COSMOS
Navigate the Compliance Universe

Compliance Today - June 2020
What to consider when structuring a hospital-based coverage agreement

By Joe Aguilar, MBA, MPH, MSN, CVA

Joe Aguilar (joe.aguilar@hmsvalue.com) is a Partner with HMS Valuation Partners in Atlanta, GA.

With the goal of increasing quality of care while containing costs, hospitals and healthcare systems are focused on reducing lengths of stay, decreasing complication rates, and cutting readmission rates. One way to effectively accomplish these objectives is purchasing hospital-based service line coverage from physicians and/or clinical management groups. These arrangements involve a wide range of specialties, including, but not limited to, hospital, intensive care, emergency medicine, obstetrics and gynecology, trauma surgery, radiology, and neonatology services.

With shrinking reimbursements and increasing provider salaries, healthcare systems are perpetually contending with increased compensation demands by contractors.[1] For example, proposed changes to the rules associated with balance billing raise concerns over their impact on contractor revenues.[2] As a result, hospitals are feeling pressure from contractors to increase the compensation terms within their professional services agreements (PSAs). These market and regulatory factors will continue to challenge both the system and compliance professionals.

As hospital-based programs increase in number throughout the country to meet these challenges, compliance professionals within hospitals and health systems will encounter a wide variety of PSAs. It is important to consider the structure of these agreements and their impact on compliance. Three key items to consider are: (a) the difference between a collection guarantee and subsidy arrangement, (b) terms that can mitigate financial and/or compliance risk, and (c) the use of advanced practice providers (APP).

Understanding the difference: Collections guarantee versus interval subsidy payments

As you consider a PSA, it is critical to understand the method of compensation. While there are many nuances to these types of agreements, the compensation structure is typically either a collections guarantee or an interval subsidy. There are many similarities between the two structures. The following operational and financial indicators are key drivers to both forms of compensation:

- Resources required of the contractor in fulfillment of the PSA;
- Level of restricted on-site coverage;
- Staffing differences (physician vs APP);
- Provider compensation, benefits, and malpractice costs; and
- Expected collections and operating expenses for the services required.

While each indicator above has an impact on the fair market value (FMV) compensation, the structure of the

compensation term can vary dramatically.

Collections guarantee

Collections guarantee means the payment amount to the contractor is variable. The subject agreement stipulates a maximum annual collections figure that the purchaser shall guarantee. However, the amount actually paid to the contractor is a function of the contractor's collections. An example of typical language used in such subject agreement is: "Purchaser shall compensate contractor an amount by which the contractor's collections are less than the maximum collections guarantee." See Table 1 for the calculations for three months.

		Month 1	Month 2	Month 3	Quarter reconciliation
Professional collections	A	$110,000	$250,000	$90,000	$450,000
Collections guarantee	B	$200,000	$200,000	$200,000	$600,000
Purchaser payment	B-A	$90,000	($50,000)	$110,000	$150,000

Table 1: Collections guarantee quarterly reconciliation

There is typically a reconciliation of payments done at certain intervals (i.e., quarterly and/or annually). Table 1 illustrates quarterly reconciliation, where the purchaser would not typically be obligated to pay or receive anything in the second month. At the end of the quarter, the parties will reconcile total payments against the total guarantee. As such, the contractor will always have $200,000 per month in funds to use for the services. However, the greater the amount the contractor collects for the professional services provided, the less the purchaser will pay and vice versa.

Interval subsidy

The interval subsidy is a predetermined rate paid based on a specific interval of coverage (per 24-hour shift, monthly, etc.) stipulated in the subject agreement. Regardless of the contractor's collections, the interval subsidy does not change. It is a fixed amount regardless of collections performance or production volume. As such, there is no reconciliation of payments. Table 2 illustrates the calculation for three months.

		Month 1	Month 2	Month 3	Quarter payments
Professional collections	A	$110,000	$250,000	$90,000	$450,000
Subsidy	B	$50,000	$50,000	$50,000	$150,000

Purchaser payment	A+B	$160,000	$300,000	$140,000	$600,000

Table 2: Total subsidy quarterly payments

As can be seen in Table 2, the contractor's funds to cover the cost of the service change whether the collection performance is high or low in a particular month. The greater the contractor's collections, the greater the overall revenues they will receive for the service.

Now that we understand the methods of compensation, let's see their impact on the purchaser's payments in Table 3.

		Base year: FMV analysis	Annual subsidy
Professional collections	A	$500,000	$500,000
Physician compensation	B	($1,000,000)	($1,000,000)
APP compensation	C	($150,000)	($150,000)
Physician malpractice	D	($60,000)	($60,000)
APP malpractice	E	($5,000)	($5,000)
Operating expense	F	($150,000)	($150,000)
Net income/loss	G	($865,000)	($865,000)
FMV annual collections guarantee	B+C+D+E+F[1]	$1,365,000	N/A
FMV annual subsidy	G[2]	N/A	$865,000
Purchaser payment	G[3]	$865,000	$865,000

Total funds available to contractor	B+C+D+E+F[4]	$1,365,000	$1,365,000

Table 3: Collections guarantee versus subsidy for a hospitalist service

1. The FMV under an annual collections guarantee is typically derived from multiple methods; however, for the purposes of understanding Table 3, it is based on the sum of all the operating expenses for the program (B+C+D+E+F).
2. The FMV under an annual subsidy is also typically derived from multiple methods; however, for the purpose of understanding Table 3, it is based on the net loss for the service (A-B-C-D-E-F).
3. The purchaser's payment represents the hospital payment to the contractor. The numbers in Table 3 are for an annual subsidy of $865,000. As a result, the purchaser's payment to the contractor is $865,000.
4. The funds available to the contractor represents the sum of the purchaser's payment (annual subsidy) plus professional collections the contractor generates while covering the service.

As you can see, at face value, there can be a significant difference between the two methods of compensation. In the example in Table 3 associated with a hospitalist program, the annual subsidy is $865,000, while the annual collections guarantee is $1,365,000. Using $1,365,000 as the FMV limit when the agreement terms are structured as a subsidy could lead to an overpayment to the contractor of $500,000 ($1,365,000 minus $865,000). As can be seen through this example, your system could face a recordable event associated with overpayment if attention is not paid to aligning the FMV result with the actual term of the subject agreement. This is critical from the start of negotiation to the point of signing, as we have seen material terms change at the final stages of negotiations (i.e., converting the terms from a collection guarantee to annual subsidy).