post-merger integration process, identify key strengths and weaknesses within the “target’s” management team, help senior executives develop the overall strategic direction for the combined entity as well as a variety of items.

Bill Introduced To Increase Medicaid Assistance To States

The Committee on Energy and Commerce announced February 8 that a bill had been introduced that, if passed, would provide a temporary increase in the Medicaid federal medical assistance percentage (FMAP) so that cash-strapped States can continue to provide health care to low income residents. This bipartisan legislation would increase the Medicaid FMAP by 2.95 percent for five quarters (April 1, 2008 through June 30, 2009); protect States against a decline in their Medicaid FMAP during the same five quarters of the 2008 and 2009 fiscal years; require the States to maintain Medicaid eligibility at current levels in order to receive the 2.95 percent temporary increase; and require the States to adjust payments by localities and counties to account for additional federal funding. The FMAP for Kentucky is presently at 70 percent.

The articles in Financial Times often contain summaries of complex legal or accounting issues and may not cover all the “fine points” related to specific situations. Accordingly, they are not intended to be legal or accounting advice, which should always be obtained in direct consultation with a legal or accounting professional.
Hospital Employees Snoop In George Clooney’s Medical Records – Film at 11  By Michael K. Kirk and Erin Brisbay McMahon

With the recent Oscars and the attending celebrity hype this may be a good time to recall a recent incident in which over twenty employees of Palisades Medical Center, located in New Jersey, were suspended for improperly accessing actor George Clooney’s medical records. Clooney was admitted to the Medical Center for treatment following a motorcycle accident and it was reported that some employees may have contacted the media with information they found in the records. The suspensions were to last for four weeks without pay. Some of the employees were union members and their union squawked at what it considered a harsh penalty. Clooney himself said he hoped no hospital personnel would be suspended. But no matter how you react to the discipline, this incident is a good reminder of a medical provider’s duties to comply with HIPAA and to protect the confidentiality of patients and their medical records. This is true whether the patient is a celebrity or not.

First, all medical providers should now have clear and detailed HIPAA privacy and security policies that inform employees that they are required to maintain the confidentiality of protected health information. Among other things, the policies should admonish employees against discussing the patient’s care and treatment with anyone not involved in the case, unless such a disclosure is permitted under HIPAA. The policies should warn those not involved in a patient’s care to refrain from accessing a patient’s records or inquiring about the patient or his/her care, unless necessary for a legitimate purpose recognized by HIPAA, such as billing or peer review. The policies should include references to the HIPAA privacy and security rules. A sanction policy must be in place, and it should state that violations of the HIPAA policies are grounds for discipline up to and including termination of employment, and that any employee aware of violations of HIPAA or the provider’s policies should immediately report them to their supervisor and the HIPAA privacy officer. But having policies in a binder is not enough.

Second, all new employees should be provided with training on HIPAA and the provider’s policies on confidentiality. Third, all existing employees should be reminded, at least annually, in department meetings or otherwise, about the provider’s policies on confidentiality and the basics of HIPAA. Finally, if a celebrity is treated by a provider, the provider should immediately remind all employees of their duties by announcement, e-mail or other means, and consider implementing a warning screen on all computerized records for that patient (e.g., when the patient’s name is queried, a screen appears stating, “STOP! Do you really need this information to do your job?”). All of these steps ensure that employees are on notice of what is expected of them and what the penalties are if they fail to comply with company policies.

These steps will also be helpful in developing a defense if the provider is investigated by the federal government for a HIPAA violation or sued for breach of confidentiality or invasion of privacy. While there is no private cause of action under HIPAA, a few state courts are allowing common law confidentiality and privacy claims to proceed with HIPAA as the standard of care. The provider will be much better off if it can show it took appropriate steps to create policies and to educate employees about confidentiality and HIPAA, and the employee violated the policies and acted outside the scope of his or her duties. In fact, a United States Attorney who prosecuted the first HIPAA criminal case (employee of cancer center stole patient information and opened credit accounts in patient’s name) stated that she investigated the employer and found that the employer had attendance logs showing the indicted employee had been trained on HIPAA and specifically cautioned against identity theft. Therefore, the employer did not face civil money penalties or criminal prosecution.

What should a provider do if an employee violates a patient’s confidentiality? Investigate immediately and interview all witnesses. Have the IT department investigate whether access was gained through an employee’s computer (computer monitoring is for another article, but providers should have an “e-policy” which informs employees that the employer has the right to monitor their computers, voice mail, e-mail, IMs, and so forth). After the investigation, if appropriate, the provider should discipline or fire anyone who violated policies and/or HIPAA (and must impose discipline if a HIPAA violation is discovered). What if, as in the case of Mr. Clooney, the person whose rights are violated asks that the violators not be disciplined? Sorry, the provider must follow its policies and apply them consistently. All employees should

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know the rules and the consequences, and employers cannot make exceptions. That’s why it’s important to have a flexible progressive discipline policy; otherwise, an employer might be forced to fire an employee for a minor infraction or be unable to fire an employee for an egregious act.

If an employer (whether in the health care field or not) provides a self-insured health plan administered by a third party (including a flexible spending account) and uses some of its HR employees to help employees with appeals or deal with employee health information, the same principles discussed above will apply. The health plan will be subject to HIPAA, and the employer should make sure policies are in place and employees are trained.

Michael K. Kirk and Erin Brisbay McMahon are partners with Wyatt, Tarrant & Combs, LLP practicing in the areas of labor and employment and healthcare respectively. They may be reached by e-mail at mkirk@wyattfirm.com or emcmahon@wyattfirm.com.


Chapter Membership Report  By Theresa Scholl

Through December 2007, we currently have a total count of 525 members, with a retention rate of 86.6% (goal of 87%). Compared to a year ago, this is up by six members. It’s great to have so many members; however, it’s not about the count, it’s more about member participation and the benefits members can gain from being an HFMA member. I encourage members to attend the educational institutes and meet other healthcare finance professionals. We want to meet your needs so if you have any suggestions, please don’t hesitate to share them with us.

November — 4 new members
1. Pamela Jones, Controller, Baptist Regional Medical Center
2. Steven Block, Chief Executive Officer, Medical Credit Bureau
3. Tyler Walters, Senior Reimbursement Acct., Our Lady of Bellefonte Hospital
4. Florence Mahoney, Accounting Manager, St. Joseph Healthcare

December — 1 new member and 1 member transferred in
1. Aline Roberts, Director of Case Management, Murray Calloway County Hospital
2. Dana Morgan, Regional Director, Ingram & Associates transferred from Chapter 30 Northeast Ohio
On December 20, 2007, the Internal Revenue Service (IRS) unveiled its updated Form 990 for tax-exempt organizations, with a new schedule designed specifically for hospitals (Schedule H). While the IRS is phasing in Schedule H for the 2008 tax year, only Part V required to obtain identifying information. However, the entire schedule will be mandatory in the 2009 tax year.

In short, hospitals must use the 2008 tax year to ready themselves by assessing their charity processes and related reporting in order to meet the upcoming IRS requirement for 2009.

**Closer Charity Monitoring is Imminent**

The evolution of the Form 990 began in 2006 when the IRS sent “compliance check questionnaires” to more than 550 tax-exempt hospitals, seeking detailed information about their operations and billing practices and the compensation of top hospital executives. While only auditing 5% of nonprofit hospitals in the past 10 years, the IRS is clearly looking for new ways to monitor the non-profit healthcare industry with more scrutiny.

The timing of the new schedule is not surprising. Hospitals have come under more and more scrutiny by the IRS and the Senate Finance Committee to justify their tax-exempt status by demonstrating how they benefit their community. Many legislatures and government officials are lobbying for tighter standards for hospitals to keep their tax-exempt status. These senators do not want to recognize the community benefits such as health fairs, cancer screenings, and medical research, as replacements for charity care.

The IRS does not outline how it will use the information collected in the 990, but IRS Exempt Organizations Director Lois G. Lerner was quoted in a December news conference as saying, “We want to look at what the hospitals are doing. We think having broader information will better inform us on any decisions we would like to make in the future.”

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**Meet the 5% or Be Scrutinized?**

Senate Finance Committee Chairman Max Baucus, D-Mont and Sen. Charles Grassley, R-Iowa, have both expressed concern over the overcharging of uninsured patients, the allocation of too few resources to charity care, and overstatements of the amount of free care provided.

Senator Baucus’ opinion on this topic is well known. He believes that hospitals should allocate at least 5 percent of their annual revenues or expenses to free care for those unable to pay.

The revised Form 990 asks new questions about a non-profit hospitals’ charity care program. While no legislation exists today to back the 5% rate proposed by Baucus, the new 990 will clearly identify hospitals that need to increase their charity care enrollment.

**Readying Your Charity Program**

Form 990 is forcing hospitals to reassess their charity care programs, if they haven’t already. The evaluation should be two-fold, examining the process itself and the measurement of a successful program.

1. Process: Is the correct charity care process in place? Is it non-discriminatory and defensible?

Non-discriminatory. A charity program cannot discriminate by age, race, sex or any other personal characteristic. Unfortunately, people are human and biases do exist, even under the best of circumstances. Hospitals need to demonstrate that their process identifies every patient who would qualify for charity care under their specific guidelines. Only by automating the screening process using technology, without human intervention and natural subjectivity, can the process be truly objective.

Defensible. The process of identifying a qualified charity patient must be defensible. Screening must be performed on every patient who could potentially qualify for a charity discount based on the hospital’s specific guidelines at the point of registration using a third-party or neutral service. The independent service’s audit trail validates that the screenings took place and that the patient was directed to the appropriate financial arrangement based on the data provided.

2. Measurement: Is the hospital near the recommended 5%? Should some bad debt be reclassified?

Too often bad debt accounts should have been enrolled in the charity care program from the beginning. In Part III of the Form 990, bad debt can be included but smart hospitals realize there is more benefit to reclassifying them to charity.

When re-classified, many hospitals determine that they are providing more charity care than first reported. Correcting this error could improve a hospital’s standing with their community and the IRS.

**Automation is the Only Option**

Hospitals need to be ready for a new era in their relationship with the IRS.

There is only one way to improve compliance and minimize the risk of an IRS audit or possible loss of tax exempt status — by automating the process using a third party provider of patient information such as demographics and credit scores.

Governed by the unique rules of the hospital’s charity care program, the automated screening service can objectively determine whether or not a patient is qualified based on data not appearances. If the patient qualifies, it can also aid in the enrollment phase with pre-populated forms for patient signature.

Before the IRS Form 990 was unveiled, many hospitals had proactively automated their charity care screening and achieved tremendous results. Lesa Klepper at Novant Health explained that, “For every self pay patient, we have SearchAmerica automatically run a credit and financial profile. If this information indicates that their income level matches the criteria of Novant’s charity care program, the patient is immediately enrolled. Since implementing this new process, we have more than tripled our number of charity cases and delivered a 50% decline in bad debt.”

IRS Form 990 is a wake-up call for tax-exempt hospitals to bring their processes and charity expenses to appropriate levels. With less than 12 months until tax year 2009, time is of the essence and solutions from SearchAmerica are available to solve the most burdensome aspects of the 990.

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