Goodwill

Examples, of

G Acquisition Price	H Indexed Price	I Replacement Cost New	J Devaluage Percentage	K Condition Factor	L Restated Value
$3,629.73	$ 5,915.70	—	85.00%	80.00%	$ 709.88
—	—	$65,000.00	48.83%	100.00%	$33,258.33
$2,354.00	$ 3,731.31	—	85.00%	90.00%	$ 503.73
—	—	$ 3,500.00	18.11%	110.00%	$ 3,152.72
$ 255.00	$ 339.67	—	54.28%	100.00%	$ 155.30
$ 900.00	$ 1,221.56	—	58.94%	100.00%	$ 501.52
$7,138.73	—	—	—	—	—
	$11,208.24	—	—	—	—
					$38,281.48

Goodwill and Patient-Related Intangible Assets

Once the identifiable and separately quantifiable intangible assets are valued, the residual amount of intangible asset value that remains is often referred to as **goodwill**. This term may appropriately be considered as the propensity of patients (and the revenue stream thereof) to return to the practice incremental to that which is quantified as the contribution of the other tangible and intangible assets in the assemblage of assets which comprises the enterprise. Keep in mind that goodwill is only one of the several intangible assets that may be found to exist in a professional practice; it is not a "catch-all-moniker" for all intangible assets in the aggregate.

Intangible assets that are sometimes considered as part of goodwill and relating to patients include custodial rights to medical charts and records, electronic medical records, patient recall lists, and both personal or professional goodwill, practice or commercial goodwill, or both. The custody of medical charts, electronic medical records, and patient recall lists may be identified separately and quantified as a distinct intangible asset aside from goodwill, however, they often are considered together with goodwill because they create the background that supports the propensity for the continued patient–provider relationship.

Sources for guidance on the definition of goodwill can be found in IRS RR 59-60 and established judicial opinions from valuation related case law. In the event that the valuator first determines the existence of intangible asset value in the subject enterprise and then determines the existence of goodwill as one of the intangible assets, the next step is to identify, distinguish, disaggregate, and allocate the relevant potion of the existing goodwill to either professional or personal goodwill or practice or commercial goodwill. Note that further discussion of goodwill and the conflicting definitions used to define it, as it relates to valuation, is found in *Conflicting Definitions of Intangible Assets Versus Goodwill.*

Professional or Personal Goodwill

Professional or personal goodwill results from the charisma, education, knowledge, skill, board certification, and reputation of a specific physician practitioner. Professional or personal goodwill is generated by the physician's reputation and personal attributes that accrue to that individual physician. Because these attributes "go to the grave" with that specific individual physician and, therefore, cannot be sold, they have no economic value.

Professional or personal goodwill is not transferable. Even with long transition periods of introduction for a new acquiring physician owner, the charisma, skills, reputation, and personal attributes of the seller cannot, by definition, be transferred.

It is often stated that with assisted transfer (that is, extended transition period) a large portion of professional goodwill may be transferred. The transferability violates the definition of professional or personal goodwill. That portion of goodwill that may be transferred is defined as practice (or commercial) goodwill and is described in the following section.

Practice or Commercial Goodwill

Practice or commercial goodwill, as distinguished from professional or personal goodwill, is transferred frequently. Practice or commercial goodwill may be described as the unidentified, unspecified, residual attributes of the practice as an operating enterprise that contribute to the propensity of patients (and the revenue stream thereof) to return to the practice. Several significant factors should be considered when determining the existence and quantity of practice or commercial goodwill related value.

It must be determined whether patients return to the practice because of attributes of the practice or because they are mandated to do so by their managed care insurance coverage. The practice's participation on a given managed care panel of providers may be subject to rapid and unexpected change. In that circumstance, the valuator needs to decide whether the value of the practice that may be attributable to managed care organization relationships should perhaps be considered as an identifiable, specific contract related asset, and separately valued, as opposed to being treated as practice or commercial goodwill.

Human Capital-Related Intangible Assets

Intangible assets that may be classified as relating to human capital include staff or employee and provider employment agreements, trained and assembled workforce in place, policies and procedures, and depth of management. Staff or employee and provider employment agreements provide the subject enterprise with certain assurances under which the employee or provider fulfills his or her role as a representative of the subject enterprise. The value of recruiting, hiring, and assembling employees and their training, as well as their practice experience, is encompassed in the intangible asset referred to as "trained and assembled workforce in place." This is a growing type of investment due to the high-tech nature of managing and operating practices and the complexity involved in the coding, billing, or claims resolution process and other related tasks. The policies and procedures of a subject enterprise are usually developed and refined over an extended period of time and at a cost to the owner(s) of the subject enterprise. These policies and procedures lend to the efficiencies and productivity of the subject enterprise. Typically, the success of any organization is significantly reliant upon the leadership of the organization. Accordingly, the qualifications and experience brought to the subject enterprise by management personnel may provide depth-of-management value to the subject enterprise.

Intellectual Property-Related Intangible Assets

Intangible assets that may be classified as intellectual property related may include practice protocols, treatment plans or care mapping, procedure manuals and laboratory notebooks, technical and specialty research, patents and patent applications, copyrights, trade names, trade secrets, and royalty agreements. Practice protocols and treatment plans, or care mapping, are standardized steps and an agreed upon process to diagnose and manage a patient's care through the term of the medical need. These assets are usually developed over time based upon tested and researched patient outcome data, which may require significant investment. They may bring value to the subject enterprise, if continuously followed, recorded, and reported, in as much as they provide evidence of a higher quality or more cost-effective delivery of services, which gains competitive advantage in the market. Procedure manuals outline the steps necessary to perform the various tasks required for the operation of the subject enterprise. When followed, procedure manuals can assure the continuous productivity and consistency of performance of the staff even when there is turnover or cross-training of staff.

Technical and specialty research are considered the "work-in-progress" of patents, copyrights, or other intangible assets. Patents acquired by healthcare professional practices may include specialized equipment and instruments that may lend to the increased care and beneficial quality outcomes of the practice's patients. Copyrights acquired by healthcare practices include proprietary software that can generate schedules and track patient care across multiples providers and disciplines, producing utilization and outcome reports based upon the treatment provided for use in negotiating reimbursement from managed care companies. Copyrights also may include books, patient information brochures, websites, and similar communication-related assets. Such software may increase productivity, patient care outcomes, and reimbursement at the practice. Trade names, such as the name of the subject enterprise, can bring recognition and brand loyalty to the subject enterprise. Royalty agreements, usually related to copyrights or patents owned, can provide a continuing revenue stream not subject to healthcare reimbursement risks.

Locations and Operations-Related Intangible Assets

Intangible assets that may be classified as relating to locations and operations may include computerized management information systems that produce customized reports on the financial, operating, and patient outcome performance of the subject enterprise to aid in management decision-making and strategic planning. Favorable leases, and the leasehold interests they generate, can contribute to the value of a subject enterprise, depending upon the ability of the subject enterprise to sublease its leased space at a rate higher than it is paying. The subject enterprise, as a going concern, is a revenue-generating business enterprise and has the immediate ability to create economic benefit for the owner(s). The assemblage of assets may refer to the value of all of the practice's assets in place and working together to generate revenue. Historical documents, such as financial statements, patient charts, and productivity reports create a historical record for which future records can be compared for the purpose of management decision-making and strategic planning. Supplier contracts, typically those obtained through group purchasing organizations, can provide the subject enterprise with pricing and service assurances that can provide increased accuracy and reliability for budgeting of the practice's operations and with a competitive cost advantage for producing and providing its services.

Governance or Legal Structure Related Intangible Assets

Intangible assets that may be classified as relating to governance or legal structure may include organizational documents, income distribution plans, and noncompete covenants. Organizational documents, such as corporate by-laws, operating agreements, and shareholders agreements, are a written record of the "rules" by which the organization operates and provides certain privileges and protections to the owner(s) or shareholder(s) on an individual, as well as a collective, basis. Income distribution plans are the agreed upon formula(s) by which the owner(s) or shareholder(s), as well as other providers, are compensated. Noncompete covenants may provide some competitive protection to the subject enterprise from employees or colleagues who may, at their departure to a competitor, put the practice at risk of losing patients, referrals, or both.

Marketing and Business Development-Related Intangible Assets

Intangible assets that may be classified as marketing and business development may include advertising, franchise or licensing agreements, joint ventures or alliances, and market entrance barriers. Advertising (e.g., websites, Yellow Pages and print media ads, telephone numbers, and billboards) serves, much like trade names do, to create a desired image of the organization in an effort to create brand loyalty. Franchise or license agreements can enable an organization to access markets (either geographical or service) that may not have been feasible previously, for example, licensing the rights to operate a nationally developed cancer treatment center. In much the same way, joint ventures and alliances with other organizations may enable an organization to gain access to additional revenue streams. For example, a healthcare professional practice may partner with a local hospital to develop an ambulatory surgery center. The healthcare practice gains access to the facility fees that, in the past, have been flowing solely to hospital, while it shares the capital responsibility for the development with the hospital.

The stringent requirements for licensing act to restrict the number of practicing professionals, which in turn acts as a limit to competition and sets barriers to participation in the profession. Credentialing restrictions and medical staff requirements of certain hospitals, ambulatory surgery centers, diagnostic imaging centers, and other outpatient facilities also may present a "barrier to entry" for providers in a given location or setting, which provides an element of value for the practice that is the "gatekeeper" for access to the credentialing. Established referral patterns and closed panel managed care contracts also can act as an entry barrier to practices within certain markets.[40] Depending on the specific circumstances, this can either add or detract from practice value. Additionally, allied health professionals and alternative medicine practitioners increasingly are being accepted and recognized by payors and patients as a legitimate alternative to traditional providers and services. A healthcare practice that has already overcome these potential barriers can provide added value to the subject enterprise.

Regulatory or Legal-Related Intangible Assets

Intangible assets that may be classified as relating to regulatory or legal matters may include facility licenses, medical licenses, permits, litigation awards and liquidated damages, certificates of need (CONs), Medicare certification, and other certifications and accreditations. Facility and medical licenses, as well as permits, are consistently under the review of regulatory and legal authorities. Just as they may be a barrier to entry, continued possession can be a competitive advantage. Litigation awards can be in the form of a tangible benefit (for example, cash) or an intangible benefit (for example, upholding a noncompete dispute). A CON, or similar program, is one in which government determines where, when, and how capital expenditures will be made for healthcare facilities and major equipment. A CON acts in a manner similar to a license or permit to allow a provider to offer certain services. Medicare certification of a facility or provider allows reimbursement by the government for patients subscribed to Medicare. The revenue stream of some healthcare organizations (that is, nursing homes, cardiology practices, and hospitals) are heavily dependent upon the revenue stream of Medicare patients, as a result, the ability to bill and receive reimbursement for services provided to these patients is of great value to these organizations. Attainment of other certifications and accreditations, such as the National Committee for Quality Assurance (NCQA), the Accreditation Association for Ambulatory Health Care (AAAHC), and the Joint Commission on Accreditation of Healthcare Organizations (The Joint Commission), can create an added image of quality or superior service for an organization. In addition some third-party payors may require certain accreditations for participation on their panels.

Financial or Revenue Stream-Related Intangible Assets

Intangible assets that may be classified as relating to financial or revenue streams may include office share arrangements, management services agreements, financing agreements, underwriting or private placement memoranda, and budgets, forecasts, or projections. Office share arrangements, whereby a healthcare practice may share office space and staff with another healthcare practice, can enable a practice to see patients in different geographical areas on a periodic basis without bearing the entire overhead costs related to the "satellite" office. Management services agreements (MSAs) define the terms (for example, timeliness and cost) under which an outside organization provides certain management services (for example, accounting, billing, and managed care contracting) to a healthcare practice. In the event that the specific MSA provides a competitive financial advantage to the practice, it may hold economic value to the owner(s). Financing agreements may prove to have value if the favorable terms (for example, amount of credit, interest rate, and amortization of loan) by which an organization may obtain additional capital to grow the organization, through additional working capital, capital purchases, acquisitions, and so forth. Budgets, forecasts, and projections often serve as a road map for the financial performance of an organization. These budgets can assist management in making strategic decisions, such as equipment purchases and provider recruiting, which enhances the probability of future net economic benefit to the owner(s).

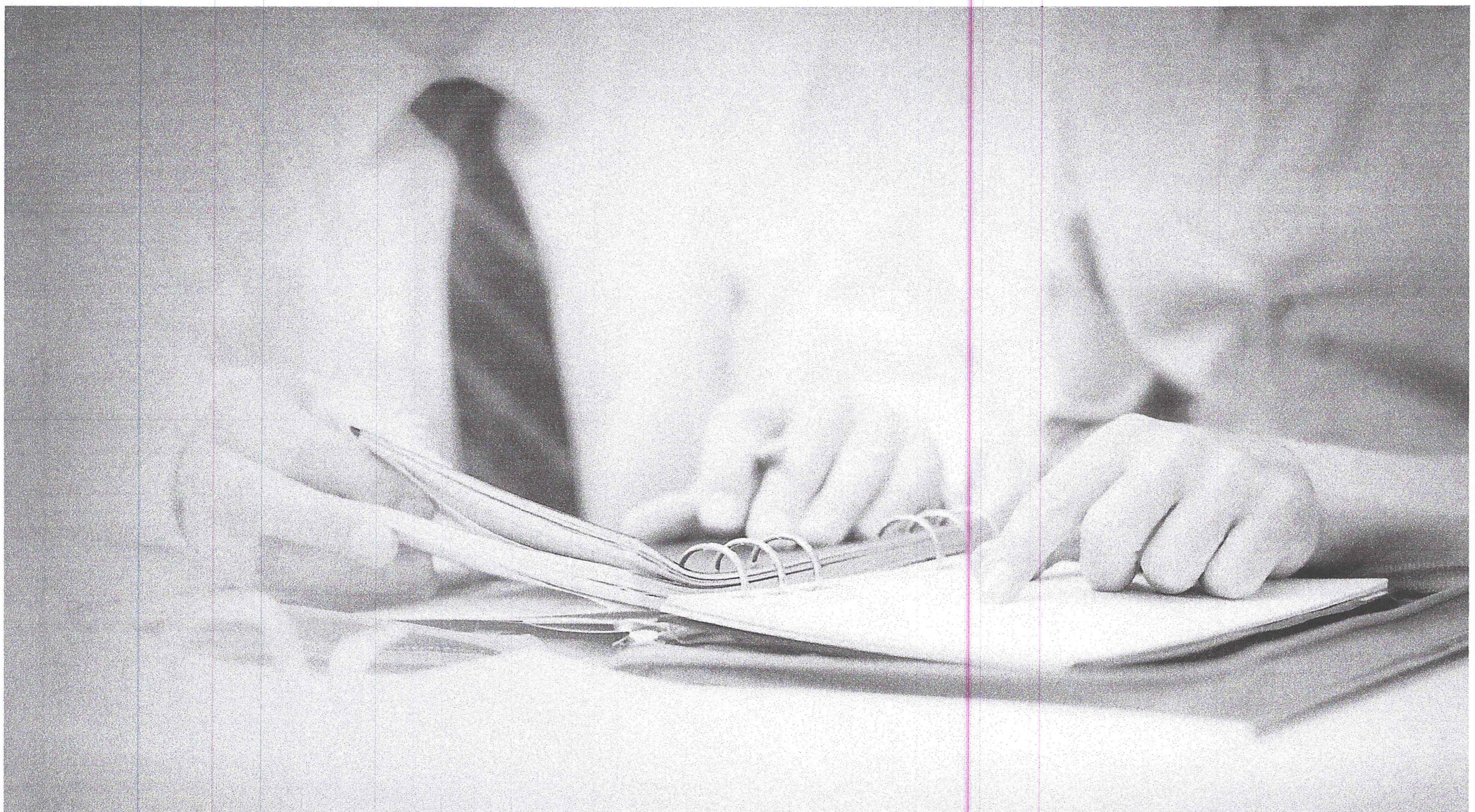
Technology-Related Intangible Assets

Intangible assets that may be classified as relating to technology may include computer software or network integration, technical or software documentation, and maintenance or support agreements. With the increase in productivity provided by office automation, computer software and network integration contribute to the efficient operations of an organization. The documentation of the computer software or network integration of an organization is a written record of these assets in use. The technology in an organization can create economic benefit and value to the organization only if it is working effectively to increase productivity, thereby decreasing costs and enhancing the net economic benefit of ownership. Maintenance and support relationships, typically through written agreements, provide an organization with assurances that the technology will consistently perform as expected and required during the term of the relationship or agreement. The existence and implementation of these agreements may prevent "downtime" with the resulting loss of productivity and related revenue opportunity costs.

Conflicting Definitions of Intangible Assets Versus Goodwill

As discussed in *Goodwill and Patient-Related Intangible Assets*, goodwill is one type of intangible asset that may be considered in the valuation of professional practices. Goodwill is considered by some valuation professionals to be the residual amount of intangible asset value that may exist after the separately identified, separately distinguishable, and separately appraised elements of intangible value have been determined.

In June 2001, the Financial Standards Accounting Board (FASB) instituted Statement of Financial Accounting Standard (SFAS) Nos. 141 and 142. Prior to these standards, companies generally reported as goodwill the entire difference between the purchase price and the book value of identified tangible assets. Intangible assets typically were capitalized as part of overall acquire goodwill and amortized over a finite period; they were *not* required to be separately identified. SFAS Nos. 141 and 142 now require that goodwill be calculated as the overall purchase price minus the value of both tangible and identifiable



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