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PRACTICE & TRENDS

Applying a Clinical Model of Care to Transaction Due Diligence

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In high performing healthcare institutions, complex patient cases are met by a multi-disciplinary set of specialized clinicians who perform an assessment of symptoms and interpret various tests to appropriately diagnose the patient's condition. High quality clinicians also evaluate other risks to patient health, which may be tangential to the core ailment. This holistic diagnosis informs the best treatment plans, and successful outcomes.

In healthcare acquisitions, due diligence of a potential target should take a similar approach. The "patient" is the target organization. The "clinicians" are advisors spanning financial, operational, compliance, technology, real estate, and valuation disciplines to holistically assess the risks of the organization. Such a collaborative approach produces a more comprehensive diagnosis of enterprise risk and informs the buyer of how to effectively "treat" risk and opportunities post close. On the contrary, a limited or fragmented

diligence process jeopardizes missing key assessments of overall "health" – financial, operational, and compliance – of a target enterprise.

Why Traditional Diligence Is No Longer Enough

Consolidation has continued across hospitals, health systems, physician practices, ambulatory care, post-acute, and behavioral health settings involving private equity investors, strategic buyers, payers, and other non-traditional buyers. While these buyers often bring needed capital, they may have limited familiarity with complex healthcare reimbursement, regulatory requirements, licensure complexity, and clinical operations risk. Compressed deal timelines can further compound this problem, resulting in a greater need for a coordinated, enterprise-level diligence model that evaluates not only financial results but also the factors that drive them.

A frequent industry default – quality of earnings – is no longer sufficient on its own. Revenue is the product of more than just collections, reflecting combined results of clinical documentation procedures, coding and billing accuracy, payer contracting, and payer denials management. Inaccuracies in documentation, coding, and billing risk not only impact revenue, but also cash repayment obligations, penalties, and potential self-disclosure requirements.

In healthcare, contingent liabilities can be pervasive in the absence of robust and sophisticated compliance programs. Traps abound in physician contracting and compensation, real estate lease administration, and information technology (IT) security of protected health information, which can cripple an organization if not effectively managed. Risk identification of such potential liabilities, through thorough and comprehensive pre-close due diligence, can be the difference between investment success and failure.

Where Disciplines Intersect and Risk Compounds

The most consequential diligence findings are often not confined to one discipline. Those findings are informed by evaluations across disciplines, which, when intersecting, emphasize potential risk. Therefore, it is not only what each advisor finds independently, but what those findings mean together. Collaboration among experts performing due diligence helps to tease out the true enterprise risk areas. Three operational intersections help illustrate this point:

Coding, Compliance, and Potential Financial Impact

A pattern of billing for unsupported services may appear first in a coding review. In isolation, a coding advisor flags the encounters, but in reality, the

issue could create broader financial, compliance, or operational risk. Accordingly, financial diligence may need to adjust revenue expectations, assess reserve adequacy, and evaluate accounts receivable. The compliance review could determine whether inaccurate billings raise the level of potential repayment or even self-disclosure obligations, which could impact purchase price and indemnification provisions. Operational due diligence may find that the root cause is a lack of physician education and opportunities for clinical documentation improvement, which could be addressed through integration.

For example, in a False Claims Act dispute arising after the acquisition of a physician practice, the buyer discovered post-closing that the target had engaged in pervasive improper billing practices, including submitting claims under a physician who was not present and inflating patient volumes. These issues were not identified during due diligence and ultimately led to litigation exposure for the acquirer as a successor to the business. This case highlights how insufficient review of coding and billing practices can result in significant post-transaction liability, underscoring the importance of robust compliance diligence in healthcare transactions.

Electronic Health Records (EHR), Revenue Cycle, and Capital Planning

Effective IT diligence can connect what may otherwise appear to be separate concerns into a single view of transaction risk and post-close investment. An aging or poorly configured EHR environment may require significant capital investment to modernize systems, strengthen interoperability, and support successful integration. The same diligence process may also identify cybersecurity deficiencies that create compliance exposure, particularly where protected health information is involved, and financial risk of remediation costs, breach response obligations, business interruption, or potential penalties. At the same time, antiquated EHR functionality can impede clinical operations by limiting accurate charge capture, delaying documentation, increasing claim denials, and creating workflow inefficiencies for providers and staff.

When evaluated together, these findings help the buyer understand not only where underperformance exists, but also why it exists, and what will be required to correct it. The conclusion may affect purchase price, integration budgeting, capital planning, and risk allocation. By contrast, when IT, revenue cycle, cybersecurity, and clinical operations are reviewed in disparate silos, each advisor may report only a partial issue, while the full cost and operational impact of closing the performance gap may go unrecognized in the transaction.

Provider Arrangements, Fair Market Value, and Referral Risk

A physician employment or call coverage agreement may appear routine in a legal review. However, if the same arrangement involves a significant referral source without a thoughtful, fact-based assessment of fair market value and commercial reasonableness, it can create exposure for Stark Law and Anti-Kickback Statute violations. Real estate leases with referral-sources which aren't documented, current, or in accordance with fair market value lease rates warrant similar scrutiny.

These arrangements are best evaluated through simultaneous review by legal counsel and valuation advisors. A compensation rate that satisfies a narrow legal review may not withstand a fair market value analysis, and a lease that appears commercially reasonable in isolation may look different when the landlord's referral relationship is considered. As with clinical diagnosis, a finding that appears benign within one discipline may reveal a more significant issue when examined alongside findings from another.

Such examples highlight the necessity of integrating legal, regulatory, and financial perspectives early in diligence to identify and mitigate compliance risks before they become costly liabilities.

High-Impact Diligence Areas

In addition to these intersections, certain areas carry disproportionate risk and warrant structured attention in most healthcare transactions:

1. *Financial sustainability.* Financial diligence must do more than confirm historical earnings before interest, taxes, depreciation, and amortization (EBITDA). It should also assess whether performance is sustainable, absent significant non-recuring events, and considers trends in payer mix, contractual allowances, bad debt, accounts receivable aging, reserve adequacy, and working capital. Also important for assessment is the target's ability to perform under value-based contracts, labor cost pressures, and service-line shifts not reflected in historical statements.

2. *Deferred investments and capital needs.* Reported earnings at acceptable levels can mask significant deferred investment in facilities, equipment, technology, and clinical programs. These deferrals can become buyer obligations post-closing. Buyers should assess facility conditions, equipment age, maintenance backlogs, technology roadmaps, and cybersecurity remediation needs to ensure purchase price considers required investments and integration budgets reflect total cost of ownership.

3. *Revenue integrity and reimbursement.* Revenue integrity spans clinical documentation, coding, billing, charge capture, payer contracting, and collection efforts. Diligence should evaluate claim support, medical necessity evaluations, denials management, patient status determinations, cost report accuracy, managed care reimbursement terms, and payer audit exposure.

4. *Enterprise compliance.* An effective compliance program is not a checkbox but a risk management infrastructure. Diligence should assess auditing and monitoring practices, reporting mechanisms, investigation protocols, remediation history, and program maturity and should assess alignment with the Seven Elements of a Compliance Program. A deficient program can create repayment obligations, penalties, and disclosure requirements that transfer to the buyer.

5. *Clinical operations.* Clinical diligence goes beyond documentation and coding. Buyers need to understand care delivery models, staffing levels, provider coverage, quality and patient safety indicators, service-line viability, and physician alignment. These factors directly influence revenue, cost, compliance, patient experience, and integration success. These attributes are critical in shaping the post-close work plan.

6. *Information technology and cybersecurity.* IT and security reviews are an essential component of any complete diligence process. Buyers should assess EHR and billing systems, data integrity, reporting capabilities, vendor contracts, conversion requirements, and cybersecurity controls, including HIPAA security risk assessments, breach history, access controls, and disaster recovery posture. IT findings routinely affect both transaction economics and integration timelines.

7. *Other Considerations.* Other areas not to neglect include tax, real estate, and provider arrangements. Tax diligence addresses transaction structure, tax attributes, payroll and sales/use tax compliance, unrelated business income, and tax-exempt implications. Real estate review covers ownership, leases, referral-source relationships, fair market value support, and deferred maintenance. Provider compensation review examines payment terms, productivity incentives, stacked compensation, call coverage, and fair market value and commercial reasonableness, with particular attention to referral-source arrangements.

From Diagnosis to Decision

The value of integrated diligence lies in accumulating various data points and perspectives to assess the overall "health" of a healthcare organization. Coordinated diligence findings across multiple perspectives inform purchase price adjustments, escrow or indemnification provisions, closing conditions, post-closing financial projections, and integration plans for the buyer. It's important for any diligence firm to apply this multi-disciplinary approach for an enterprise risk assessment to support clients in buying decisions.

Due Diligence, PYA

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