

THE BIGGEST MISTAKES THAT DOCTORS MAKE WITH RESPECT TO MANAGING THEIR MEDICAL PRACTICES AND INVESTMENTS

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A thriving and successful medical practice can quickly be pulled under by one catastrophic incident that destroys its financial solvency, credibility, or both. How and why do such catastrophes occur, and what are their most common forms?

EXECUTIVE SUMMARY:

This commentary reviews eleven avoidable mistakes that can be the cause of fatal errors for medical practices and investment portfolios.

COMMENT:

While different physicians and groups of physicians tend to make more mistakes in one area than another, each common mistake area should be reviewed and understood with appropriate advisors. These common errors, which are described in more detail below, are as follows:

1. Failure to Maintain and Appropriately Use Independent Professional Advisors
2. Failure to Maintain Medical Law Compliance
3. Failure to Maintain Proper Malpractice Insurance
4. Failure of Multiple Physician-Owned Practices to Have Appropriate Buy-Sell and/or Shareholder Agreements in Place
5. Failure to Procure and Maintain Proper Insurances
6. Failure to Make the Medical Practice and Doctor Judgment-Proof
7. Failure to Theft-Proof the Practice's Monies and Accounts Receivable
8. Using Greedy Investment Advisors
9. Unbalanced Investment Portfolios
10. Doing Business with the Wrong People
11. Failure to Have Anyone in the Practice Pay Attention to Contracts with Third Parties

1. Failure to Maintain and Appropriately Use Independent Professional Advisors

Many of the calamities described below will be avoided if a medical practice has experienced advisors on board. The practice should consult with its advisors when making major practice decisions and periodically confirm that appropriate procedures and safeguards are in place.

(a) CPA: Quite often the quarterback of the advisor team will be a good, caring Certified Public Accountant who does extensive medical practice work. CPA's are often well-versed in investments, business matters, and methods of theft-proofing a medical practice from a financial standpoint.

CPAs should prepare quarterly or monthly financial statements for the medical practice; these statements should involve a review of accounts receivable, cash flow, and general practice financial information.

(b) Attorney: An experienced lawyer who represents a number of medical practices should have sufficient experience to help physicians avoid terrible problems before they occur.

Just as physicians advise patients to have an annual check-up, and may wisely require this before prescriptions are renewed beyond 12 months, a medical practice client should confer with its lawyer on a periodic basis. Commonly, the primary lawyer for the practice will refer matters to appropriate sub-specialist attorneys in a number of different areas. Often this happens in conjunction with a CPA meeting.

(c) Other Advisors: Other advisors commonly and appropriately used by a medical practice group will include (i) a qualified pension plan advisor, who is also preferably an actuary, as well as (ii) a banker who is knowledgeable as to practical business expense and loan-associated planning, and (iii) a reputable and conservative financial advisor (or advisors) who assists with pension planning, various insurances, and other practice-associated financial instruments.

Good advisors should be honest and always let the physician and the rest of the team know about questions, concerns, or the need to bring in additional experts to handle any particular matter or situation. Advisors who show up to sell a single product or scheme commonly cause problems, as described below.

2. Failure to Maintain Medical Law Compliance

A great many physicians are annihilated financially when Medicare and/or private insurance carriers request hundreds of thousands of dollars in refunds because the physician has used inappropriate billing practices or financial arrangements with third parties. In many cases, these

problems are reported to the government by employees who can earn a 15% "whistle-blower fee."

Many physician clients simply do not realize that they use improper coding, do not maintain sufficient patient file back-up, or bill for items that are inappropriately unbundled or altogether un-billable.

Several years ago, the concept of a "medical practice compliance audit" was in vogue, and many professionals, in the opinion of the author, significantly over-charged physician groups for "practice audits." Such audits extended far beyond a reasonable review of billing, patient file documentation, and third-party financial arrangement review.

Reasonable and periodic practice maintenance and review by trusted medical consultant advisors eliminates the need for such a costly venture. In the author's experience, most medical practices benefit from hiring an independent consultant to come into the practice, perhaps annually, to spend a day randomly reviewing patient charts and the billing and collection processes associated therewith.

Quite often a good consultant can spot billing opportunities where the practice is undercharging or not knowing to charge for certain services. An independent consultant can also be a tactful go-between to let certain members of a medical practice know that their file documentation is not sufficient. Such corrections are best conveyed by a neutral third party.

Consultants should be hired by a lawyer on behalf of the medical practice so that any problems they may discover can stay confidential under the attorney-client privilege to the extent possible.

If and when the government criticizes a medical practice's coding, file documentation, or other billing procedures, it is very helpful to be able to show that the practice conscientiously hired and followed the advice of a reputable billing and coding consultant on a periodic basis.

Many physician groups are also unfamiliar with or intentionally disregard rules relating to arm's length leases, compensation arrangements, and the ability to refer tests within a group medical practice. The author has had law-abiding and well-meaning physician clients arrested in their lobbies by the FBI as a result of being in business with the wrong people at the wrong time.

Doctors can rest assured that any "scoundrel" that they have legitimate or questionable business relationships with will turn them in to get amnesty if and when approached

by law enforcement, even if the doctor did nothing wrong. When law enforcement comes knocking, the doctor should immediately have appropriate sub-specialty lawyers contact law enforcement on his or her behalf. Neither the doctor nor his or her staff should directly speak with any law enforcement officers at any time on any topic.

3. Failure to Maintain Proper Malpractice Insurance

While malpractice insurance is not inexpensive, it is necessary in order to protect physicians from the significant legal fees, expert witness costs, and liability exposure associated with defending lawsuits. The proliferation of the personal injury lawyer industry shows no sign of slowing down, and a sympathetic jury system, coupled with experts willing to testify that a doctor committed malpractice under complicated circumstances that a jury can never understand provides good cause for maintaining appropriate malpractice insurance coverage.

Many advisors and clients believe that a practice need only maintain the lowest limits of liability coverage because "they will always settle for your limits," but the author has found that, in many cases, plaintiffs will not settle for low limits of medical malpractice insurance liability where there are other significant assets exposed. Physician clients will sleep better and have a greater sense of financial security, as well as significantly less personal exposure, when they have higher levels of liability insurance than the legally required minimum.

Many physicians will obtain malpractice insurance coverage from low-cost carriers that turn out to be infirm and go bankrupt, leaving doctors high and dry to defend their own claims and without any coverage whatsoever for legal and expert expenses.

Any opportunity to pay significantly less than the going rate for malpractice coverage should be reviewed carefully with the above concerns in mind.

Also, the income tax laws permit a medical group to form its own "captive insurance carrier" and deduct premiums paid to the carrier company. Under the tax law, the carrier company may not have to include premiums received as income unless or until it is determined what portion of the premiums will be used to pay claims as expenses and what portion of the premiums will be profits. Profits taken out later may be taxed at favorable capital gains rates.

Nevertheless, there is a significant economic risk taken since the carrier could "go under" if there are extensive claims, and when there are multiple doctors being insured by the carrier, one or two doctors who make a lot of mistakes could cost all of the equity for the other doctors.

Further, unlike conventional malpractice insurance, which requires a carrier to offer tail malpractice insurance coverage at the request of each doctor, captive insurance carrier

reinsurance contracts will commonly not bind the reinsurance company to even renew the coverage, let alone provide a tail policy on termination, leaving an entire group of doctors without any coverage whatsoever. Successor carriers will not provide tail coverage for periods of time that no other carrier is on the hook for.

The laws of most states require that malpractice insurance be provided by a state-registered carrier. Doctors who have malpractice insurance furnished by an unregistered carrier may be considered to be "going bare" under state law, and may therefore have to notify patients that the doctor is "bare." A possible loss of license can occur if a doctor cannot satisfy a claim by reason of not having malpractice insurance or the financial wherewithal to pay a claim.

Many doctors are not aware that for a small additional premium, they can have a separate "corporate" malpractice insurance policy issued by the same carrier that provides individual policies that covers the medical practice company in order to effectively double the limits of malpractice insurance that would be available to pay on a claim and to assure that the company will have coverage if one of the doctors leaves and refuses to buy tail malpractice insurance.

Also, nurse practitioners and registered nurses can often qualify for insurance with high limits of liability for very low cost. Many physicians will not treat certain types of high-risk patients unless they, at all times, have a nurse practitioner in the room with them to make sure that there is plenty of coverage, witnesses to what is said, and appropriate follow-up.

4. Failure of Multiple Physician-Owned Practices to Have Appropriate Buy-Sell and/or Shareholder Agreements in Place

Many successful medical practices are run on a handshake or a long-forgotten and now archaic agreement, but when problems or changes in circumstances arise, the results can be catastrophic and quite lucrative for the legal profession.

For the sake of example, assume that Doctor A and Doctor B are lifelong friends who have practiced together 25 years and share 50% each ownership of a medical practice without current legal agreements. Their spouses have also been best friends.

They have always worked approximately the same and have always been paid the same. A couple of years ago, they were offered \$3,000,000 for the practice, which involved signing 5-year non-competes and 5-year employment agreements. They also own the practice real estate together in a separate company under which they have signed a \$2,000,000 mortgage on real estate now worth only \$1,500,000.

If Doctor A becomes disabled, they may not be able to agree on how much Doctor B should be paid to administer the practice. Disagreements may also arise regarding the hiring of a replacement doctor or doctors.

They may also not be able to agree on a price or terms for Doctor B to buy Doctor A out.

Often disabled physicians believe they will be returning to work. Meanwhile, their partners see the writing on the wall and take a more skeptical view of their capacity for recovery. The practice can be significantly damaged during this period of time until the disabled physician's status on returning to work is absolutely confirmed.

What if Doctor A becomes a drug addict or begins having an affair with medical practice personnel that could cause obliteration of the practice? How can Doctor B force Doctor A to leave or to even behave? How can Doctor B protect the practice and himself from responsibility for Doctor A's misconduct?

What if Doctor A dies? Doctor A's widow may believe that the practice is worth \$3,000,000 and will be voting Doctor A's stock unless or until she is bought out. How can Doctor B convince Doctor A's widow and her lawyers and valuation experts that the practice has lost significant value because of Doctor A's death? How can Doctor B run the practice if Doctor A's widow will not agree to any significant changes in situations where such changes become necessary?

How can Doctor B attract a new doctor to the practice if he has to disclose that he is not getting along with the 50% widow owner of the practice?

The list of examples goes on and on. It does take time and money to put together an appropriate Buy-Sell/Employment/Shareholder document package. Almost no two are the same as circumstances change. However, it is a valuable investment that every practice should make.

In addition, applicable state law and/or Medicare law often requires that compensation be based upon methods determined in advance that do not take into account the referral of patient services. As mentioned under number 2 above, the referral of a patient within a group practice for certain testing or other "designated health services" under the Stark Law can be a felony unless there is a properly documented method of sharing that qualifies under the

Stark Laws. Failure to have this in writing in advance of a particular calendar quarter can constitute a felony offense.

5. Failure to Procure and Maintain Proper Insurances

There are a myriad of insurances required to appropriately safeguard a medical practice from the normal risks of doing business, particularly in view of the American trial system.

Fortunately most of these risks can be reasonably handled on an affordable basis, assuming that proper coverage is in place.

The most important coverage is clearly malpractice insurance, which is addressed below as a separate section, but other insurances which are essential to the well-being of physicians and their medical practices include:

- 1) disability insurance,
- 2) overhead insurance to handle practice expenses during a period of disability or in the event of a natural disaster such as a hurricane or acts of terrorism,
- 3) liability insurance to cover non-malpractice obligations, such as if patients or others hurt themselves in the parking lot or fall on slippery areas in the office,
- 4) workers' compensation insurance to protect the practice against state laws that can require lifetime support and/or significant monetary payments to be made to an employee injured in the course of employment, and
- 5) un-owned automobile liability insurance to insure against the liability that occurs to a medical practice if any employee is in an automobile accident while running errands or otherwise working in the course of medical practice business.

Individual automobile liability policies should also be reviewed to ensure that each physician has coverage for medical practice-related driving. Many personal policies will not cover business driving without additional policy riders. The author commonly recommends at least \$3,000,000 - \$5,000,000 worth of umbrella liability coverage to cover all business and personal driving and driving by others who might use the doctor's car.

There are thousands of disabled physicians in the United States now living on disability insurance. The author has more than 15 clients who have been able to "retire" on their

disability insurance. This explains why the rates are so high to procure such coverage but also why having good coverage is a necessity rather than a luxury for physicians who do not have adequate retirement savings to support themselves and their families for their remaining lifetimes.

Sometimes individual health insurance policies will not cover on-the-job injuries under the presumption that a doctor will be covered under workers' compensation for on-the-job injuries. Doctors who do not have workers' compensation insurance, which is often waived to save money, should check their health insurance policies to make sure that they are covered for on-the-job injuries.

6. Failure to Make the Medical Malpractice and Doctor Judgment-Proof

There are many ways that a medical practice and a doctor can work to make themselves a less-attractive target for a plaintiff's lawyer.

Often, the practice incurs debt in its name, and the lender or lenders have liens on practice and personal assets that must be paid before a plaintiff is able to levy upon a doctor or practice. Also, valuable assets like real estate and furniture and equipment can be owned by a separate entity that would lease those assets to the medical practice to make them inaccessible, or at least less accessible, to a malpractice claimant.

It is also important to ensure that each physician in a group has his or her personal creditor protection planning properly in place so that a plaintiff lawyer can be led to settle within policy limits if and when a catastrophic lawsuit occurs.

Because of state and bankruptcy law fraudulent transfer law statutes, it is often crucial that creditor protection planning for the medical practice entity and the doctors occur well before any problems arise.

When a serious lawsuit occurs, the doctors should keep in mind that the lawyer hired by the insurance company does not necessarily have duty of absolute loyalty to the doctor. The malpractice insurance carrier selects and pays the lawyer.

There are often circumstances whereby an independent lawyer should be hired by the doctor to encourage the insurance carrier to settle a claim within policy limits when the opportunity arises, in order not to risk the doctor's personal and practice assets to an "excess verdict." Many states have laws that will require an insurance carrier to be responsible for any excess verdict if proper demand has been made upon the carrier when it had the opportunity to settle within policy limits. These are called the "bad faith" rules.

7. Failure to Theft-Proof the Practice's Monies and Accounts Receivable

The author regularly receives at least one phone call per year from a very upset physician who has had tens of thousands of practice dollars stolen by an employee. This employee has often been with the practice many years, and, most of the time, is the most-trusted person in the practice other than the physicians themselves. As such, the employee is able to obtain physical possession of checks made payable to the practice by one or more payer sources and/or has written checks on the practice accounts for bogus expenses.

Over the years, the author has seen medical practices unwillingly and unwittingly pay credit card expenses, electric company expenses, car payments, and even home mortgage payments for a medical practice employee. When the circumstances are reviewed, they reveal that most of these situations would have been avoidable with proper supervision and use of appropriate safeguards.

Additionally, money is often stolen from practice accounts when large projects such as buildings, construction, or similar matters are administered by a person who signs the checks and/or administers the checks and invoices for a busy physician.

Most of the time, the theft is carried out by the most-trusted office manager without any assistance from another employee.

It is a very basic accounting system principle that the person or people who physically open the envelopes containing checks payable to the practice record the checks onto a log and ensure that the checks are properly deposited. These deposits are then reported to a separate employee who has the ability to record the payments in the practice's computer system.

It is a fatal error to allow one individual to have physical possession of checks and also the ability to enter payments or write-offs onto the practice's billing computer system. Even spouses have been known to steal from medical practices, especially when there are multiple partners.

Many practices use a post office box for checks to eliminate the risk of someone being able to "snatch a few checks from the mail" before they can be posted. Many banks offer check-depositing services and addresses that can be used as well. These are often known as "lock box" arrangements.

Larger practices can have someone from their CPA firm visit the practice on an annual basis without advance notice to the practice personnel. This demonstrates to employees that there is some degree of monitoring going on and can discourage practice theft.

8. Using Greedy Investment Advisors

There are a number of different investments and life insurance and annuity arrangements that can be sold to doctors and their practices in the financial world. The quality of each particular investment vehicle can vary dramatically in terms of actual financial safety, conservative versus aggressive orientation, likelihood of being acceptable to the IRS in the event of an audit, and the amount of commissions paid to advisors who may suggest such arrangements.

Expecting a physician to read a prospectus or to understand a complicated tax maneuver is like expecting a lawyer or a CPA to read an EKG- it is easy to be fooled!

If the advisors are earning a significant portion of the amounts invested as compensation, a degree of manipulation, non-disclosure, exaggeration, or outright lying can take place.

In the pension world, actuaries and many CPA firms who practice extensively in the retirement plan arena can yield the great results for clients. Pension and profit-sharing plans are well-protected under applicable creditor laws and well-accepted under the tax law in conventional form.

More aggressive plans such as 419A Welfare Benefit plans and 412i plans should be examined carefully by independent advisors before investing.

The author urges clients to use independent accountants who are not compensated directly or indirectly for the sale of financial products. The author has seen entire fortunes lost to tax shelter deals in the 1970s, leveraged real estate deals in the 1980s, land development deals in the 1990s, and now Madoff and related Ponzi and margined securities deals in the present decade. Crime often pays, and the victim is the doctor who gets involved in these types of arrangements.

There is rarely a good reason for a pension or profit-sharing plan to own a life insurance or annuity product, except to compensate anyone who may be licensed in life insurance and annuities who has involvement in the pension or profit-sharing.

9. Unbalanced Investment Portfolios

Statistical studies show that a diversified portfolio of investments will generally out perform a non-diversified portfolio with significantly less risk. Many successful clients own investment real estate, mutual funds allocated among the various classes of stock investments, and bond funds or CDs. It almost never makes sense for anyone to put all of their eggs in one basket.

Go for Singles and Doubles, not Home Runs. Time and time again, we have seen physicians place significant portions of their financial assets into high-risk investments or ventures with the intention of hitting “a home run” under risky circumstances. By our experience these clients almost always strike out. Many end up working full-time into their 70's and eventually retire only by selling their home and living in an apartment.

There is almost always a direct and opposite correlation between expected rate of return and risk being taken. Many high income professionals recognize this and are nevertheless willing to take risks. Quite often, however, physician investors are assured that an arrangement is “virtually risk free” even though it is expected (or touted) to yield a significant return. If it is too good to be true, it probably is.

10. Doing Business with the Wrong People

Unfortunately, crime, and also deceitful or misleading behavior can be lucrative for the "bad or careless actor," and these individuals are often found courting doctors to do business and investment transactions or to provide consulting services.

Since the overwhelming majority of doctors are very honest and do not have formal business training, it is not difficult to market "unique propositions" to doctors and to eventually find a handful of doctors who may succumb to participate in a recommended arrangement.

Commonly these "bad actors" will present themselves through relatives, friends and possibly even misled advisors.

Typically the doctor will be asked to invest in a startup or growing company, to help start a new business, or to be involved in the purchasing or financing of real estate.

Bad actors are often well-dressed, exhibit success in the forms of nice houses, cars, stunning vacations, trophy wives, impressive club memberships, and sometimes even jet airplanes.

A team of advisors can usually sniff out this type of individual or organization by checking references (or the lack thereof), licensing, and with other professionals who have

worked with the applicable individual. The author has seen this occur in billing companies, unique invention startups, real estate ventures, medical related companies, ice machines (that did not exist), Ponzi schemes, and other situations.

If it sounds too good to be true, it usually is! And do not forget the adage about the experienced businessman and the doctor who become partners. The businessman puts in his experience, and the doctor puts in his money. At the end of the day, the businessman has the money, and the doctor merely has an experience!

Doctors with gamble-holic tendencies are often drawn to elusive schemes where the doctor is told that he or she has earned millions of dollars and should have colleagues put money in so that they can earn millions, too. In reality, the "con job" is that the money is being stolen or used to pay debts on assets that will never be worth anything. A junior Madoff may be your next door neighbor or brother-in-law!

Every year, the IRS publishes the "Dirty Dozen," a list of tax frauds, including schemes involving the internet, domestic tax crimes, offshore frauds and false claims for refunds. This is done for the benefit of citizens and their awareness of financial predators. The IRS website at <http://www.irs.gov/newsroom/article/0,id=206370,00.html> states the following:

"Taxpayers should be wary of scams to avoid paying taxes that seem too good to be true, especially during these challenging economic times," Commissioner Doug Shulman said. "There is no secret trick that can eliminate a person's tax obligations. People should be wary of anyone peddling any of these scams."

11. Failure to Have Anyone in the Practice Pay Attention to Contracts with Third Parties

Quite often, medical practices get into disputes or find themselves stuck in agreements as a result of a trusting nature or lack of attention to details associated with contracts they enter into with third parties. Say, for example, somebody delivers a copier to the medical practice that the office manager has requested on a trial basis. Upon delivery, that person gets the receptionist to sign a contract accepting the copier and binding the practice to 48 months of payments.

Another example is when a medical practice has a lease that gives the doctors the right to extend after a certain date, but they forget to give notice of extension by the deadline. The practice gets held up by the landlord for a larger rent payment or has to vacate and find new property.

A third example is when a lease for a large piece of equipment also requires the practice to maintain the equipment with one company only. The company may provide poor

service or may not permit the practice to pre-pay the lease or re-finance it from a high rate of interest without paying tens of thousands of dollars in penalties.

Another trap some practices fall into is using an office manager or non-CPA accountant to draft legal documents that employ physicians or to set up companies for the practice, not realizing that the contracts have inappropriate provisions or do not cover essential items that a lawyer or appropriately-qualified advisor would have pointed out.

F. Lee Baily said that "anyone who acts as his own lawyer has a fool for a client."

Most successful lawyers hire other lawyers to do work for them personally when it is outside of their area of specialty or sometimes even when it is within their area of specialty because of this phenomenon.

If lawyers are smart enough not to do legal work for themselves, why aren't doctors and their other advisors?

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