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Top Ten Issues to Consider in a Valuation Engagement

Valuations in the health care industry are becoming more complex every year. Creative joint ventures, carved out entities, interlocking ownership interests and new reimbursement structures require a level of expertise beyond that of the traditional appraiser. Buyers, sellers, transaction lawyers and appraisers need to be aware of the compliance risk and technical issues that impact the valuation. Based on our years of experience with health care appraisals and fairness opinions, we have prepared this list of the top ten things to consider when hiring an appraiser in the health care industry.

- ▶ **Credentials of appraiser.** The appraisal industry has several organizations that credential appraisal professionals. The oldest and most strenuous of these is the American Society of Appraisers which grants an Accredited Senior Appraiser designation to individuals (ASA) who pass their proctored examinations, have five years experience, have passed the ethics exam and are current on the Uniform Standards of Professional Appraisal Practice (“USPAP”). While appraisal designations do not assure a level of expertise in health care, they assure a level of continuing education and grasp of the basic underlying concepts that are appreciated by legal counsel, the IRS and the courts.
- ▶ **Appraiser’s experience in the health care industry.** Most appraisers are generalists that can be equally comfortable and credible placing a value on a pet shop, car wash or restaurant. However, complex highly-regulated industries such as healthcare, aerospace, and utilities require experts in their industry as well as the appraisal field. Quantifying the value of a health care company requires understanding the risks in the industry and the subject company’s position in the local delivery system – this is not something that can be taught during the appraisal engagement.
- ▶ **Adherence to USPAP.** The appraisal Foundation was authorized by Congress as the source of appraisal standards and appraiser qualifications. Appraisers should have evidence of complying with the standards put forth by the Foundation, the Uniform Standards of Professional Appraisal Practice. This is especially important when using the fair market value standard and when independence is required.
- ▶ **Appraisal methodologies proposed.** There are three primary methodologies to be considered in a valuation engagement. When conducting a “full scope” valuation, the appraiser should at least attempt all three. If a method is inapplicable, the reasoning behind that decision should be clearly documented in the appraisal report.
- ▶ **Clarity regarding deliverable (calculation, limited scope, full scope).** Appraisers can offer a variety of levels of assurance and scope in the valuation process. Every engagement does not require a full scope written certified report, so make sure the deliverable matches your needs.
- ▶ **Clarity regarding independence or advocacy.** If you are engaging an appraiser to be independent you should ask for a copy of their proposed certification statement and have it clearly stated in the proposal. Both the buyer and seller should understand that the appraiser is independent and not an advocate for either side when an independent appraisal is required.

- ▶ Clarity regarding conflicts of interest. Check for conflicts of interest with the appraiser. Some conflicts, such as a financial interest in the buyer or subject company are obvious ones to avoid or disclose. Additionally, in the SOX regulations independent appraisals are viewed similarly to audit professionals. If you have a significant fee relationship with your appraisal firm, it could be perceived to threaten the independence of the appraiser.
- ▶ Appraiser's understanding of your organization. Beyond an understanding of the health care industry in general, it is important that your appraiser have a firm grasp on the specific issues and risks affecting your organization. Assess the appraiser's experience with similar entities (nonprofit systems, physician-hospital joint ventures, independent hospitals, large medical groups, long-term care facilities, specialty services, rural health clinics, etc.) Look for evidence of their ability to judge the risks inherent in your specific situation or geographic area.
- ▶ Clarity regarding fees including scope. The appraiser should spend some time discussing the engagement with you before issuing a proposal. There are many nuances to a valuation engagement that will affect the time necessary to complete the engagement as well as the related fees. The appraisers proposal should clearly identify their understanding of the scope of the engagement and the proposed fees. Some questions to ask include: Will the transaction require a minority interest discount study or a marketability discount study? Is the valuation approach defined or limited by an existing buy-sell agreement? Is the subject of the valuation a stand-alone entity or an integral part of a larger entity (for example a department of a hospital) that would require a "carve-out" of financial data? All of these factors should be discussed up front in order to avoid "scope creep" and unexpected fees.
- ▶ Depth of the appraisal team. Complex problems often require complex solutions. When selecting an appraisal firm, make sure their team has the depth of knowledge and breadth of experience to understand your issues and provide you with thorough, well-founded advice. Successful transactions contribute significantly to the success of your organization and a professional valuation is a key factor in ensuring a smooth transition.

For more information on valuation considerations, contact Rebecca Bales at (310) 320-3990, x4021.