

# Health Care Accounting for the Non-Accountant

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# Agenda

- What is this “GAAP”?
- Sources of GAAP for Health Care Organizations
- Accounting Issues Impacting Not-For-Profit Health Care Organizations
- Accounting Hot Topics
- Trustee Responsibility for Hospital Financial Viability

# What is this “GAAP?”

## The GAAP Hierarchy

- Levels of GAAP:
  - **Level a**—FASB Statements, Interpretations, and Staff Positions and APB Opinions and Accounting Research Bulletins
  - **Level b**—FASB Technical Bulletins and, if cleared by the FASB, AICPA Industry Audit and Accounting Guides and Statements of Position

# What is this “GAAP?”

## The GAAP Hierarchy

- Levels of GAAP:
  - **Level c**—AICPA AcSEC Practice Bulletins that have been cleared by the FASB and consensus positions of the EITF
  - **Level d**—FASB Concepts Statements, AICPA Accounting Interpretations and Implementation Guides published by the FASB Staff and practices widely recognized as prevalent in general or in the industry

# Sources of GAAP

## Applicable to Health Care Organizations

- Level a:
  - Financial Accounting Standards Board (FASB) Statements, Interpretations and Staff Positions (1973 to the present)
  - Accounting Principle Board (APB) Opinions (1959 to 1973)
  - Accounting Research Bulletins (ARB) (1939 to 1959)

# Sources of GAAP

## Applicable to Health Care Organizations

- Level b:
  - FASB Technical Bulletins
  - AICPA Audit and Accounting Guide, *Health Care Organizations* (Guide)
  - AICPA Statements of Position (SOPs)
- Level c:
  - Consensuses of the Emerging Issues Task Force (EITF)

# Sources of GAAP

## Applicable to Health Care Organizations

- Level d:
  - HFMA Principles and Practices Board Statements
  - AICPA Technical Practice Aids

# Accounting Issues Impacting Not-for-Profit Health Care Organizations

- Revenue Recognition:
  - How hospitals are paid
  - Patient accounts receivable
  - Allowance for bad debts and charity
  - Allowance for contractual adjustments
  - Estimated third-party payor settlements
- Professional Liability
- Charitable Contributions



# How Hospitals are Paid

- Major Sources of Payment for Services:
  - Federal government (Medicare)
  - State government (Medicaid, a joint program with the Federal government)
  - Private payors (BCBS plans and commercial payors)
  - Patients (private payors)

# How Hospitals are Paid

- Payment Methodologies:
  - Prospective
  - Per diem
  - Cost
  - Percent of charges
  - Capitation
- Payment methodologies impact accounting

# Patient Accounts Receivable

- Composition of patient accounts receivable:
  - By payor class
  - By aging
- Gross or net?
- Revenue cut-off

# Patient Accounts Receivable

- Questions to ask:
  - Are patient accounts recorded at gross or net?
  - How does management ensure proper cut-off at month end?
  - Are accounts prorated?
  - Are there any trends in the composition of receivables?

# Allowance for Contractual Adjustments

- What is a contractual adjustment?
- Purpose of the allowance for contractual adjustments—  
Net realizable value
- Gross vs. net is key consideration—when are contractual adjustments recognized?
- Approaches to estimate the allowance:
  - Contract management system
  - Historical experience

# Allowance for Contractual Adjustments Example

## Facts:

Patient discharge date: September 20

Gross charges: \$8,000

Reimbursement from Medicare received October 5: \$2,000

Due from patient: \$1,000

Contractual adjustment: \$5,000

## Accounting:

If contractual adjustments are recorded at time of billing, allowance for contractual adjustments at September 30 is \$0

If contractual adjustments are recorded at receipt of payment, allowance for contractual adjustments at September 30 is \$5,000

# Allowance for Contractual Adjustments

## Questions to ask:

- When are contractual adjustments recorded, at the time of billing or receipt?
- What method is used to estimate the allowance for contractual adjustments at month end?
- How does management validate that the method used provides reasonable results?
- How does management ensure that there is no “exposed” accounts receivable at month end, including revenue accruals?
- How does management account for discounts given to the uninsured?

# Allowance for Bad Debts and Charity

- Bad debts vs. charity
- Purpose of the allowance for bad debts and charity—  
Net realizable value
- Approaches to estimate the allowance for bad debts  
and charity
- Validation of the allowance for bad debts and charity—  
retrospective review



# Allowance for Bad Debts and Charity

- Questions to ask:
  - How does management distinguish between bad debts and charity (i.e., what is the hospital's charity care policy)?
  - How does management estimate the allowance for bad debts and charity?
  - Has management performed a retrospective review of the allowance for bad debts and charity? What were the results? How often is the analysis performed?
  - How does management ensure that there is no “exposed” accounts receivable at month end, including revenue accruals?

# Third-Party Settlements

- Nature of third-party settlements
- Cost reports
- Settlement process
- Other exposures
- Valuation allowances:
  - FASB 5
  - SOP 00-1
- Changes in estimate

# Third-Party Settlements

- Questions to ask:
  - Which cost report years are subject to settlement?
  - Which prior cost report periods have been settled this year and what was the impact of the settlements?
  - What is the change in estimate recorded in the financial statements and what were the major components?
  - How are settlements with significant payors calculated?
  - Does the hospital have valuation allowances recorded? If so, how were they calculated and how do they compare with prior periods?
  - What types of exposures does the organization have outside the cost report?

# Professional Liability

- Accounting is prescribed by the Guide
- Use of actuaries
- Discounting and discount rates
- Confidence levels—funding vs. expense
- Risk management system

# Professional Liability

- Questions to ask:
  - Does the organization discount its professional liability for reporting purposes?
  - If so, what is the discount rate and how was it derived?
  - Are the assumptions used by the actuary consistent with prior year?
  - At what confidence level is the recorded liability? Does the recorded amount include an amount for “adverse deviation?”
  - Where is the organization’s recorded liability within the range developed by the actuary? Is it consistent with prior years?
  - What process does the organization have in place to identify potential claims on a timely basis (risk management system)?
  - What are the organization’s current coverage limits? What is the organization’s self-insured retention? Have there been any gaps in coverage?

# Charitable Contributions

- Unique accounting considerations
  - Unrestricted vs. restricted net assets
  - Pledges
  - Contributions of long-lived assets
  - Release of restrictions
  - Investment income

# Accounting Hot Topics

- Asset retirement obligations (FIN 47)
- Physician income guarantees (FSP 45-3)
- Off balance sheet real estate transactions (EITF 97-10 and FASB 98)
- Classification of long-term debt (FASB 6 and 78)
- Accounting for interest rate swaps (FASB 133)
- Accounting for defined benefit retirement plans (FASB proposal)
- Accounting for and valuing alternative investments (AICPA Practice Aide)

# Trustee Responsibility for Hospital Financial Viability

- Financial Planning
  - Budgeting
- Monitoring Results
- Accountability
  - Are Numbers Accurate?



# Fiduciary Responsibility

- Financial Literacy vs. Financial Expert
- AHERF
  - Wake-Up Call for Trustees
- Healthy Skepticism
  - Ask Questions
- Financial Literacy Can Be Developed

# Monitoring Results

- Timely Financial Information
- Key Ratios
- Comparative Data
  - Bond Rating Agencies
  - Peer Groups
  - Industry Publications
  - Comparisons to Budget / Prior Years

# Accountability

- Periodic Reporting
- External / Internal Audits
- Sarbanes / Oxley
- Performance Evaluations
- Finance and Audit Committees

# Audit Committee Financial Expert

- Understands GAAP and Financial Statements
- Ability to Assess the General Applications of such Principles to Estimates, Accruals and Reserves
- Experience in Preparing, Auditing, Analyzing or Evaluating Comparably Complex Financial Statements, or Actively Supervising One Who Does
- Understanding Audit Committee Functions
- Attributes Attainable via Education and Experience
- CPA Not Required

# Understand Hospital's Operations

- Organization Structure and Controls
- Understand Risks in the Organization
- Quality of Financial Reporting

# Financial Reporting Process

- Understand Financial Results
- “Quality of Earnings” Schedule
- Inquire as to Distribution of Financial Reports
- Inquire as to Significant Estimates and How Management Formulated Judgment as to Reasonableness
- Consider “Hard Close” and Review Financial Reporting Package on a Quarterly vs. Monthly Basis

# Financial Reporting Package

- Balance Sheet
- Statement of Operations and Changes in Net Assets
- Statement of Cash Flows
- Notes to Financial Statements (Year End)
- Management's Discussion and Analysis
- Statistical Reports and Key Performance Indicators
- Audit Committee Review Before External Distribution

# Balance Sheet

	September 30	
	2006	2005
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash	\$ 5,246	\$ –
Short-term investments	40,601	47,484
Accounts receivable, less allowance for doubtful accounts of \$29,519 in 2006 and \$37,797 in 2005	29,224	31,730
Inventories	4,187	4,688
Prepaid expenses and other current assets	3,670	2,588
Current portion of investments limited as to use	4,759	1,160
Total current assets	<u>87,687</u>	<u>87,650</u>
Investments limited as to use:		
Internally designated for:		
Expansion	10,659	9,891
Other purposes	5,257	3,727
Investments held by trustee under bond indenture agreement	4,749	14,164
	<u>20,665</u>	<u>27,782</u>
Less amount required to meet current obligations	4,759	1,160
	<u>15,906</u>	<u>26,622</u>
Net property, plant and equipment	109,665	99,700
Long-term investments	918	832
Other assets	31,792	22,390
Total assets	<u>\$245,968</u>	<u>\$237,194</u>



# Balance Sheet (continued)

	<b>September 30</b>	
	<b>2006</b>	<b>2005</b>
	<i>(In Thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 13,540	\$ 10,167
Accrued compensation and benefits	6,689	8,061
Accrued interest	1,522	1,590
Estimated third-party settlements	7,985	5,984
Current portion of long-term debt	4,759	1,160
Other current liabilities	616	3,224
Total current liabilities	<u>35,111</u>	<u>30,186</u>
Long-term debt, less current portion	104,548	108,770
Other long-term liabilities	21,921	23,606
Total liabilities	<u>161,580</u>	<u>162,562</u>
Net assets:		
Unrestricted	83,151	73,507
Temporarily restricted	1,237	1,125
Total net assets	<u>84,388</u>	<u>74,632</u>
Total liabilities and net assets	<u>\$245,968</u>	<u>\$237,194</u>

# Statement of Operations & Changes in Net Assets

	Year ended September 30	
	2006	2005
	<i>(In Thousands)</i>	
Unrestricted revenues and other support:		
Net patient service revenue	\$258,644	\$233,308
Other revenue	2,773	2,974
Net assets released from restrictions	140	59
Total unrestricted revenues and other support	<u>261,557</u>	<u>236,341</u>
Expenses:		
Salaries and benefits	100,033	91,522
Supplies	50,915	46,184
General, administrative and other	32,704	26,775
Provision for bad debts	39,186	33,431
Professional fees and purchased services	17,822	14,764
Depreciation and amortization	12,629	13,094
Interest	4,501	5,251
Total expenses	<u>257,790</u>	<u>231,021</u>
Income from operations	<u>3,767</u>	<u>5,320</u>
Nonoperating (losses) gains:		
Change in value of interest rate swap agreements	1,632	–
Loss on early extinguishment of debt	–	(1,591)
Investment income	1,515	1,724
Other, net	(878)	(261)
	<u>2,269</u>	<u>(128)</u>
Excess of revenues and gains over expenses	<u>6,036</u>	<u>5,192</u>

# Statement of Operations & Changes in Net Assets

(continued)

	Year ended September 30	
	2006	2005
	<i>(In Thousands)</i>	
Unrestricted net assets:		
Excess of revenues and gains over expenses	6,036	5,192
Other changes in unrestricted net assets:		
Net unrealized gains on other than trading securities	4,243	2,093
Minimum pension liability adjustment	(782)	(6,537)
Net assets released from restrictions for the purchase of property, plant and equipment	67	78
Other	80	52
Increase in unrestricted net assets	9,644	878
Temporarily restricted net assets:		
Contributions	325	500
Net unrealized gains on other than trading securities	52	–
Net assets released from restrictions	(207)	(137)
Other	(58)	57
Increase in temporarily restricted net assets	112	420
Increase in net assets	9,756	1,298
Net assets, beginning of year	74,632	73,334
Net assets, end of year	\$ 84,388	\$ 74,632

# Statement of Cash Flows

	Year ended September 30	
	2006	2005
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
Change in net assets	\$ 9,756	\$ 1,298
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Restricted contributions received	(325)	(500)
Net unrealized gains on other than trading securities	(4,295)	(2,093)
Depreciation and amortization	12,629	13,094
Change in value of interest rate swap agreements	(1,632)	–
Loss from early extinguishment of debt	–	1,591
Minimum pension liability adjustment	782	6,537
Provision for bad debts	39,186	33,431
Other	1,891	–
Net increase in components of working capital	(37,479)	(27,449)
Net cash provided by operating activities	<u>20,513</u>	<u>25,909</u>
<b>Investing activities</b>		
Decrease (increase) in short-term investments	6,883	(21,432)
Increase in long-term investments	(86)	(65)
Decrease (increase) in investments limited as to use	11,412	(10,936)
Decrease (increase) in other assets	223	(59)
Capital expenditures	(22,899)	(18,430)
Net cash used in investing activities	<u>(4,467)</u>	<u>(50,922)</u>

# Statement of Cash Flows (continued)

	<b>Year ended September 30</b>	
	<b>2006</b>	<b>2005</b>
	<i>(In Thousands)</i>	
<b>Financing activities</b>		
Issuance of long-term debt	569	57,905
Repayments of long-term debt	(1,234)	(47,818)
Restricted contributions received	325	500
Net (advances to) repayments from affiliated organizations	(9,625)	9,788
(Decrease) increase in other long-term liabilities	(835)	2,634
Net cash (used in) provided by financing activities	<u>(10,800)</u>	<u>23,009</u>
Net increase (decrease) in cash and cash equivalents	5,246	(2,004)
Cash, beginning of year	-	2,004
Cash, end of year	<u>\$ 5,246</u>	<u>\$ -</u>

# Key Accounts: Balance Sheet

- Accounts Receivable and Allowances
- Investments
- Other Assets
- Estimated Third-party Settlements
- Other Long-term Liabilities
- Net Assets = Equity

# Key Accounts:

## Statement of Operations & Changes in Net Assets

- Net Patient Services Revenue
  - Net of Charity and Contractual Allowances
- Provision for Bad Debts
- Income from Operations
- Investment Income
- Unrealized Gain/Loss Investments
- Restricted Contributions

# Key Accounts: Statement of Cash Flow

- Operating Activities
- Investing Activities
- Financing Activities
- Cash Reconciliation



# Notes to Audited Financial Statements

- Basis of Presentations
  - What Entities are Included?
- Significant Accounting Policies
  - Medicare / Medicaid Programs
  - Use of Estimates
- Long-term Debt
- Professional Liability
- Guarantees
- Community Benefit
- Pension Plans

# Key Performance Indicators

	YTD Target	Cumulative	
		1 <sup>st</sup> Q	2 <sup>nd</sup> Q
Operating Margin %	5.3%	6.7%	7.0%
Total Margin %	4.6%	7.3%	7.3%
Admissions	21,478	10,564	20,777
Average Length of Stay	4.89	4.89	4.88
Case Mix Index	1.35	1.35	1.34
Out Patient Visits	77,000	36,700	74,000
Days Cash on Hand	144	141	142
Net Days in Accounts Receivable	49.9	55.7	59.6
Community Benefit - % Expenses	7.0%	6.8%	7.1%
Debt Service Coverage Ratio	3.0	3.3	3.5
Debt / Capitalization Ratio	40%	38%	40%

# Quality of Earnings

- Changes in Accounting Estimates
- Unusual Charges or Credits
- Request CFO to Prepare Analysis

# Community Benefit

- Definition
- Disclosure in Annual Financial Reports
- Reporting Guidelines and Tools
- Accounts within Report Package
  - Charity Allowances
  - Operating Expenses

Questions?