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Compensation Philosophies

Developing an Effective Compliance Tool for Home Health & Hospice Medical Directors

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Compensation Philosophies as Compliance Tools for Contracted Medical Directors

Home health and hospice agencies must take special care when contracting with referring physicians for medical director services. It is important that payments meet compliance standards—including commercial reasonableness, fair market value, and volume or value standards. When compensation paid to contracted medical directors does not meet these standards, the arrangement may be perceived as a sham to pay for patient referrals. Under federal healthcare programs, it is a crime to pay for referrals. There are recent examples of big dollar settlements being paid by home health and hospice organizations accused of fraudulent medical director arrangements, and executives being held personally liable for portions of the settlements.

A compensation philosophy is a helpful tool for ensuring that medical director compensation is compliant with applicable healthcare laws and regulations. A compensation philosophy is a written document that describes an organization's principles and approaches to compensation. Compensation philosophies are different from compensation plans. They are not overly detailed or complicated—they are most useful when they provide a general guide and effectively communicate an organization's intent related to compensation.

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BuckheadFMV ("BFMV") is a boutique healthcare valuation and consulting firm.

FMV OPINIONS

BFMV provides fair market value opinions for the compensation included in employment agreements, services agreements, and various financial arrangements.

VALUATIONS

BFMV performs valuations for purposes such as merger and acquisition transactions, joint ventures, owner buy-ins and buy-outs, leasing arrangements, purchase price allocations, dispute resolution, litigation matters, and tax purposes.

CONSULTING

BFMV provides physician compensation consulting services to organizations that employ and contract with physicians.

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Many organizations will say they have a compensation philosophy, but very often those compensation philosophies aren't in writing—and employees don't know they exist. A compensation philosophy is not helpful if it is filed away and never sees the light of day.

The compensation philosophy is not a new concept. Many organizations use them, especially industries in which employee compensation may be regulated or scrutinized. A Google search for the term "compensation philosophy" will yield different compensation philosophies used by city governments, educational institutions and financial organizations across the U.S. (For best results, try setting your search results to pdf documents by typing filetype:pdf after the search term.)

Reviewing real life examples online will show that compensation philosophies can vary significantly from one institution to another. For any organization developing a compensation philosophy for medical director compensation, we recommend the following to ensure maximum effectiveness:

Be Specific. The compensation philosophy should be specific to contracted medical directors—do not try to make it extend to other positions or disciplines.

Be Concise. Compensation philosophies that exceed one page often lose some of their impact.

Be Straightforward. The purpose of a compensation philosophy is to communicate and be helpful. Corporate blather is not useful and detracts from the message.

Be Open. Include information with the expectation that it will be shared across a wide user group. Make the document as informative as possible without exposing company secrets.

Be Rational. Do not overpromise and do not use language that locks your organization into an uncompetitive stance on compensation.

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FAIR MARKET VALUE
Fair market value is the value in an arm's-length transaction, consistent with the general market value of the subject transaction. General market value when dealing with compensation for services is the compensation that would be paid at the time the parties enter into the service arrangement as the result of bona fide bargaining between well-informed parties that are not otherwise in a position to generate business for each other.

COMMERCIAL REASONABLENESS
Commercially reasonable means that the particular arrangement furthers a legitimate business purpose of the parties to the arrangement and is sensible, considering the characteristics of the parties, including their size, type, scope, and specialty.

VOLUME OR VALUE
The "volume or value standard" and the "other business generated standard," respectively, mean that compensation paid under the arrangement is not determined in any manner that takes into account the volume or value of referrals by the physician who is a party to the arrangement, and is not determined in any manner that takes into account any other business generated between the parties.

For maximum impact, an organization has to be very selective about what it includes in its compensation philosophy. However, the document should include these elements:

1. Statement of Objectives

A compensation philosophy should include a statement that answers the question: "What are the organization's goals related to contracted medical director compensation?" There are goals that may not be compliancerelated. For example, if an organization has attracting first-rate physicians as a high priority goal, it will want to offer competitive compensation. However, when home health and hospice agencies are dealing with contracted medical directorships, compliance must always be a stated goal. It is important to let everyone know that compliance is top of mind when compensation decisions are being made.

2. Recognition of Standards That Must Be Met

A compensation philosophy should identify any standards that have been set internally by the organization as well as any heightened legal standards that must be met when setting compensation. For example, in the case of compensating referring physicians for contracted medical director services, the compensation philosophy should acknowledge that compensation will be consistent with the fair market value, commercial reasonableness, and volume or value standards in order to meet the requirements of certain exceptions and safe harbors to the Stark Law (42 U.S.C. § 1395nn) and/or the Anti-Kickback Statute (42 U.S.C. § 1320a-7b).

3. Identification of Compensation Components

The compensation philosophy should include a section that clearly lists the compensation components the organization will use to meet its goals. This section may be brief, as contractors do not qualify for employee benefits. But it is important to nail down the specific types of compensation contracted medical directors can expect to receive (if compensation components are limited to an hourly rate for administrative work, for example).

Using a Tiered Compensation Structure

The compensation philosophy may state whether tiering will be utilized alongside the various compensation components. Physician tier assignments may be developed based on role, years of experience, level of board certification, and/or other reasonable differentiations. A tiered compensation structure is generally designed so that physicians in lower tiers are paid at lower rates than physicians in higher tiers.

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Identifying survey sources and benchmark targets in the compensation philosophy shows the organization has a well thought out and consistent approach for how market data will be used to set contracted medical director compensation rates.

4. Description of the Benchmarking Process

The compensation philosophy should outline how contracted medical director compensation will be benchmarked to market data. Questions that may be answered include:

- Is there a specific survey or resource that will be used for benchmark data?
- What peer group will be used?
- Will national, regional, or state level benchmarks be utilized?
- Are there specific benchmark levels that the organization will target and/or not exceed?

When answering these questions, the organization should remember that it is important to choose a benchmark source that has a big enough data set, is well known and widely available, and is affordable. Relying on datasets that do not meet these criteria may prove to be problematic in future years.

5. Instructions Regarding Updates and Special Situations

The compensation philosophy should identify when the compensation philosophy will be updated and how special situations should be addressed. A "no exceptions" approach to compensation can be problematic given the ever-evolving world of healthcare. While exceptions should not be the rule, a compensation philosophy should identify how special situations will be managed. For example, the document may state that deviations from a target benchmark percentile must be approved by a specific committee or member of management, or even require a third-party fair market value opinion.

Summary

If properly crafted, a compensation philosophy is a great tool to show that an organization has a well thought out and consistent approach to compensating contracted medical directors. While there are many benefits to having a compensation philosophy, a primary one is to help ensure medical director contracts are compliant with applicable healthcare laws and regulations.

FOR EXAMPLE PURPOSES ONLY

Compensation Philosophy Statement for Contracted Medical Directors

These are our guiding principles for how pay will be determined for contracted medical directors.

As it relates to compensating contracted medical directors, our objectives are to:

- Ensure compensation practices are compliant with applicable laws and regulations.
- Attract physicians who embrace our values and principles.
- Be internally consistent and equitable in a competitive marketplace.
- Always remain easy to understand and simple for management to implement and administer.

The standards we will adhere to when compensating contracted medical directors include:

- Standards set out in our Corporate Mission and Values Statement regarding fair and equitable compensation.
- Compensation will be fair market value and commercially reasonable, and will not vary with the volume or value of referrals or other business generated between the parties.

To accomplish our objectives, we will utilize the following compensation components:

- Contracted medical directors will be paid an hourly rate for documented hours worked.
- Hourly rates will be tiered to recognize and reward medical directors for their years of relevant experience.
    - Tier One: Less than 5 years of experience
    - Tier Two: 5 to 10 years of experience
    - Tier Three: More than 10 years of experience

We will use a benchmarking process to set compensation. As a part of this process, we will:

- Utilize the most current version of *(Name of Survey)*.
- Use the peer group most comparable to contracted medical directors in similar organizations.
- Use hourly rates data presented in the report.
- Target compensation at the 50th percentile of market data for Tier Two medical directors.
- Tier One and Tier Three rates will be set at 90% and 110% of the Tier Two rate, respectively.

We will update the compensation philosophy and approve special situations as follows:

- An ad hoc committee will review the compensation philosophy at least every two years.
- In the setting of contracted medical director compensation, any material deviations from the tiered compensation structure must be approved in writing by senior management.

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ANTITRUST SAFETY ZONE

The Agencies will not challenge, absent extraordinary circumstances, provider participation in written surveys of (a) prices for healthcare services, or (b) wages, salaries, or benefits of healthcare personnel, if the following conditions are satisfied:

(1) the survey is managed by a third-party (e.g., a purchaser, government agency, healthcare consultant, academic institution, or trade association);

(2) the information provided by survey participants is based on data more than 3 months old; and

(3) there are at least five providers reporting data upon which each disseminated statistic is based, no individual provider's data represents more than 25 percent (on a weighted basis) of that statistic, and any information disseminated is sufficiently aggregated such that it would not allow recipients to identify the prices charged or compensation paid by any particular provider.

Selecting Compensation Benchmarks for Contracted Medical Directors

Why Third-Party Surveys Are Used

When it comes to benchmarking contracted medical director compensation, there are several ways to procure market data. However, for many years, the Federal Trade Commission has cautioned the healthcare industry that the exchange of price information among healthcare providers may facilitate collusion or otherwise reduce competition on prices or compensation. To avoid antitrust concerns, market data for contracted medical directors are best observed in third-party published reports.

The U.S. government understands that market data are critical for healthcare providers to be competitive and make informed compensation decisions. Therefore, it has issued guidance on how to avoid antitrust issues when participating in data exchanges. In 1996, a report titled Statements of Antitrust Enforcement Policy in Health Care was issued by the U.S. Department of Justice and the Federal Trade Commission. The report outlines steps (see side note) to fall within an Antitrust Safety Zone regarding exchanges of price and cost data among providers.

Clinical Versus Administrative Data

Two distinct types of physician compensation data available in third-party surveys are clinical compensation data and administrative compensation data. Clinical compensation data focus on amounts of compensation paid to physicians at the clinical specialty level for clinical work (i.e., seeing and providing healthcare services directly to patients), whereas administrative compensation data focus on amounts of compensation paid to physicians at the position level for administrative work.

It is important to choose correctly between clinical and administrative benchmarks because not all services have the same value, even when they are performed by the same physician. The same hourly rate may be used to compensate physicians for both administrative and clinical work only when the rate paid for clinical work is fair market value for the clinical work performed and the rate paid for administrative work is fair market value for the administrative work performed.

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FINDING SURVEY DATA

BFMV relies on several different survey sources for medical director compensation benchmarks. One of the more accessible sources is the Hospital & Healthcare Compensation Service (HHCS).

Each year HHCS, in conjunction with the National Association for Home Care & Hospice (NAHC), produces two surveys – one for hospice and one for home care – that focus on salary and benefits. The reports are separate and unique, although there are some jobs that are common to both surveys, including the job of medical director for which hourly rates are reported.

Annual Versus Hourly Data

It is important to use surveys that report data in a manner that aligns with the organization's pay practices. Because the compensation structure for contracted medical directors will often be an hourly rate, a survey reporting hourly rates for medical director services may be a better fit than one reporting only annual compensation data. If hourly benchmarks aren't available, annual rates may be converted to hourly rates, but this requires extra steps and wrong assumptions will reduce the reliability of the data.

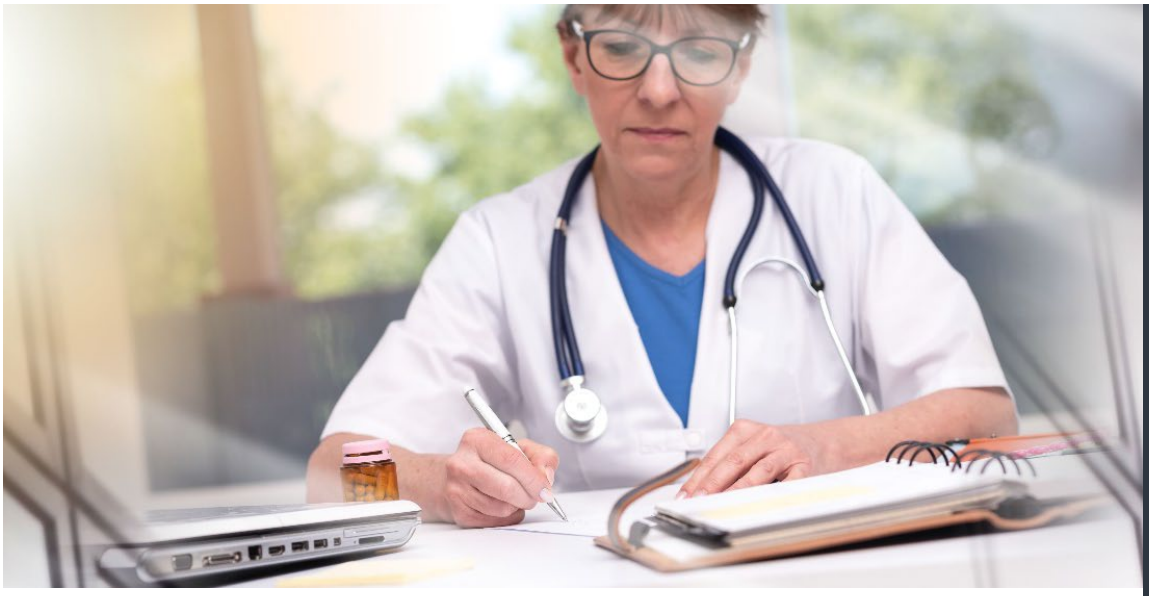
Employed Versus Independent Contractor

Similarly, it is best to use market data that are directly comparable to the subject medical director position in terms of employed versus independent contractor status. For many physician compensation surveys, the sample is predominately employed physicians. In benchmarking contracted medical director services, an adjustment to the survey data to reflect benefits, employment taxes, paid time off, and other employee benefits may be appropriate. Again, this requires extra steps and assumptions.

The same hourly rate may be used to compensate physicians for both administrative and clinical work only when the rate paid for clinical work is fair market value for the clinical work performed and the rate paid for administrative work is fair market value for the administrative work performed.

Part-Timers Versus Full-Timers

Another factor to consider when selecting benchmark data for contracted medical directors is the need to know whether the respondent pool was composed of mostly part-time physicians. This is especially important when evaluating data that aren't reported on a per hour basis. This is one of the main issues with medical director salary data published online by recruiters and salary data aggregators. While numerous websites will quote average annual salaries for medical directors, there's no accompanying information about full-time equivalencies or hours worked. Since many medical director positions are part time, annual compensation benchmarks may be misleading. The better salary surveys will separate full-timers from part-timers when publishing annual compensation data.



Converting Annual Compensation Data Into Hourly Rates

There are many situations where it makes sense to pay physicians on an hourly basis for services provided. Hourly compensation arrangements work well when a relatively short or a definitive amount of time is being compensated. They are also appropriate for arrangements when physician time, instead of physician output or production, is the valuable resource.

Medical directorships lend themselves well to hourly compensation arrangements. Often, home health and hospice medical directors are part-time. Physicians in these roles are typically required to track their time on an hourly basis, and the number of hours compensated under medical director agreements is routinely capped.

The Annual Hours Assumption Is Significant

By and large, physician compensation survey data are gathered and published in terms of annual dollar amounts. Surveys reporting annual compensation generally do not provide data (or sufficient data) regarding the number of hours being worked by the responding physicians. The onus of determining the most appropriate hours assumption is on the user—and the decision is an important one.

For example, a survey may specify that its annual physician compensation data reflect full-time, employed physicians working in primarily clinical roles. Based on several different studies, full-time employed physicians generally work an average of 40 to 60 hours per week. Multiplying the midpoint of 50 hours by 46 weeks per year, for example, calculates out to 2,300 hours worked per year.

This seems simple enough, but many employers define a standard work year as 2,080 hours (i.e., 40 hours per week for 52 weeks) and compensate only on that basis. Moreover, if physicians receive 6 weeks of vacation, holiday and sick pay, the employer may view only 1,840 of the “compensated hours” as being actual work hours.

Under these circumstances, if the employer wants to pay a physician an hourly rate, a decision must be made as to whether annual compensation data should be converted using a 2,300, a 2,080, or an 1,840-hour year. The impact of an 1,840 to 2,300 hourly range in denominators is obviously very significant when it comes to the resulting hourly rate calculations.

Based on national market data from several independent third-party surveys, the median hourly rate for home care and hospice medical direction ranges between $115 and $150.

STARK PHASE II

One of the Stark Phase II methodologies called for averaging the 50th percentile national compensation level for physicians in the same specialty, using at least four of six specified salary surveys, and dividing the result by 2,000 hours to establish an hourly rate. If the relevant physician specialty did not appear in one of the recognized surveys, the parties were required to use the survey's reported compensation for general practice in order to be within the safe harbor based on this method.

Guidance for Converting Annual Compensation to Hourly Rates

The National Standard

Per the Office of Personnel Management, for the purpose of calculating the hourly rates of pay for Federal civilian employees, the national standard in the United States is 2,087 hours per year. Prior to 1984, the divisor was 2,080, which assumes a 52-week year and a 40-hour workweek. However, a General Accounting Office study in 1981 study showed that, because some years have 366 days, over a 28-year period (the time it takes for the calendar to repeat itself), there are an average of 2,087 work hours per calendar year.

While the physician archetype is that of a sleep deprived professional working "long, irregular, and overnight hours," on average, physicians work about the same number of hours as other full-time employees. Gallup data from 2013 and 2014 Work and Education Polls show that full-time adult workers in the United States work an average of 47 hours per week. Nearly 40% say they work at least 50 hours per week. This matches data from recent studies on physician work and lifestyles which show most physicians work 40 to 60 hours per week.

If physicians put in the same number of hours as other full-time employees, it makes sense to use the national standard of 2,087 hours per year to convert annual physician compensation data to hourly rates. It is important to note that many employers provide their employees with some amount of paid time off. A 2,087 denominator may therefore result in too low an hourly rate when working with physicians who do not receive paid time off.

Stark Phase II

In 2004, the Centers for Mediare & Medicaid Services published Phase II of the federal physician self-referral prohibition (the Stark Law). Phase II created a ''safe harbor'' provision in the definition of ''fair market value'' at §411.351 for hourly payments to physicians for their personal services. The safe harbor consisted of two methodologies for calculating hourly rates that would be deemed ''fair market value'' for purposes of section 1877 of the Act.

The safe harbor methodology identified 2,000 hours as the appropriate denominator for determining an hourly rate. The safe harbor was repealed in 2007 when the Phase III regulations were issued. However, the approach and the 2,000 hours standard are still commonly used by many participants in the healthcare industry.

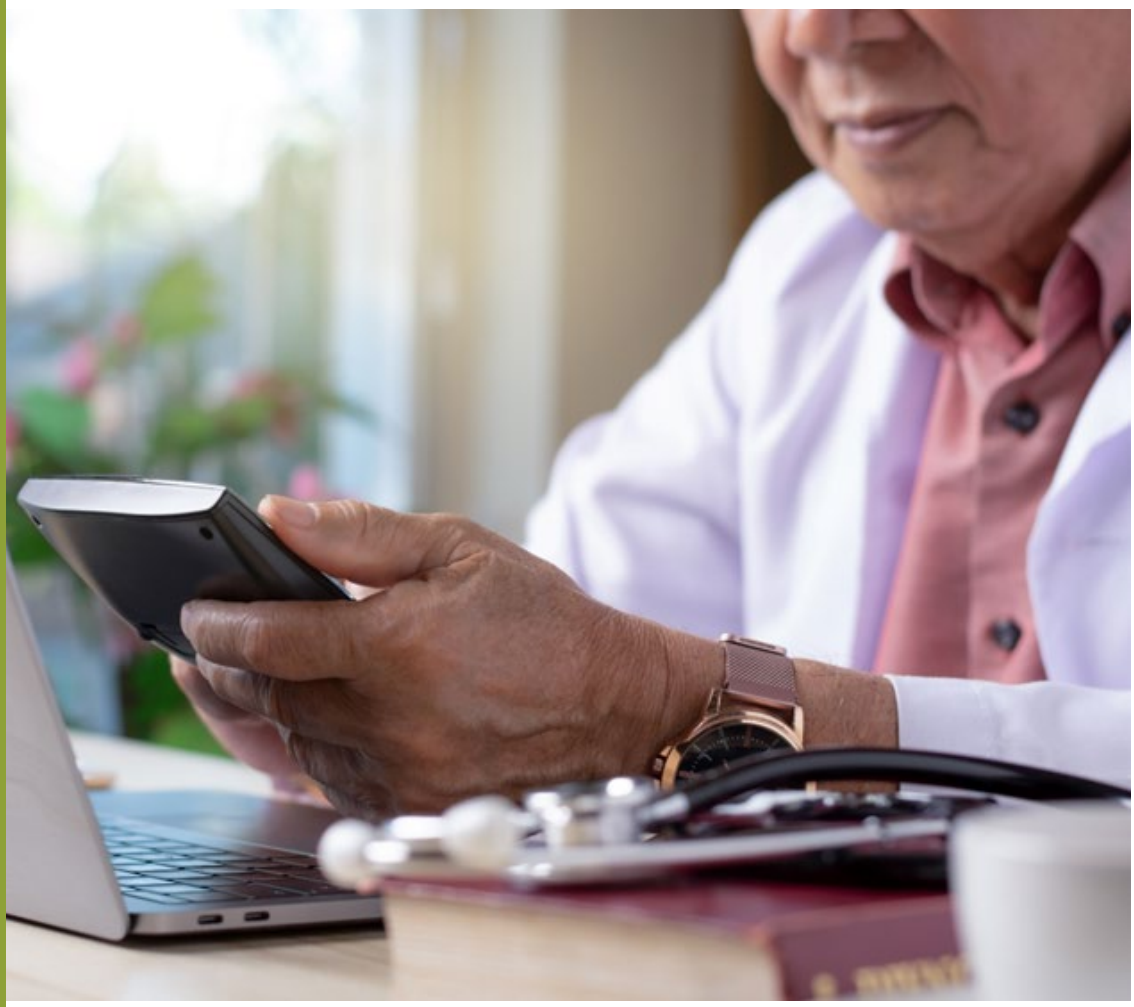
Special Studies

In certain cases, a denominator tailored to the subject position may be developed by reviewing data from studies that provide more granular, specialty- or position- specific information regarding standard work hours. These benchmarks are sometimes produced by societies or associations in connection with compensation studies or practice profiles conducted for their specialties. For example, the American Academy of Hospice & Palliative Medicine (AAHPM) has published its findings regarding the work patterns and hours of hospice and palliative medicine physicians.

Best Practices and Important Considerations to Make When Calculating Hourly Rates

Best practice is to research how many hours physicians in the clinical specialty or administrative position typically work in a year, and to determine whether the denominator should reflect lower- or higher-than-standard work hours. Often, however, what constitutes the best divisor is not clear. In the absence of reliable, specialty- or position-specific data, using a 2,000 hours denominator, consistent with the rescinded Stark safe harbor, may be the best option when converting annual physician compensation data to an hourly rate. With all matters involving physician compensation, the best decision is dependent on the specific facts and circumstances of the individual arrangement at hand.

In the absence of reliable, specialty- or position-specific data, using a 2,000 hours denominator many be the best option when converting annual physician compensation data to an hourly rate.



BuckheadFMV specializes in healthcare valuation and physician compensation. We are members of and certified by recognized professional valuation associations. Our collective experience includes consulting and valuation work involving nearly every physician specialty and many different types of healthcare businesses. We have significant experience helping home health and hospice companies with their physician compensation and valuation-related needs.

To learn more, visit our website at www.buckheadfmv.com.

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