

# CALIFORNIA ORTHOPAEDIC ASSOCIATION APRIL 18, 2010



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**The Integrated Model for  
Practice Organization**

*Presented by:*  
**Michael J. McCaslin, CPA**  
**Health Care Team**



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# The Integrated Model for Practice Organization



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# PRACTICE AFFILIATION ISSUES

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Geographic dispersion of the practices involved significantly influences the integration model utilized.



# PRACTICE AFFILIATION ISSUES

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Size and scale of the groups may dictate whether a true merger is to occur or whether it will be an acquisition that is called a merger.



# PRACTICE AFFILIATION ISSUES

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1. Pre-Integration Process
2. Integration Structures Evaluation
3. Physician Issues
4. Clinical Impact
5. Central Business Office (CBO)/MSO
6. Operating Entity Issues
7. Operations Start-up Issues
8. Post-Merger Issues



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# **PRE-INTEGRATION PROCESS DEFINE GOALS AND OBJECTIVES**



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# PRACTICE AFFILIATION ISSUES

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- Pre-Integration Process, etc.
  - If you haven't defined what you want to accomplish...how will you know when you've accomplished anything?



# PRACTICE AFFILIATION ISSUES

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- Before you invest in legal fees for Anti-Trust analysis, shouldn't you have a sense of whether the goals are worthy of moving the Integration forward?





# PRE-INTEGRATION PROCESS

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- Definition of Goals and Objectives
  - Patient/Services Issues
    - Improve overall patient services - broaden the scope of services offered
    - Improve physician coverage
    - Possibly provide more in-house ancillary services subject to any oppressive CON laws
    - Market preservation/increasing/maintaining existing market share. Increase market share through expanding base of primary, secondary, and other markets to be served



# PRE-INTEGRATION PROCESS

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- Definition of Goals and Objectives
  - Patient/Services Issues (Cont'd)
    - Greater financial resources for peer review and quality assurance programs
    - Greater financial resources for developing quality of care programs on benchmarks



# PRE-INTEGRATION PROCESS

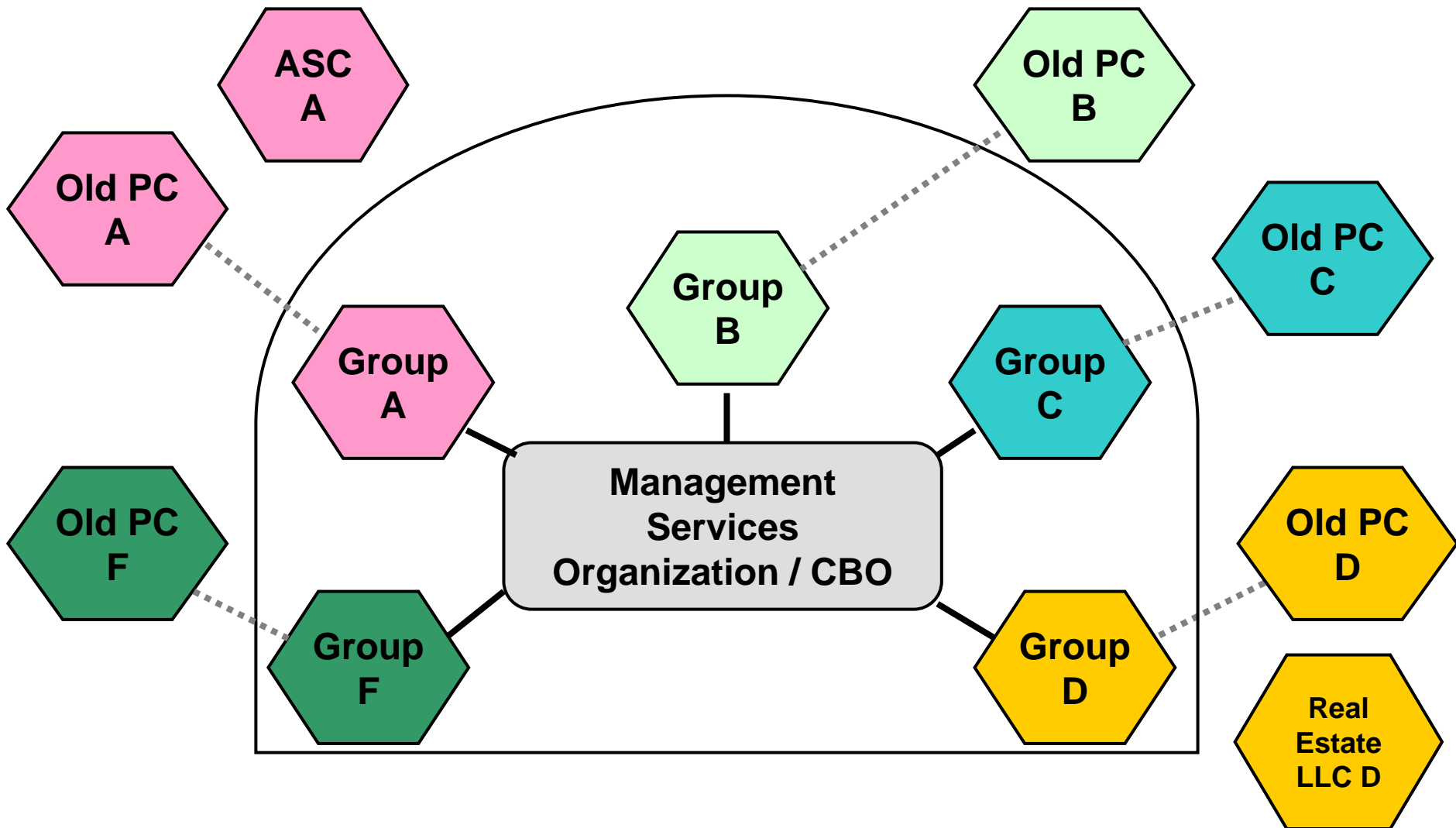
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- Definition of Goals and Objectives
  - Patient/Services Issues (Cont'd)
    - Enhance the physicians' ability to participate in more insurance plans, overall greater contracting capabilities
    - Enhance orthopaedic manpower planning by becoming a more attractive recruitment alternative
    - Develop group-wide processes to address quality, access and cost containment to prepare the group to be the Providers of Choice in a bundled payment system



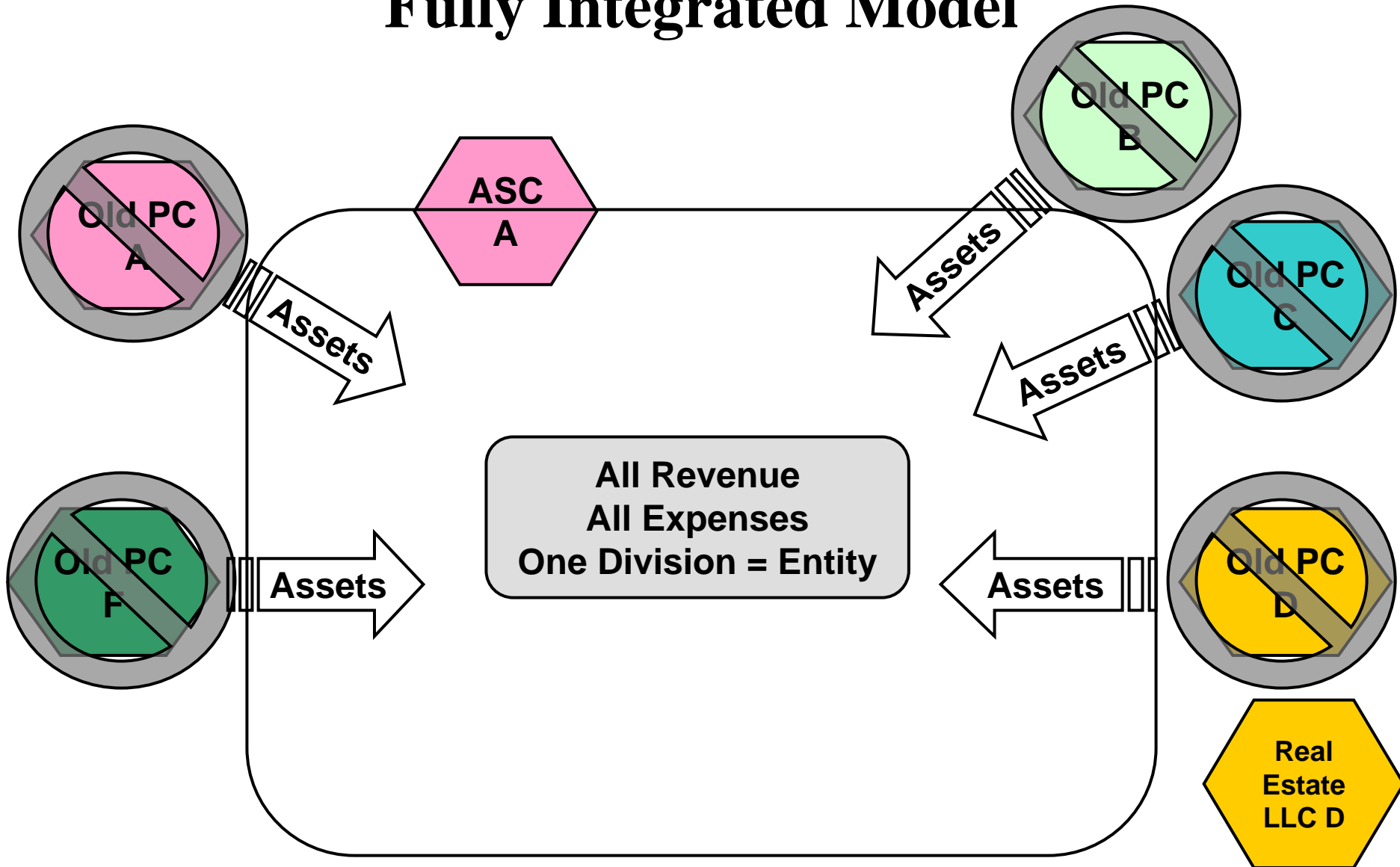
# INTEGRATION STRUCTURE

## Partially Integrated Model



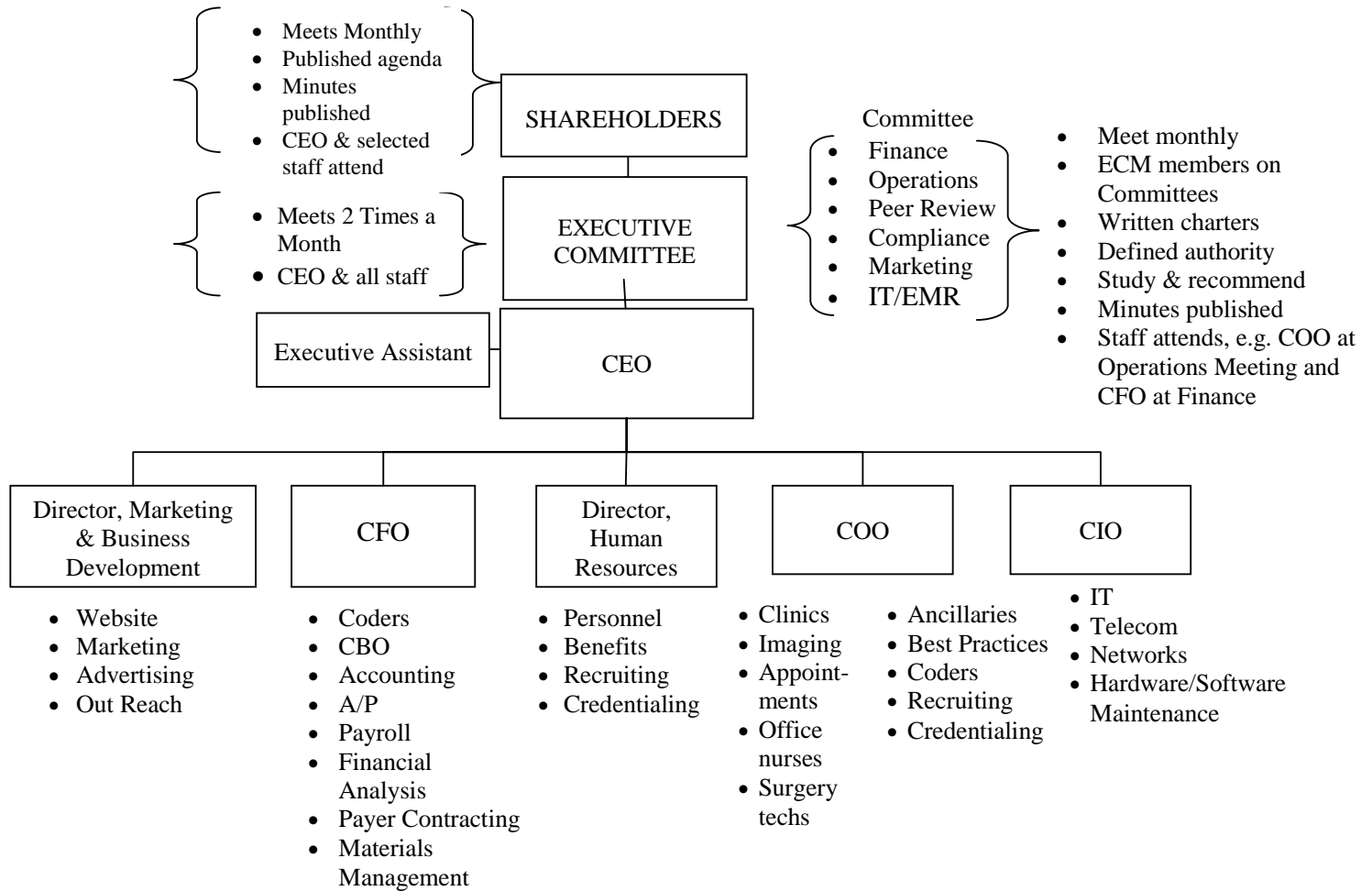
# INTEGRATION STRUCTURE

## Fully Integrated Model



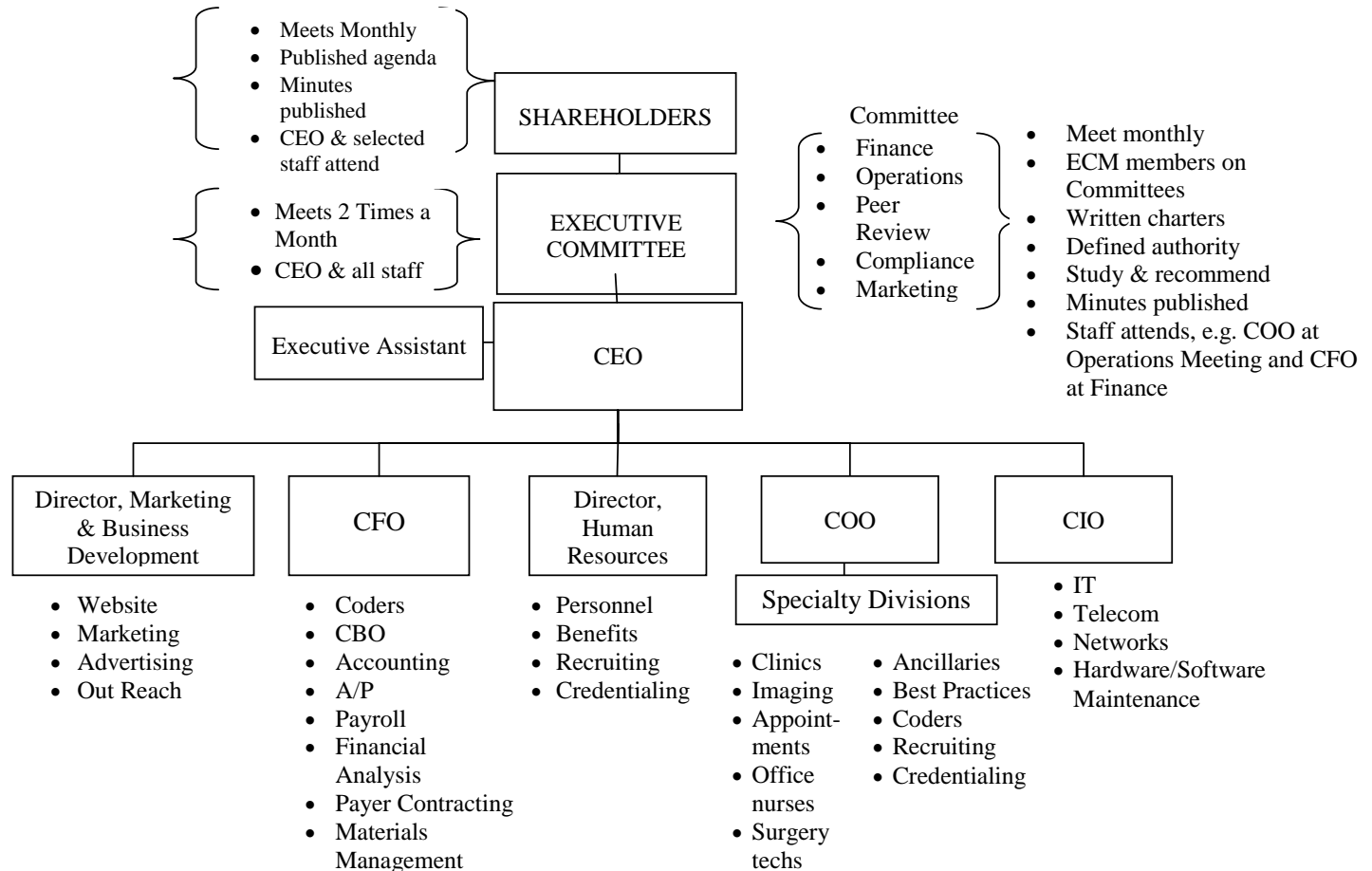
# FULLY INTEGRATED MODEL

## ORGANIZATIONAL CHART

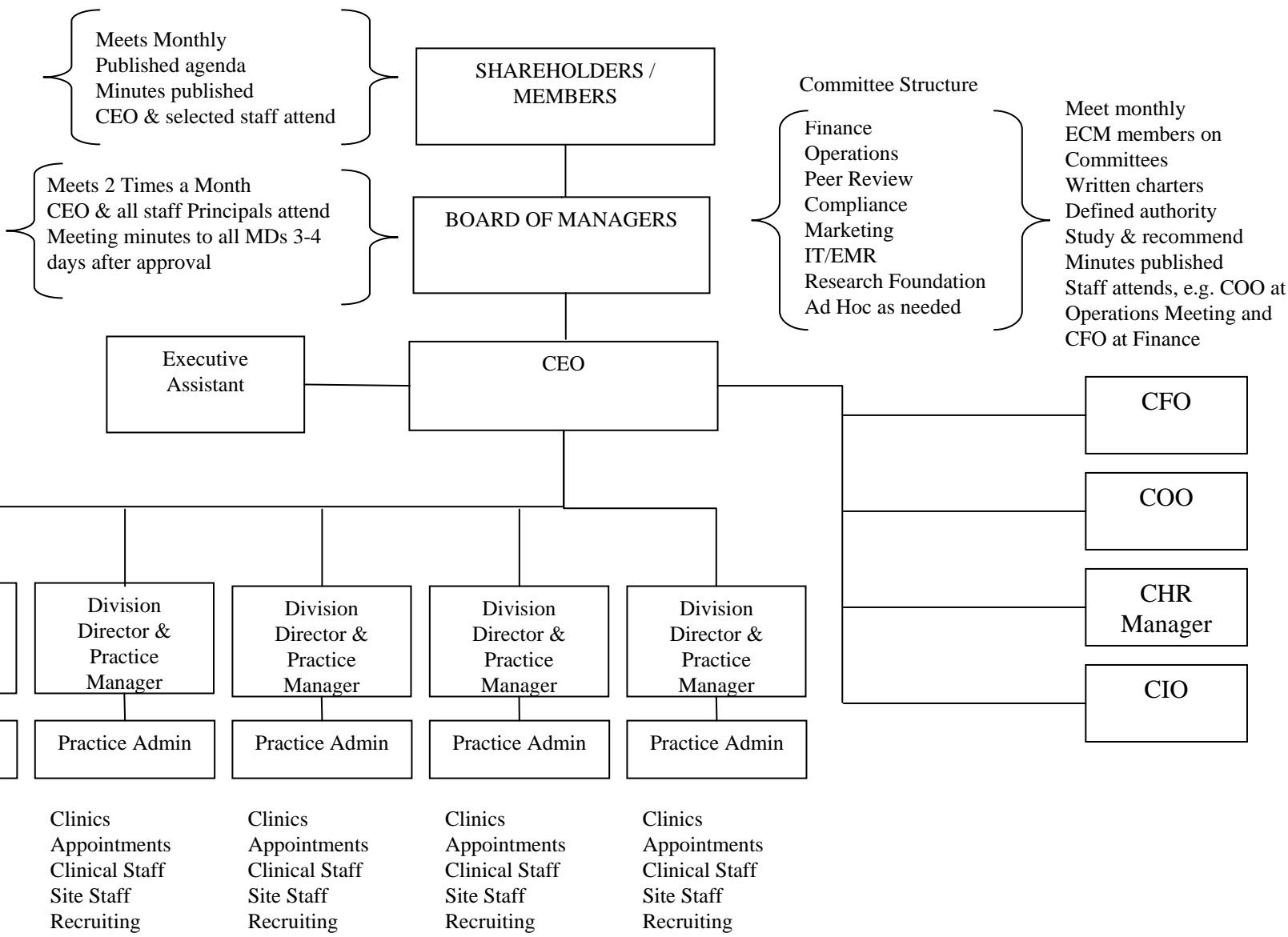


# INTEGRATION WITH SOME DIVISION FOCUS

## ORGANIZATIONAL CHART

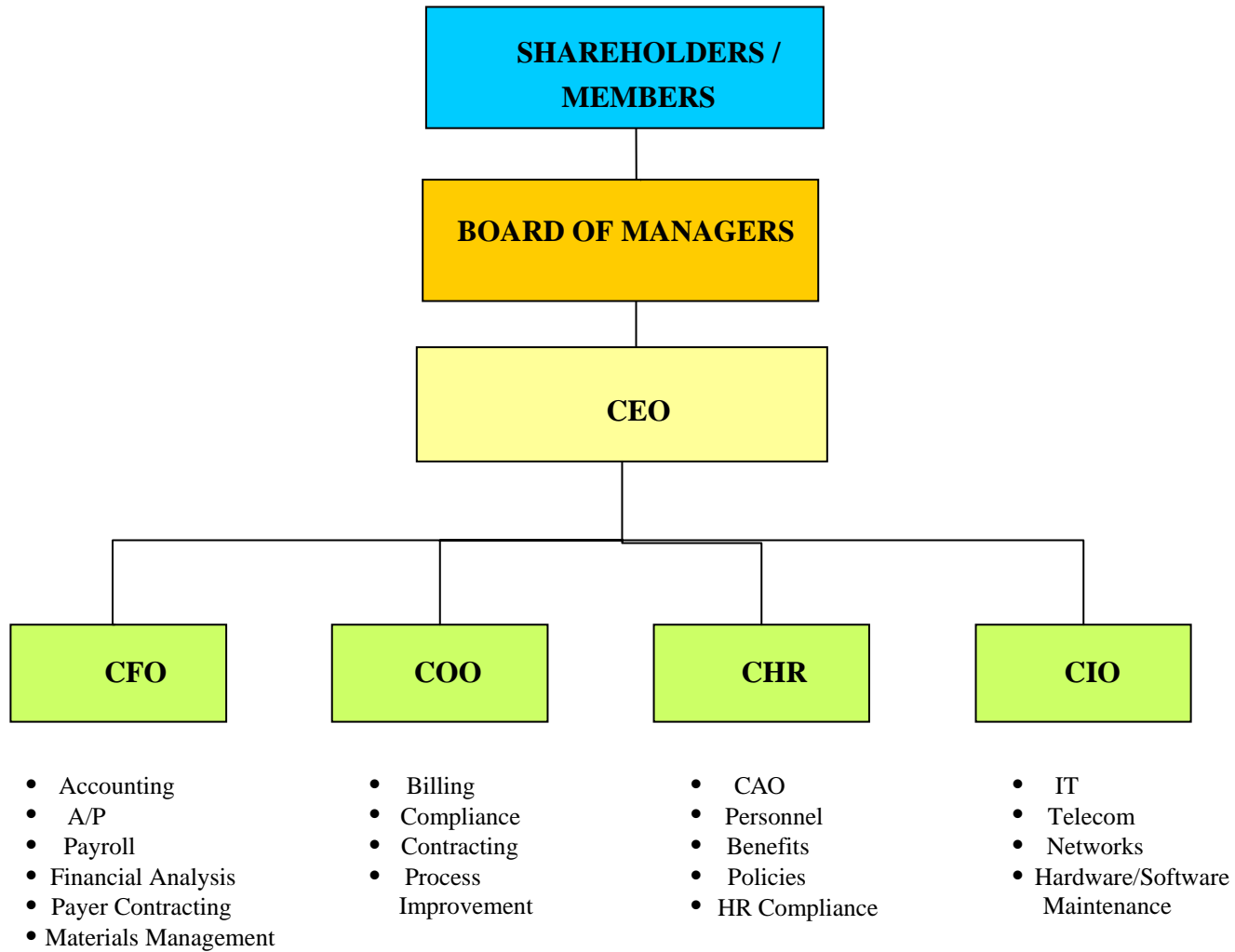


# UMBRELLA FOCUS





# UMBRELLA FOCUS



## GOVERNANCE GRID

R=Recommend

A=Approve

NOTE: Super-Majority vote is defined as 75% except for the instances noted which will require 80% vote for Super-Majority	CEO	EC/Board of Managers	Member/ Owners	Division	Vote
<b>APPOINTMENTS:</b>					
Selection/election of Board of Managers					Majority Vote of each division
Replacement of Board members					Majority Vote of each division
Decision to increase/decrease the number of Members on the Governing Board					Majority
Election of Officers					Majority
<b>MISSION:</b>					
Amending Operating Agreements					Super-Majority
Amending Physician Member/Owner Employment/ Services Agreements					Super-Majority
Amending Associate Employment Agreements					Majority
Approve, change or interpret any statement of or requirements for the mission, vision, role or purpose of the Company					Majority
<b>STRATEGIC:</b>					
Strategic/long-range planning					Majority
Committee appointments					Majority
Decision to sell the entity and/or the assets of the entity					Super-Majority – 80%
Decision to dissolve the entity					Super-Majority – 80%
Decision to add a Division					Super-Majority
Decision to terminate a Division					Super-Majority
Decision to merge the entity with another entity or any other business					Super-Majority – 80%
Approve academic or other strategic affiliation with third parties					Majority

## GOVERNANCE GRID (Cont'd)

	CEO	Board of Managers	Member/ Owners	Division	Actual or Somerset Proposed Vote
<b>STRATEGIC: (CONTINUED)</b>					
Change in primary practice location and/or change in any satellite practice location(s) that would infringe on a current Division's existing locations					Majority
<b>PHYSICIAN MANAGEMENT:</b>					
Change in physician benefits and retirement plans					Majority
Change in AO/APOM, LLC Entity cost allocation					Majority
Change in physician income distribution methodology - Division only					Majority Vote of each division
Definition of physician direct expenses - Division only					Majority Vote of each division
Physician scheduling (office and call) - Division only					Majority Vote of each division
Hiring an employed physician (the Board shall establish basic criteria that each physician must meet in order to be hired)					Majority
Establish performance standards for physicians					Majority
Evaluate performance standards of physicians					Majority
Approve physician performance					Majority
Adding a physician as a shareholder/member					Majority
Discharging a physician shareholder/member					Majority
Discharging an associate physician					Majority
Hiring direct physician clinical personnel - Division only					Majority Vote of each division
<b>MANAGEMENT:</b>					
Hiring or terminating of the CEO					Majority
Hiring or terminating of the CFO/Controller, COO/Billing Manager or CIO/Director of Information Technology					Majority
Establish evaluation policies and processes for CEO, CFO/Controller, COO/Billing Manager, and CIO/Director of Information Technology					Majority
Evaluate performance of CEO					No Vote
Evaluate performance of CFO, COO and CIO					No Vote
Evaluate performance of other management personnel					No Vote
Hiring of new legal and/or accounting representation					Majority (60%)

## GOVERNANCE GRID (Cont'd)

	CEO	Board of Managers	Member/ Owners	Division	Actual or Somerset Proposed Vote
<b>OPERATIONS:</b>					
Material change in duties and responsibilities of AO					Super-Majority
Change in location of Administrative office					-Majority
Hiring staff/excluding management personnel					No Vote
Oversight of administrative/management personnel					No Vote
Development of administrative policies					
Approval of administrative policies					Majority
Development of policies and procedures					
Approval of policies and procedures					Majority
Development of job descriptions					
Approval of job descriptions					Majority
Development of wage scale					
Approval of wage scale					Majority
Development of marketing plan, including budget					
Approval of marketing plan					Majority
<b>FINANCIAL:</b>					
Require additional capital (cash only)					Super-Majority
Declare distribution of capital to members (cash or other assets)					Super-Majority
Settlement of any litigation that names APOM as a party					Super-Majority
Preparation of budgets					
Approval of budgets					Majority
Non-budgeted expenditures of \$5,000 or less for the year					No Vote
Non-budgeted expenditures of \$5,001 to \$25,000 for the year					Majority
Non-budgeted expenditures of \$25,000 to \$99,000					Super-Majority
Single non-budgeted expenditure of \$100,000 or greater					Super-Majority
Approval or termination of payor contracts					Majority

# PRACTICE AFFILIATION ISSUES

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2. Integration Structures Evaluation
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4. Clinical Impact
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# CHALLENGES BETWEEN INTEGRATION MODELS

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- CBO Cost Allocation to Divisions Versus
- Fully Integrated Income Distribution Formula
- DHS Allocation Issues if a Division is less than 5 Physicians
- Governance



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# ECONOMICS

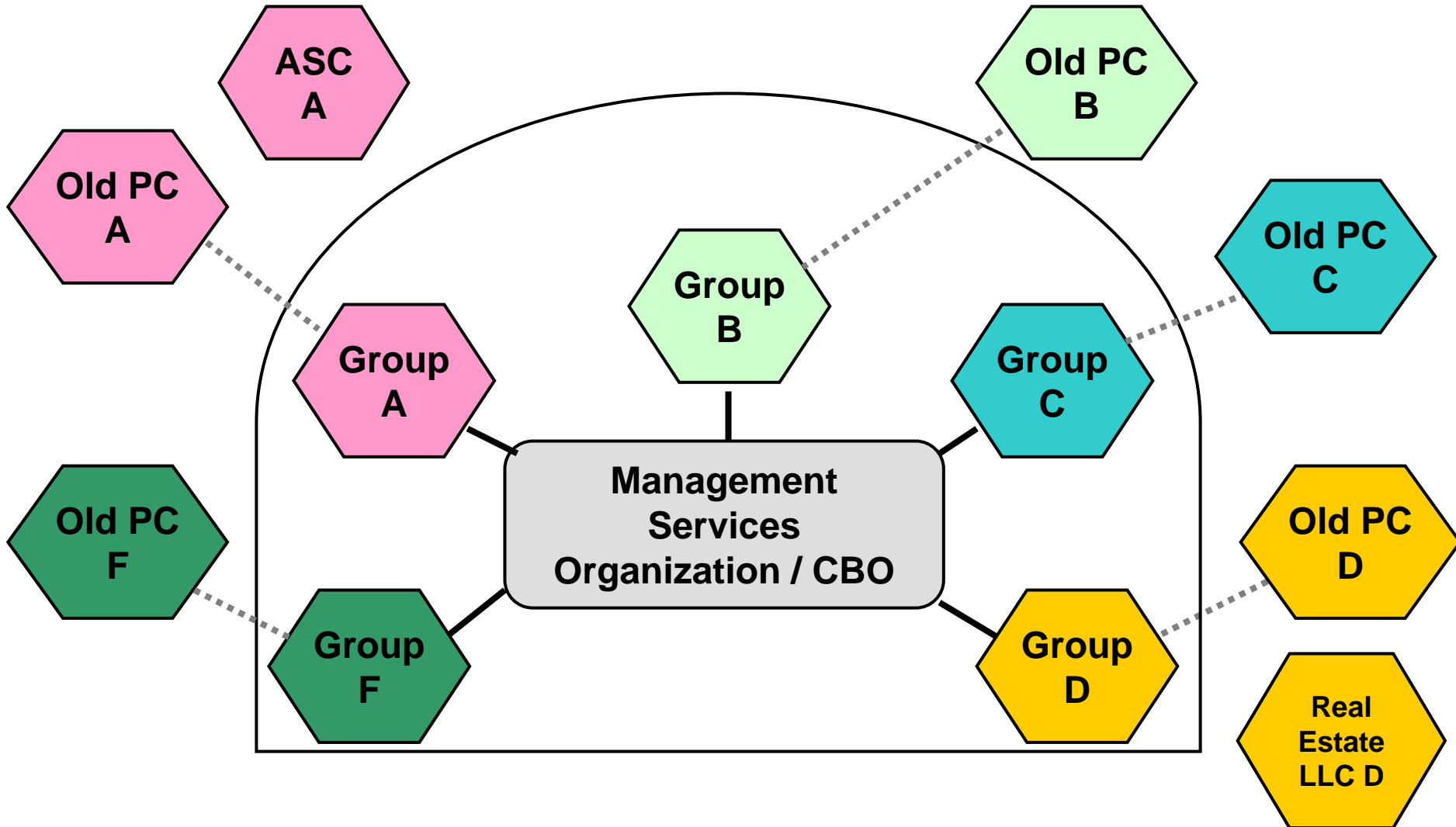


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# INTEGRATION STRUCTURE

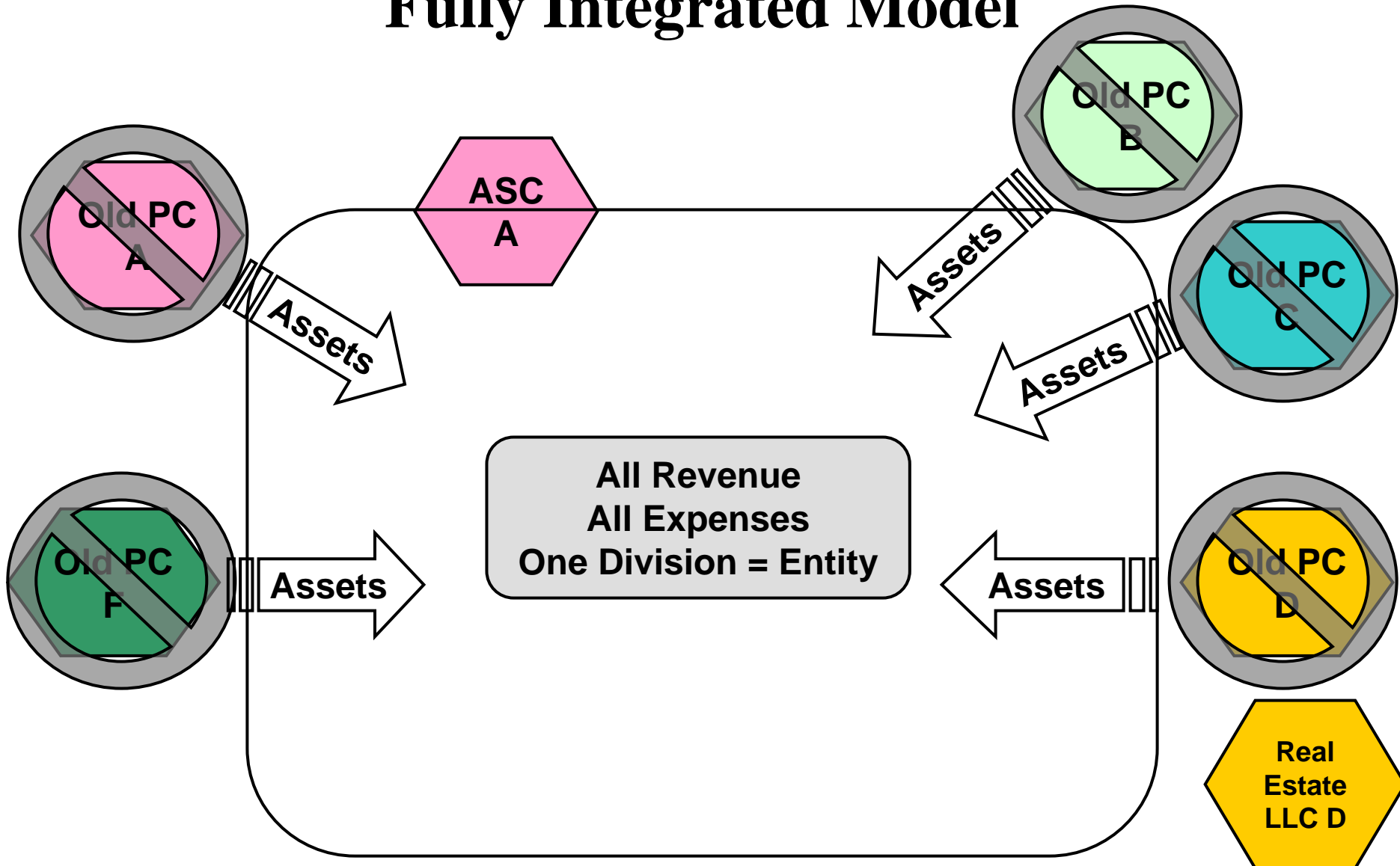
## Partially Integrated Model





# INTEGRATION STRUCTURE

## Fully Integrated Model



**ABC Medical Group**  
**Example of Practice Asset Lease from Division Practice Entities**

**EXAMPLE ONE:**  
**\$100,000 in Office Equipment, 5 Year Loan at 7%, Straight-Line Depreciation**

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Total</u>	
<b>REVENUES:</b>							
Practice lease income (from Ventura Division).....	\$ 26,451	\$ 25,200	\$ 23,859	\$ 22,419	\$ 20,879	\$ 118,808	Essentially the future depreciation + interest
<b>EXPENSES:</b>							
Depreciation Expense.....	20,000	20,000	20,000	20,000	20,000	100,000	Non cash expense
Interest Expense.....	6,451	5,200	3,859	2,419	879	18,808	Interest on Equipment Loan
Total Expenses.....	<u>26,451</u>	<u>25,200</u>	<u>23,859</u>	<u>22,419</u>	<u>20,879</u>	<u>118,808</u>	
<b>Practice Net Income.....</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	Ignores transition period
<b>CASH FLOW ITEMS:</b>							
Add back depreciation.....	20,000	20,000	20,000	20,000	20,000	100,000	Add Back Non-Cash Expense
Less: Debt Service Principal Payments.....	(17,309)	(18,560)	(19,901)	(21,341)	(22,889)	(100,000)	Principal portion of loan payments
Change in Cash .....	<u>2,691</u>	<u>1,440</u>	<u>99</u>	<u>(1,341)</u>	<u>(2,889)</u>	<u>-</u>	
Cumulative Cash Balance.....	<u>\$ 2,691</u>	<u>\$ 4,131</u>	<u>\$ 4,230</u>	<u>\$ 2,889</u>	<u>\$ -</u>	<u>\$ -</u>	

# ABC Medical Group

## EXAMPLE TWO:

**\$100,000 in Office Equipment, 5 Year Loan at 7%, Tax Accelerated Depreciation**

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>	<u>Total</u>	
<b>REVENUES:</b>								
Practice lease income (from Ventura Division).....	\$ 41,451	\$ 31,200	\$ 19,459	\$ 13,439	\$ 13,259	\$ -	\$ 118,808	Essentially the future depreciation + interest
<b>EXPENSES:</b>								
Depreciation Expense.....	35,000	26,000	15,600	11,020	11,020	1,360	100,000	Non cash expense
Interest Expense.....	6,451	5,200	3,859	2,419	879		18,808	Interest on Equipment Loan
Total Expenses.....	<u>41,451</u>	<u>31,200</u>	<u>19,459</u>	<u>13,439</u>	<u>11,899</u>	<u>1,360</u>	<u>118,808</u>	
<b>Practice Net Income.....</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,360</u>	<u>\$ (1,360)</u>	<u>\$ -</u>	Ignores transition period
<b>CASH FLOW ITEMS:</b>								
Add back depreciation.....	35,000	26,000	15,600	11,020	11,020	1,360	100,000	Add Back Non-Cash Expense
Less: Debt Service Principal Payments.....	(17,309)	(18,560)	(19,901)	(21,341)	(22,889)		(100,000)	Principal portion of loan payments
Change in Cash .....	<u>17,691</u>	<u>7,440</u>	<u>(4,301)</u>	<u>(10,321)</u>	<u>(10,509)</u>	<u>-</u>	<u>-</u>	
Cumulative Cash Balance.....	<u>\$ 17,691</u>	<u>\$ 25,131</u>	<u>\$ 20,830</u>	<u>\$ 10,509</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	

# ABC Medical Group

## Example of Practice Operational Transition

### Newco Group A Division

#### Transition Period Fundamentals:

- (1) - Physician Compensation stays in Group PC thru transition
- (2) - Practice Overhead shifts to Newco immediately
- (3) - Group "loans" the income in early months to Newco
- (4) - Group funds losses in last months with loan repayment

### Group A LLC/Corp

#### **Pre-Integration Typical Month**

	<u>B/S</u>	<u>I/S</u>
Collections.....	1,000,000	1,000,000
Overhead Expenses.....	(500,000)	(500,000)
Physician Compensation.....	(500,000)	(500,000)
Cash Balance.....	<u>-</u>	
Net Income.....		<u>-</u>

#### **Post-Integration Example Transition:**

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 1</b>		
Collections.....	-	-
Loan from Group P.C.....	500,000	
Overhead Expenses.....	(500,000)	(500,000)
Physician Compensation.....	-	-
Repayment of Loan.....	<u>-</u>	
Cash Balance.....	<u>-</u>	
Net Income.....		<u>(500,000)</u>

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 1</b>		
Collections.....	1,000,000	1,000,000
Loan To Newco (Division).....	(500,000)	
Overhead Expenses.....	-	-
Physician Compensation.....	(500,000)	(500,000)
Repayment of Loan.....	<u>-</u>	
Cash Balance.....	<u>-</u>	
Net Income.....		<u>500,000</u>

**Post-Integration Example Transition:**

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 1</b>		
Collections.....	-	-
Loan from Group P.C.....	500,000	
Overhead Expenses.....	(500,000)	(500,000)
Physician Compenation.....	-	-
Repayment of Loan.....	-	
Cash Balance.....	<u>-</u>	
Net Income.....		<u>(500,000)</u>

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 1</b>		
Collections.....	1,000,000	1,000,000
Loan To Newco (Division).....	(500,000)	
Overhead Expenses.....	-	-
Physician Compenation.....	(500,000)	(500,000)
Repayment of Loan.....	-	
Cash Balance.....	<u>-</u>	
Net Income.....		<u>500,000</u>

**Post-Integration Example Transition:**

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 2</b>		
Collections.....	250,000	250,000
Loan from Group P.C.....	250,000	
Overhead Expenses.....	(500,000)	(500,000)
Physician Compenation.....	-	-
Repayment of Loan.....	-	
Cash Balance.....	-	
	<u>          </u>	
	<u>          </u>	
Net Income.....		<u>(250,000)</u>

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 2</b>		
Collections.....	750,000	750,000
Loan To Newco (Division).....	(250,000)	
Overhead Expenses.....	-	-
Physician Compenation.....	(500,000)	(500,000)
Repayment of Loan.....	-	
Cash Balance.....	-	
	<u>          </u>	
	<u>          </u>	
Net Income.....		<u>250,000</u>

**Post-Integration Example Transition:**

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 3</b>		
Collections.....	750,000	750,000
Loan from Group P.C.....	-	
Overhead Expenses.....	(500,000)	(500,000)
Physician Compensation.....	-	-
Repayment of Loan.....	(250,000)	
Cash Balance.....	-	
	<u>                    </u>	
Net Income.....		<u>                    </u> <u>                    </u> 250,000

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 3</b>		
Collections.....	250,000	250,000
Loan To Newco (Division).....	-	
Overhead Expenses.....	-	-
Physician Compensation.....	(500,000)	(500,000)
Repayment of Loan.....	250,000	
Cash Balance.....	-	
	<u>                    </u>	
Net Income.....		<u>                    </u> <u>                    </u> (250,000)

**Post-Integration Example Transition:**

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 4</b>		
Collections.....	950,000	950,000
Loan from Group P.C.....	-	
Overhead Expenses.....	(500,000)	(500,000)
Physician Compensation.....	-	-
Repayment of Loan.....	<u>(450,000)</u>	
Cash Balance.....	<u>-</u>	
Net Income.....		<u><u>450,000</u></u>

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 4</b>		
Collections.....	50,000	50,000
Loan To Newco (Division).....	-	
Overhead Expenses.....	-	-
Physician Compensation.....	(500,000)	(500,000)
Repayment of Loan.....	<u>450,000</u>	
Cash Balance.....	<u>-</u>	
Net Income.....		<u><u>(450,000)</u></u>



**Post-Integration Example Transition:**

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 5</b>		
Collections.....	1,000,000	1,000,000
Loan from Group P.C.....	-	
Overhead Expenses.....	(500,000)	(500,000)
Physician Compensation.....	(450,000)	(450,000)
Repayment of Loan.....	(50,000)	
Cash Balance.....	<u>-</u>	
Net Income.....		<u>50,000</u>

Year To Date Net Income.....	<u>-</u>
Inter-Company Loan Balance...	<u>-</u>

	<u>B/S</u>	<u>I/S</u>
<b>MONTH 5</b>		
Collections.....	-	-
Loan To Newco (Division).....	-	
Overhead Expenses.....	-	-
Physician Compensation.....	-	-
Repayment of Loan.....	50,000	
Physician Retirement	<u>(50,000)</u>	(50,000)
Cash Balance.....	<u>-</u>	
Net Income.....		<u>(50,000)</u>

Year To Date Net Income.....	<u>-</u>
Inter-Company Loan Balance...	<u>-</u>

# CONCLUSION

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- Definition of Insanity

“Doing the Same Thing  
Over and Over Again and  
Expecting Different Results.”

*Albert Einstein*



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