



The Valuation of Intangible Assets in the Absence of Positive Net Cash Flows

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Presenter Bio



Robert James Cimasi, MHA, ASA, MCBA, FRICS, CVA, CM&AA, serves as Chief Executive Officer of **HEALTH CAPITAL CONSULTANTS (HCC)**, a nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, MO, serving clients in 49 states since 1993. Mr. Cimasi has over thirty years of experience in serving clients, with a professional focus on the financial and economic aspects of healthcare service sector entities including valuation consulting and capital formation services; healthcare industry transactions, including joint ventures, mergers, acquisitions, and divestitures; litigation support & expert testimony; and certificate-of-need and other regulatory and policy planning consulting.

Mr. Cimasi is a nationally known speaker on healthcare industry topics and the author of numerous peer-reviewed articles, chapters in legal treatises and anthologies, and nationally published books, including: *“Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services”* [2014 - John Wiley & Sons]; *“Accountable Care Organizations: Value Metrics and Capital Formation”* [2013 - Taylor & Francis]; and, his most recent book, *“The Adviser’s Guide to Healthcare – 2nd Edition”* [2015 - AICPA].

He serves on the editorial boards of the Business Appraisals Practice of the IBA, of which he is a member of the College of Fellows, and on The Value Examiner of NACVA. In 2006, Mr. Cimasi was honored with the prestigious *“Shannon Pratt Award in Business Valuation”* conferred by the Institute of Business Appraisers (IBA), and, in 2011, he was named a Fellow of the Royal Institution of Chartered Surveyors (RICS). In 2016, Mr. Cimasi was named a *“Pioneer of the Profession”* as part of the recognition of the National Association of Certified Valuators and Analysts (NACVA) *“Industry Titans”* awards, which distinguishes those whom have had the greatest impact on the profession. You can see his full CV at https://www.healthcapital.com/hcc/html2pdf30/RCimasi_CV.pdf.





Presenter Bio

Todd A. Zigrang, MBA, MHA, FACHE, ASA, is the President of Health Capital Consultants (HCC), where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 20 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 1,000 transactions and joint ventures involving acute care hospitals and health systems; physician practices; ambulatory surgery centers; diagnostic imaging centers; accountable care organizations, managed care organizations, and other third-party payors; dialysis centers; home health agencies; long-term care facilities; and, numerous other ancillary healthcare service businesses. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.



Mr. Zigrang is the co-author of the “Adviser’s Guide to Healthcare – 2nd Edition” (AICPA, 2015), numerous chapters in legal treatises and anthologies, and peer-reviewed and industry articles such as: The Accountant’s Business Manual (AICPA); Valuing Professional Practices and Licenses (Aspen Publishers); Valuation Strategies; Business Appraisal Practice; and, NACVA QuickRead. Additionally, Mr. Zigrang has served as faculty before professional and trade associations such as the American Bar Association (ABA); the National Association of Certified Valuators and Analysts (NACVA); Physician Hospitals of America (PHA); the Institute of Business Appraisers (IBA); the Healthcare Financial Management Association (HFMA); and, the CPA Leadership Institute.



Introduction

- ▶ Contrasting viewpoints in the valuation community surrounding issues related to the valuation of intangible assets in physician practice enterprises:
 - Existence of value for intangible assets of a healthcare professional practice enterprise in the absence of positive net cash flow being generated by the operations of the entity in its entirety
- ▶ Valuation methodologies available for use by the valuation analyst, that:
 - Are legally permissible
 - Have a sound theoretical economic and financial foundation
 - Are feasible to implement in practice



Identification and Classification of Assets

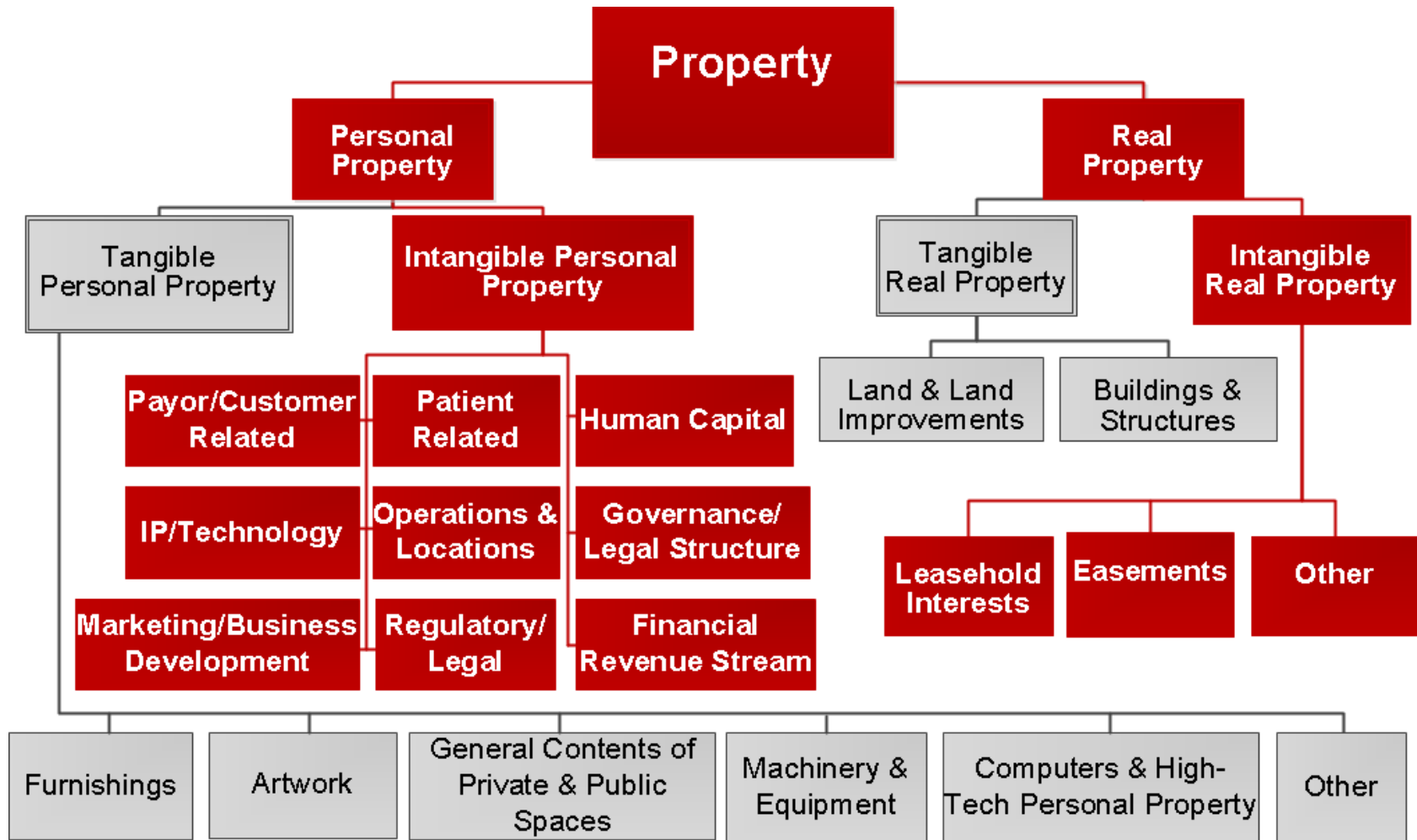
“These perplexing questions as to the nature of the thing to be valued might seem to be of no concern to the student of valuation, however...[h]ow one shall define property in a given case is bound up with the question how one shall find value in that same case.

The two problems must be treated together by persons who understand their interrelationship.”

- James C. Bonbright



Types of Assets





Identification & Classification of Assets

Existence of Intangible Assets

- ▶ To determine whether some nonphysical aspect, operation, or performance of a business enterprise qualifies as an intangible asset for the purposes of a valuation, the item should possess several attributes characteristic of “*property*,” including:
 - The item should exist and be identified in a manner that **allows it to be recognized as a legal property right which can be defended in court** as private property and the ownership of which can be sold or transferred
 - The item should have some element of **evidentiary support and documentation for its existence**, including both the inception and the termination of its existence in relation to an action, circumstance, or event that can be legally described and identified
 - The item should, despite its lack of physical substance, **generate a measure of economic benefit to its owner**
- ▶ *“Certainly the aggregate of a business’ employees, even if they be individually not property, is ‘property’ within the meaning of the Bankruptcy Act...”*



Identification and Classification of Assets

- ▶ Intangible assets are described as assets of an enterprise which cannot be seen or touched
- ▶ Intangible assets have a recognizable description, tangible manifestation of existence, are created at an identifiable time, can be destroyed, and are subject to legal existence, protection, transferability, and private ownership



Intangible Real Property

- ▶ Consists of one or more, but not all, legal rights related to use of real estate and can be influenced by government intervention through eminent domain or police power
- ▶ Police power use of real property is non-compensable, eminent domain is compensable
- ▶ Intangible real property may include:
 - Easements
 - Permits
 - Leasehold Estate
 - Zoning Waivers and Variance
 - Use Rights



Intangible Real Property

Easements

- ▶ Right to perform a specific action on a parcel of real estate, the dominant estate gains the easement and the servient estate is burdened by it
- ▶ The value of the easement is calculated by the value lost by the servient estate and reflected as an economic benefit to the dominant estate



Intangible Real Property

Permits

- ▶ A certification from a government entity to use or develop real estate, like occupancy and building permits
- ▶ Economic value is the cost and time to acquire a permit



Intangible Real Property

Leasehold Estates

- ▶ Interest, like right of use or occupancy, transferred through a lease for a certain term under specific conditions including the lessee paying the lessor rent
- ▶ The value is the rent paid discounted to present value



Intangible Real Property

Zoning Waivers and Variance

- ▶ A variance of certain restrictions or waiver from entire restrictions set on land use by government entities
- ▶ Economic value is the value of the highest and best use of the property with the waiver or variance less the value of the highest and best use of the property without a waiver



Intangible Real Property

Use Rights

- ▶ Specific interests in a specific part of real estate, including water use, mineral/drilling rights, air rights and subterranean rights
- ▶ Economic value quantified by generation of revenues or change in value of subject property



Intangible Personal Property

- ▶ Intangible personal property includes all intangibles assets that are not real property
- ▶ Intangible personal property may include:
 - Payor or Client-Related Intangible Assets
 - Goodwill and Patient-Related Intangible Assets
 - Human Capital-Related Intangible Assets
 - Intellectual Property-Related Intangible Assets
 - Operations-Related Intangible Assets
 - Governance or Legal Structure Related Intangible Assets
 - Marketing and Business Development-Related Intangible Assets
 - Regulatory or Legal-Related Intangible Assets
 - Financial or Revenue Stream-Related Intangible Assets
 - Technology-Related Intangible Assets
 - Practice or Commercial Goodwill in a Physician Practice
 - Professional or Personal Goodwill in a Physician Practice



Intangible Personal Property

Payor or Client-Related Intangible Assets

- ▶ Includes managed care agreements, provider service agreements and HMO enrollment lists. These can provide economic benefit through future revenues or competitive advantages



Intangible Personal Property

Patient-Related Intangible Assets

- ▶ Assemblage of patient information helps reduce cost and therefore provides a net economic benefit
- ▶ Healthcare specific components include:
 - Custodial rights to patient medical charts and records
 - Significant value difference between paper and electronic
 - Patient recall lists
- Special Note: These types of intangible assets are distinguished elements of value separate and distinct from goodwill



Intangible Personal Property

Human Capital-Related Intangible Assets

- ▶ Staff/employee and provider employment agreements, trained and assembled workforce, policies and procedures, and depth of management are included

Intellectual Property-Related Intangible Assets

- ▶ Practice protocols, treatment plans, procedure manuals, research, patents/patent applications, copyrights, trade names and trade secrets all produce value by generating revenues and providing a competitive advantage



Intangible Personal Property

Operations-Related Intangible Assets

- ▶ Operations-related assets include computerized MIS, historical documents like financial statements, and supplier contracts
- ▶ Locations-related assets include favorable leases or leasehold interest, defined as when the lease fee is below market rate

Governance or Legal Structure Related Intangible Assets

- ▶ These may organizational documents, income distributions plans, and covenants not-to-compete, which detail the rules of organization operation



Intangible Personal Property

Marketing and Business Development-Related Intangible Assets

- ▶ This includes advertising, franchise/licensing agreements, and joint ventures or alliances, which creates brand loyalty and access to additional revenue

Regulatory or Legal-Related Intangible Assets

- ▶ Classified as facility or medical licenses, permits, litigation awards and liquidated damages, Certificate of Need, and Medicare or other certifications and accreditations, they provide tangible benefits, competitive advantage and other intangible benefits



Intangible Personal Property

Financial or Revenue Stream-Related Intangible Assets

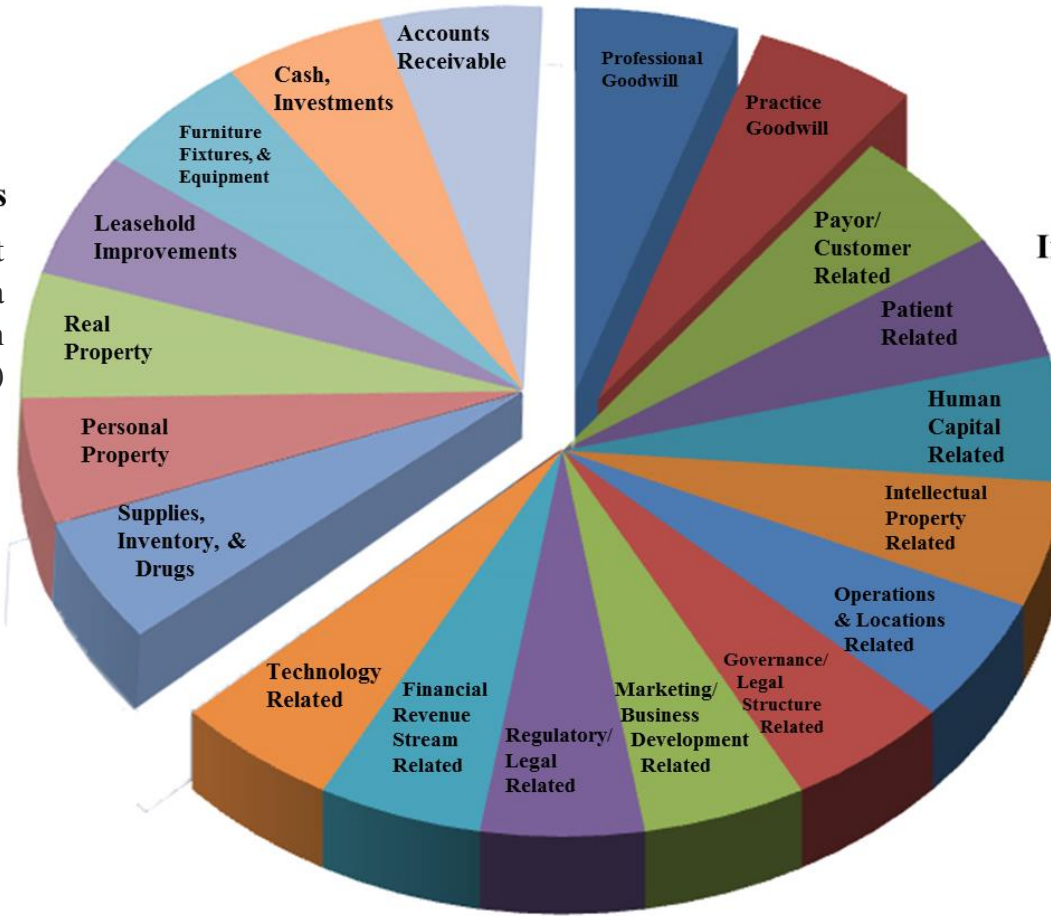
- ▶ Includes office share arrangements, management services agreements and financing agreements, and financial derivatives, which all lend to greater cost efficiency and capital growth

Technology-Related Intangible Assets

- ▶ These are classified as computer software/network integration, technical/software documentation, and maintenance/support agreements, which contribute to increased efficiency of operations and consistency of said operations

Identification and Classification of Assets

Tangible Assets
 Items owned by the subject enterprise that possess a physicality (i.e., they can be seen or touched)



Intangible Assets
 Non-physical items that grant certain specified property rights and privileges of ownership and that have or promise economic benefits to the owner(s) of the subject enterprise



Goodwill Related Intangible Assets

Accounting v. Appraisal Definitions of Goodwill

- ▶ Intangible Assets ≠ Goodwill
 - Goodwill is only one type of intangible asset that may (or may not) exist and be considered in the valuation of professional practices
 - *“There are many interpretations (and misinterpretations) of goodwill. All of these interpretations can generally be grouped into two categories: accounting interpretations and economic interpretations.”* [emphasis added]
- ▶ *“...by the accountant’s broad definition, goodwill generally includes all of the intangible value of a business enterprise. This is usually the case even if the intangible value comes from identifiable personal property assets or intangible real property assets.”* [emphasis added]



Goodwill Related Intangible Assets

Accounting v. Appraisal Definitions of Goodwill

- ▶ Goodwill in the accounting world is defined as:
 - *“The excess of the cost of the acquired interest in an investee over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed.”*
 - *“The excess of the cost of an acquisition price over the fair value of acquired net assets which is recorded as an asset and written down only when, and if, impairment is identified and measured, based on future events and conditions.”*
- ▶ Appraisal Definition of Goodwill:
 - The residual amount of intangible asset value which may exist after the separately identified, separately distinguishable, and separately appraised elements of intangible value have been determined
 - Goodwill is *“calculated as the overall purchase price minus the value of both the tangible assets and identifiable intangible assets that have a finite useful life.”*



Intangible Personal Property

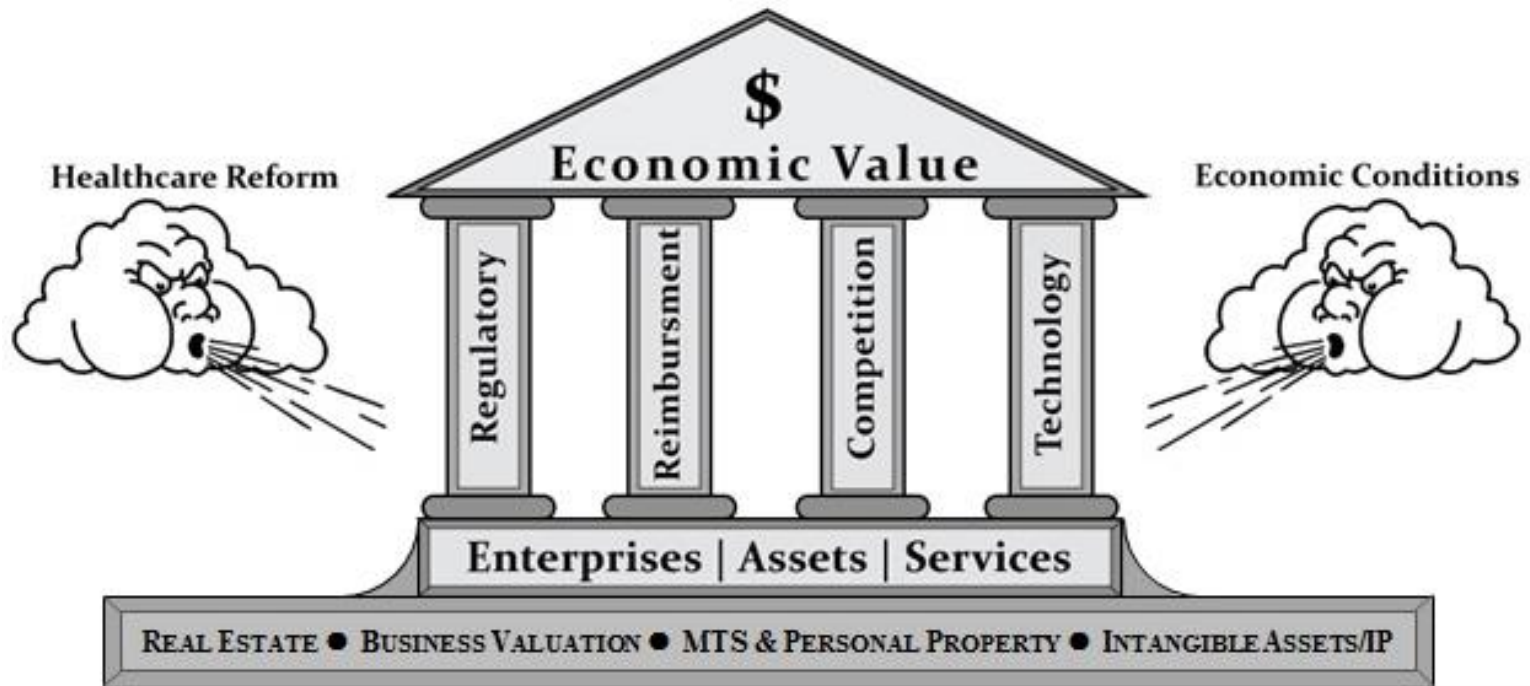
Practice or Commercial Goodwill in a Physician Practice

- ▶ Transferred frequently, this can be described as unidentified/unspecified residual attributes of the entity that contributes to propensity of patient, separated from other attributes that like managed care organization relationships

Professional or Personal Goodwill in a Physician Practice

- ▶ Stemming from the reputation and personal attributes of the physician which accrue that individual physician, these are only recognized in an extended transition period

Healthcare Trends Related to Intangible Assets: *The Four Pillars*



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Current and Future Trends Regarding Intangible Assets

Regulatory Environment Related to an Intangible Asset Transaction

- ▶ Healthcare expenditures have reached all-time highs, so healthcare reform has focused on eliminating fraud through heightened regulatory scrutiny and increased OIG inspections regarding the legal permissibility of healthcare transactions



Current and Future Trends Regarding Intangible Assets

Reimbursement for Intangible Assets

- ▶ Reimbursed for under the prospective payment system, but not directly reimbursed for under Medicare or Medicaid.
- ▶ Example of reimbursed intangible cost includes maintaining an appropriate staff.



Current and Future Trends Regarding Intangible Assets

Competition in the Intangible Asset Market

- ▶ The transition to *Accountable Care Organizations* has increased need for expansion in terms of geographic reach and services offered

Technology in the Intangible Asset Market

- ▶ Those familiar with new technology have an advantage over those without
- ▶ Further, new developments create new intangibles and generate economic benefit



Current and Future Trends Regarding Intangible Assets

Valuation of Intangible Assets

- ▶ Healthcare transactions are more complex than a simple business enterprise acquisition
- ▶ Identification and valuation of intangibles is key

Value Drivers of Intangible Assets

- ▶ Intangibles can be valued by their projected revenue stream, avoided costs under the principle of substitution, and the use of the principle of *scarcity*

Current and Future Trends Regarding Intangible Assets



Economic Principles of Valuation

- ▶ ***Substitution***
 - The cost of an *equally desirable substitute*, or one of equal utility, normally sets the ceiling of value
 - Incremental benefit – benefit of “*buying*” rather than “*building*”
- ▶ ***Investment Limits***
 - Resources are not normally spent in pursuit ***of diminishing returns*** from property
- ▶ ***Anticipation***
 - Economic benefits of rights to control or ownership of property are created from ***expectation of benefits*** or rights to be derived in the *future*
- ▶ ***Utility***
 - “*An object can have no value unless it has utility.*”
 - However, its ***utility may be derived from its exchange***



Current and Future Trends Regarding Intangible Assets

Various Standard of Value in Healthcare Transactions *Fair Market Value (FMV) – Stark Law*

- ▶ *“The value in arm’s-length transactions, consistent with the General Market Value.”*
 - *“The price that an asset would bring, as the result of bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party...” [emphasis added]*
 - *“Usually, the fair market price is the price at which bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition...where the price...has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals.” [emphasis added]*



Current and Future Trends Regarding Intangible Assets

Various Standard of Value in Healthcare Transactions *Fair Market Value (FMV) – Internal Revenue Service*

- ▶ 501 (c)(3) enterprises must avoid “*excess benefit*” transactions
- ▶ **Valuation standard (as per IRS Regs.) is *Fair Market Value***
 - “...*price at which property or the right to use property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy, sell or transfer property or the right to use property, and both having reasonable knowledge of relevant facts.*”



Current and Future Trends Regarding Intangible Assets

Various Standard of Value in Healthcare Transactions

Fair Value

- ▶ The valuation standard for financial reporting is Fair Value, as required by GAAP and the Securities Exchange Commission, which has been defined by the Financial Accounting Standards Board (FASB) ASC 820, as:

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date..”



Current and Future Trends Regarding Intangible Assets

Various Standard of Value in Healthcare Transactions

Investment Value

- ▶ The standard of Investment Value is defined as: *“the specific value of an investment to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached.”* [emphasis added]
- ▶ There may be many reasons why the Investment Value may differ from the FMV of a subject interest:
 - *“(1) Differences in estimates of future earning power,*
 - *(2) Differences in perception of the degree of risk and the required rate of return,*
 - *(3) Differences in financing costs and tax status, and*
 - *(4) Synergies with other operations owned or controlled.”*

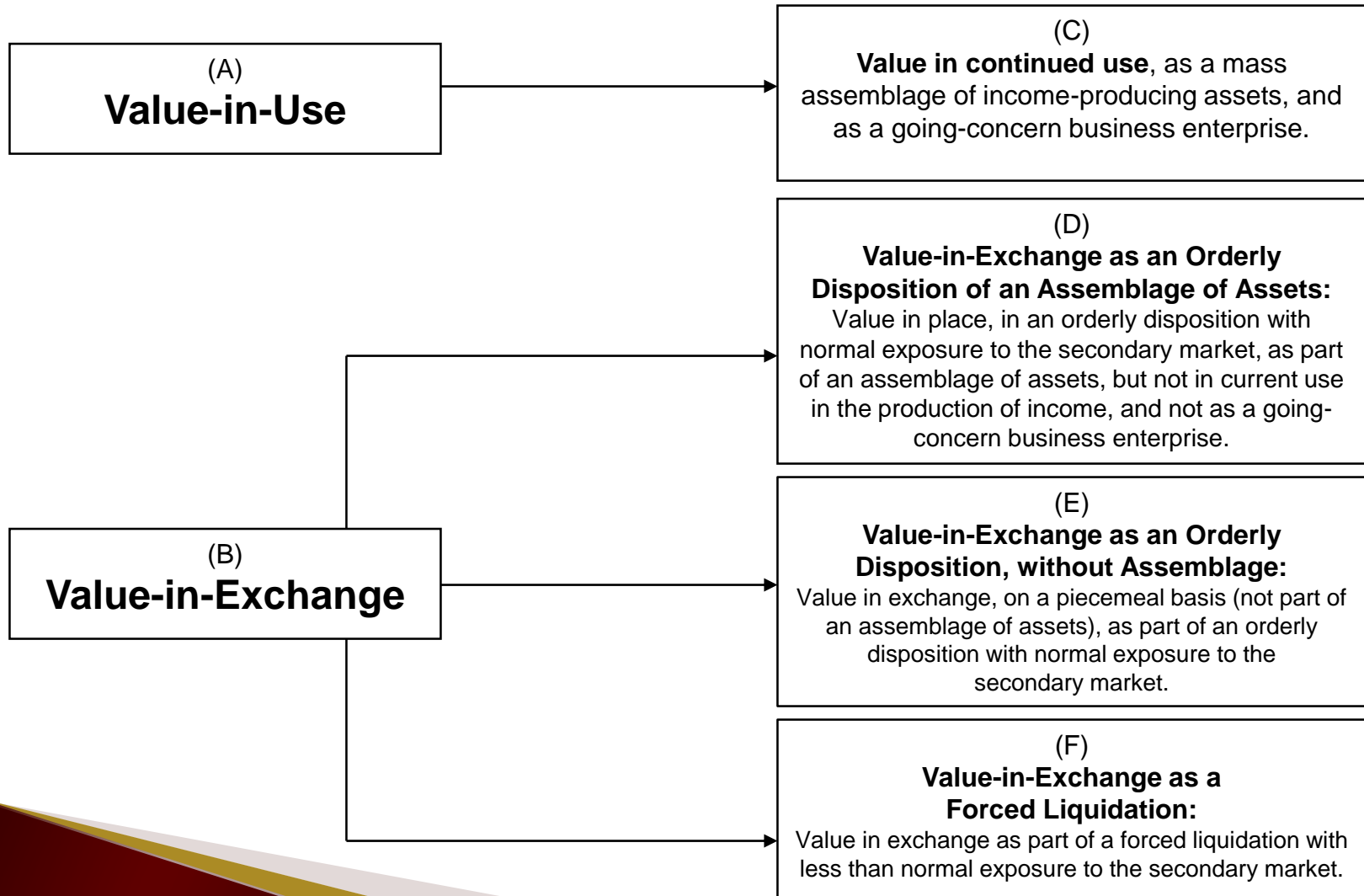


Current and Future Trends Regarding Intangible Assets

Various Premises of Value in Healthcare Transactions

- ▶ *Premise of Value* answers the question:
 - *Value under what further defining circumstances?*
- ▶ Defines the hypothetical terms of the sale
 - Value in Use
 - Value in Exchange
- ▶ Further defines the Standard of Value to be used and under which a valuation is conducted
- ▶ Should be appropriately defined and agreed to by all parties at the outset of each valuation engagement

Current and Future Trends Regarding Intangible Assets





Current and Future Trends Regarding Intangible Assets

Various Premises of Value in Healthcare Transactions *Value in Use*

- ▶ **Value in Use as a going concern** - *“value in continued use, as a mass assemblage of income-producing assets, and as a going-concern business enterprise.”*
- ▶ *“...assumes that the assets will continue to be used as part of an ongoing business enterprise, producing an economic benefit of ownership of a going concern.”*
- ▶ *“...require[s] a reasonable likelihood that the subject enterprise would generate, in the reasonably foreseeable future, sufficient net margin to generate a sufficient economic cash flow to support the value of the investment represented to generate the revenue stream of the provider enterprise.”*



Current and Future Trends Regarding Intangible Assets

Various Premises of Value in Healthcare Transactions *Value in Use*

- ▶ The basis of all economic values derive from some form of economic usefulness, also termed utility
- ▶ The benefits and/or satisfaction derived from:
 - Use of properties & services
 - Use & consumption of goods
 - Use of intangibles
 - Use of money derived from exchanging the property
- ▶ **All “*economic values*” are variations of “*Value in Use*”**



Current and Future Trends Regarding Intangible Assets

Valuation Methods Utilized for Intangible Asset Valuations

- ▶ All valuation methods (i.e., income, market, and cost approaches) should be considered for the valuation of intangibles (for both real property and intangible personal property)
 - **Real Property:** Closely related to valuations of underlying real estate
 - **Personal Property:** Economic value analysis should be focused on the economic benefits expected to be derived. The assets should be first identified then classified under a detailed examination.



Clarification of Common Misconceptions Regarding Payment for Intangible Assets in the Healthcare Industry

- ▶ Positive net cash flow is not required to support the value of an intangible asset
- ▶ *Highest and Best Use* of the invested capital may indicate the subject enterprise is “*Worth More Dead Than Alive*”
- ▶ Avoidance of an economic cost is equivalent to an economic benefit
- ▶ Bankruptcy law recognizes the value of intangible assets, even in the *absence* of positive net cash flow to the enterprise in its entirety
- ▶ Professional valuation standards and healthcare regulations permit the use of a Cost Approach to value intangible assets in the healthcare industry



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

▶ *Aggregate Cash Flow Versus Incremental Cash Flows*

- Cash flow of an enterprise in its entirety is an aggregation of multiple *contributory* incremental cash flows
- “*the sum of the parts does not equal the whole*”
- The *incremental cash flow* generated by certain of the assets owned by the enterprise may be negative, and of a *sufficient magnitude* to offset the positive incremental cash flows of the aggregation of the remaining assets
- The value of the tangible assets would not necessarily be impaired by the existence of intangible assets that are not generating positive cash flow



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

Highest and Best Use

“That use among possible alternatives which is legally permissible, socially acceptable, physically possible, and financially feasible, resulting in the highest economic return.”

- ▶ *“The selection of the appropriate premise of value is an important step in defining the appraisal assignment. Typically, in a controlling interest valuation, the selection of the appropriate premise of value is a function of the highest and best use of the collective assets of the subject business enterprise.”*
- ▶ *“Each of these alternative premises of value may apply under the same standard, or definition, of value. For example, the fair market value standard calls for a ‘willing buyer’ and a ‘willing seller.’ Yet, these willing buyers and sellers have to make an informed economic decision as to how they will transact with each other with regard to the subject business.”*
- ▶ *“**In other words, is the subject business worth more to the buyer and the seller as a going concern that will continue to operate as such, or as a collection of individual assets...In either case, the buyer and seller are still ‘willing.’ And, in both cases, they have concluded a set of transactional circumstances that will maximize the value of the collective assets of the subject business enterprise.**”*
[emphasis added]

-Pratt



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

Highest and Best Use

- ▶ A business enterprise that fails to produce sufficient evidence to indicate a reasonable likelihood that it would, as a going concern enterprise, in the reasonably foreseeable future, be able to generate sufficient economic benefit to support the invested capital utilized to generate the revenue stream of the enterprise, cannot support a valuation premise of *Value-in-Use as a Going Concern*
- ▶ In that event, the adoption of the “*Value-in-Exchange*” premise of value is indicated



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- ▶ The historical *inability* of a *particular owner* to generate a positive net cash flow emanating from the subject asset does not require (nor even imply) that a *typical investor* in a similar asset would be likewise incapable of utilizing a subject intangible asset to produce a *positive stream of economic benefit*
- ▶ The diversity in uses for assets among purchasers and sellers is an economic fact which gives rise to the *difference in anticipated benefit* to be derived from the ownership of the subject asset and the opportunity of the participants in a transaction to generate *gains from trade*, it is the existence of these differences in value, i.e., the aggregate expected economic benefit accruing to the owner of a particular asset, which underpins the concept of “*willing buyer*” and “*willing seller*”



The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- ▶ The foundation of the value of the subject asset is the *aggregate* utility, appropriately discounted to reflect the *delay* in the realization of the expected utility and the *risk* associated with actually achieving the anticipated level of utility



The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- ▶ The impact of a decrement to an economic cost is equivalent to an increase in economic benefit
 - *Expected Utility = Expected Economic Benefits – Expected Economic Costs*
 - *ΔValue = ΔExpected Utility*
 - *ΔExpected Utility = ΔExpected Economic Benefits – ΔExpected Economic Costs*



The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- ▶ The deductibility of the periodic interest payments reduces the overall tax expense for the enterprise, thereby increasing the economic cash flow available to the owners of the subject enterprise
- ▶ Patent valuers often utilize the *Relief from Royalty Method* to determine the value of a particular patent for transactional purposes, whereby the “*relief*” from having to license the patent from another party is a recognized *economic benefit* to the company that holds the patent



Monetary & Non-Monetary Economic Benefit

- ▶ Economic benefit can be derived from both *monetary* and *non-monetary* sources
- ▶ *Tax-exempt, not-for-profit entities*, in the accomplishment of their *charitable mission*, may provide *non-monetary* benefits to the “*owners/investors*” in the charitable organization
- ▶ The lack of anticipated *monetary cash flows* from an asset does not preclude the assignment of value to an asset, since a *rational economic actor* may well be willing to convert a portion of their *monetary wealth* into the *anticipated non-monetary utility* to be derived from ownership or control of an asset



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- ▶ The *bankruptcy courts* have repeatedly established that a debtor company's *assembled workforce* is in fact an asset that is subject to transfer
 - See *Glosband v. Watts Detective Agency, Inc.*
 - See *Robinson v. Watts Detective Agency, Inc.*
 - See *3DFX Interactive, Inc., Debtor, William A. Brandt, Jr, Trustee, v. nVidia Corporation, et al.*



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- ▶ If the value assigned by the bankruptcy courts to a subject intangible asset under a *forced liquidation* premise (i.e., in the absence of sufficient net cash flows of the enterprise in its entirety to offset the investment in the invested capital of the enterprise) is greater than zero, then, *ipso facto*, the value under a *non-liquidation* premise must also be greater than zero



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- ▶ As held in the *3DFX Interactive* case, tax and accounting implications of how assets are listed on the company's balance sheet have little to do with the FMV of those assets
- ▶ Based on the rulings of the tax courts, the valuation question is not ***whether*** an intangible asset has value in the absence of positive net cash flow to the enterprise in its entirety, but instead is to what degree value can be assigned to an intangible asset in the absence of positive net cash flows

Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets



- ▶ *Professional Standards Do Not Preclude the Use of Cost Based Approaches*
 - The use of Cost Based Approaches is not precluded by appraisal standards, and may even be required in the event that the *value in exchange* premise recognizes the *highest and best use* of the assets comprising the subject enterprise
 - USPAP Standards Rule 9-3 states:
 - “In developing an appraisal of an equity interest in a business enterprise with the ability to cause liquidation, an appraiser must investigate the possibility that the business enterprise may have a higher value by liquidation of all or part of the enterprise than by continued operation as is.”
- ▶ *The comment to USPAP Standard 9-3 states:*
 - “*This Standards Rule requires the appraiser to recognize that the continued **operation of a business is not always** the best premise of value because liquidation of all or part of the enterprise may result in a higher value.*”

Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets



- ▶ *The Healthcare Industry Regulatory Environment Precludes the Use of Income Based Approaches in Valuing Certain Healthcare Related Intangible Assets*
 - **Stark** prohibits a physician from making a referral of designated health services to an entity with which the physician, or the physician's family member, has a financial relationship, and where payment for such a service may be made under Medicare.
 - **Exceptions to the Stark Laws are available, and payments made under those arrangements** may not be determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties in order to be in compliance
 - **AKS** deems it a felony to solicit, offer, receive, or pay remuneration of any kind for the referral of a patient for healthcare services paid by federal healthcare programs
 - **Safe Harbors to AKS are available, and payments made under those arrangements** may not be determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties in order to be in compliance

"Limitation on certain physician referrals" 42 U.S.C. § 1395nn(a)(1); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(A)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(B)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(2)(B)(ii); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(3)(A)(v); See generally "Exceptions to the referral prohibition related to compensation arrangements" 42 C.F.R. § 411.357; "Criminal Penalties for Acts Involving Federal Health Care Programs" 42 U.S.C. § 1320a-7b; "Exceptions" 42 C.F.R. § 1001.952(b)(5); "Exceptions" 42 C.F.R. § 1001.952(c)(5); "Exceptions" 42 C.F.R. § 1001.952(d)(5).

Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets



- ▶ For example, the *U.S. ex rel. Singh v. Bradford Regional Medical Center* case held that the appraiser, who utilized an *income approach to value* the healthcare professional practice intangible asset, comprised of a covenant not to compete, took into account the *volume or value of referrals* in determining the value of the property interest
- ▶ The *Bradford* case is important to valuation professionals due to its holding, which infers that income based approaches may not be appropriate when appraising certain intangible assets of medical practices, as doing so may raise an inference that the volume or value of referrals has been considered in determining payments for those assets

"Limitation on certain physician referrals" 42 U.S.C. § 1395nn(a)(1); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(A)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(B)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(2)(B)(ii); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(3)(A)(v); See generally "Exceptions to the referral prohibition related to compensation arrangements" 42 C.F.R. § 411.357; "Criminal Penalties for Acts Involving Federal health care programs" 42 U.S.C. § 1320a-7b; "Exceptions" 42 C.F.R. § 1001.952(b)(5); "Exceptions" 42 C.F.R. § 1001.952(c)(5); "Exceptions" 42 C.F.R. § 1001.952(d)(5).

Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets



- ▶ *Tax Court Cases Provide Some Guidance Related to the Valuation of Intangible Assets in the Healthcare Industry*
 - *Caracci v. Commissioner* held that certain intangible assets may have value in the absence of positive net cash flow to the entity in its entirety
 - *Caracci* also held that when utilizing an *income approach* to value healthcare professional practice enterprise intangible assets all *economic costs* associated with the *economic benefit* generated by the subject intangible asset should be included (however, as previously mentioned, use of an income approach to value healthcare professional practice intangible assets may be legally impermissible)

Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets



- ▶ *Tax Court Cases Provide Some Guidance Related to the Valuation of Intangible Assets in the Healthcare Industry*
 - *Derby v. Commissioner* held that non-financial consideration, along with above market compensation was considered by the tax court to be payment from the buyer to the seller for the seller's intangible assets
 - *Derby* has led some valuation professionals to suggest an offset to the value of certain assets of the enterprise based on post-acquisition compensation being higher than historical compensation, which lacks a theoretical economic and financial foundation in the absence of compensation in excess of *Fair Market Value*
 - The legal permissibility of paying for assets through “*enhanced*” services compensation is certainly questionable, and risk averse valuation analysts are advised to separately identify and separately appraise the amounts paid for services from any amounts paid for assets, tangible or intangible, in order to determine whether the consideration paid for each property interest does not exceed the threshold of *Fair Market Value* or *commercial reasonableness*



Concluding Remarks

- ▶ Assets provide the company with future economic benefit
- ▶ As all value is forward looking, without assets to produce a future economic benefit, a company would have no value
- ▶ The value of any enterprise is bound up in the value of each of its discrete, separately identifiable assets
- ▶ Each and every asset, tangible and intangible, must be identified and appropriately valued, utilizing the most appropriate valuation methodologies, to estimate the value of the subject enterprise



Concluding Remarks

- ▶ The unfounded claim that positive net cash flow is required to support the value of an *intangible asset* is based upon:
 - A misunderstanding of the nature of the cash flows generated by the entirety of an enterprise
 - An incorrect (or absent) application of the concept of *highest and best use*
 - A misunderstanding regarding the nature of economic benefit



Concluding Remarks

- ▶ The valuation of healthcare intangible assets in the absence of positive net cash flows, *and the utilization of an asset approach based cost method under the fair market value-in-exchange premise to determine the value of those intangible assets:*
 - Is not a violation of professional standards
 - Is not legally impermissible under the Anti-Kickback statute, Stark Law, or other regulatory edicts
 - Is substantially supported in the canon of professional valuation literature, related case law, and applicable regulatory pronouncements