

Healthcare Accounting and Auditing Update

HFMA South Texas Fall Institute 2011

October 27, 2011

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Agenda

- FASB and GASB Codification
- Health Care Audit Guide Update and New Standards
- Potential Changes to Lease Accounting
- Accounting for E.H.R. Funds

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Codification

- Single source of U.S. GAAP
- Applies to non-governmental entities
- Effective for interim & annual periods ending after September 15, 2009
- GASB is currently developing their own Codification project

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Codification

- Approximately 90 topics (XXX)
- At least 1 subtopic per topic (YY)
- Subtopics contain sections (ZZ)
- Sections include paragraphs (PP)

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Citation Example

- 954-815-25-2
 - ❖ 954 – Health care entities
 - ❖ 815 – Derivatives & hedging
 - ❖ 25 – Recognition
 - ❖ 2 – “...gain or loss items that affect a for-profit entity’s income from continuing operations similarly shall affect the not-for-profit health care entity’s performance indicator....”

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Codification Amendments

- Made by issuing a “FASB Accounting Standards Update” (or ASU)
- Displays an issue date expressed as the year with number sequence
 - ❖ 2010-01
 - ❖ 2010-02
 - ❖ 2010-03

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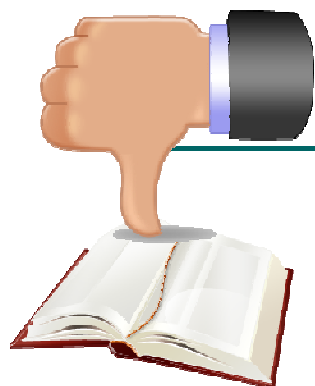
GASB Entities

- GASB 20, par. 7 election?
 - ❖ Apply only FASBs issued prior to 11/30/89
 - ✓ GASB project to codify in its own literature
 - ❖ Apply new, non-conflicting, non-contradictory FASBs
 - ✓ Use FASB codification

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GAAP Hierarchy



Codification

Health Care Audit
Guide

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The New Health Care Audit Guide



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AICPA's Health Care Audit Guide

- Published on the AICPA website on April 6, 2011
 - ❖ First comprehensive revision since 1996
- Addresses both GASB and FASB entities
- Final publishing in October 2011 and soon available for purchase

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Chapter 3 – Unique Considerations for Not-for-Profit Organizations (NEW)

- Discusses the performance indicator (revenues over expenses)
- Provides for the flexibility of having other intermediate subtotals
- Puts into words what the example financials used to provide
- Functional vs. natural classification
 - ❖ ASC 958-205-55 requires functional disclosure at least in footnotes

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Chapter 4 – Cash and Investments

- Discussion of centralized cash management arrangements – subsidiaries would show a receivable from an affiliated organization not cash under ASC Topic 230 (FAS 95) unless the subsidiary has legal title to the deposit
- Cash from restricted donations not reported separately unless requires by ASC 954-305-45 (i.e., designated for long-term purposes)

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Chapter 5 – Derivatives (New)

- ASC Topic 815-30 (FAS 133) and ASC Topic 815-25 (FAS 161)
- GASB 53
- Cash Flow Hedges vs. Fair Value Hedges
- Guidance on when a hedge is terminated or cash flow hedging is terminated

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GASB 53

- Accounting and Financial Reporting for Derivative Instruments
- Prior accounting depends on GASB 20 Election
 - ❖ Those that apply all FASBs follow most provisions of FASB 133
 - ❖ Those that only apply FASBs issued prior to 1989 generally just **disclose** information about swaps

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Common Derivative Instruments

- Futures contracts
- Some forward contracts
 - ❖ Repurchase agreements excluded
 - ❖ Commodity agreements without net settlement
- Options – exchange traded and others
- Swaps

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Common Swaps

- Interest rate swaps
 - ❖ Pay fixed, receive variable
 - ❖ Pay variable, receive fixed
- Caps and Collars
 - ❖ Interest rate caps
 - ❖ Interest rate floors
 - ❖ Interest rate collars
- Interest rate locks



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Fair Value

- GASB 53 requires that all derivatives be reported at fair value in the financial statements
 - ❖ Market observed prices
 - ✓ Exchange traded commodities
 - ❖ Models
 - ✓ For other than exchange traded commodities

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Practical Implications

- Hospital authorities, hospital districts and other government entities will need to evaluate existing contracts for previously unrecognized hedges
- Financial ratios may be affected, which could impact debt covenant compliance
- Financial advisors/consultants may be required to value derivative contracts

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FASB – Enhanced Derivative Disclosures

- FASB Statement 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*
- Why?
 - ❖ Increased use of derivative investments, especially in “non-sophisticated” businesses
 - ❖ Criticism over FASB’s existing disclosure requirements

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Objectives of Standard

- FASB 161’s objectives are to enhance the understanding of:
 - ❖ How and why an entity uses derivative instruments
 - ❖ How derivative instrument’s and related hedged items are accounted for
 - ❖ How derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows
- Objectives are met with enhanced qualitative and quantitative disclosures

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Required Qualitative Disclosures

- Disclose each derivative instrument's primary risk exposure (interest rate, credit, overall price, etc.)
- Distinguish between derivatives held for risk management vs. other purposes
- For derivatives that are hedges, distinguish between cash flow, fair value and net investment in a foreign corporation hedges
- Information to allow users to understand the volume of hedge activity

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Required Disclosures

- Tabular disclosure of the location by line-item of:
 - ❖ The fair value amounts in the balance sheet
 - ❖ The gains and losses reported in the statement of changes in net assets
 - ❖ Separately by type of derivative contract
- Separate fair value disclosures for asset and liability amounts
- Credit risk disclosures
 - ❖ I.e., collateral posting requirements

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Practical Implications

- Some entities do not know why they have derivatives – they will need to figure that out to meet the disclosure requirements
- Most health care organizations will be able to follow abbreviated disclosures compared the standard due to limited types of derivatives utilized
- Organizations must decide if they want to disclose gains on non-derivative instruments to give a full picture of the entity's strategy

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Chapter 6 – Property and Equipment

- Intangibles ASC 350
 - ❖ Types of intangibles
 - ❖ Evaluation goodwill for impairment
- Capitalized Interest ASC 835-20
 - ❖ Two different methods – tax-exempt debt for the project or outstanding borrowings
 - ❖ Does not apply to construction acquired with restricted contributions

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Chapter 6 – Property and Equipment

- Asset retirement obligations
 - ❖ Asbestos & other environmental remediation obligations
- Impairment of long-lived assets
- Discontinued operations
- ASC 350-40 internally developed software costs

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Chapter 7 – Tax Exempt Financing (NEW) and includes Chapter 8

- Definition of a public entity under FSP 126-1
 - ❖ More disclosure if you are one
- EMMA and obligated group statements
- Remarketing and Demand Bonds
 - ❖ Accounting for current/non-current liabilities based on letter of credit/reimbursement agreement terms

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Debt Restructuring – Caution!

- Many organizations are renegotiating debt obligations. Sometimes, this results in a gain or loss
 - ❖ Generally if the present value of modified cash flows are more than 10% different than original cash flows
- The accounting is different if there is a troubled debt restructuring
- Be sure to consider these rules if debt agreements are modified

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Chapter 8 – Contingencies & Other Liabilities

- ASU 2010-24 Gross presentation of insurance recoveries
- Effective date for fiscal years beginning after December 15, 2010 (calendar year-end 2011)

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Chapter 8 – Contingencies & Other Liabilities

- In current practice, health care organizations show liability for many common contingencies net of insurance recoveries (*i.e.*, offsetting)
- Decision is that net presentation should not be permitted & a receivable from the insurance company should be evaluated & presented separately, if appropriate

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Chapter 8 – Contingencies & Other Liabilities

- Any difference between recognized liabilities & insurance receivables will be recognized as a cumulative effect adjustment
- Retrospective application is permitted
- Need to evaluate if you have a system to capture appropriate information to record insurance claims & recoveries at gross

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Chapter 8 – Contingencies & Other Liabilities

- Malpractice Accruals – ASC Topic 954-450-25-2A indicates that accruals should not be based on funding amounts because the risk of adverse deviation does not meet criteria of a liability
- Discussion of discounted versus undiscounted liability

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Chapter 8 – Contingencies & Other Liabilities

- When discounting may be appropriate
 - ❖ Liability is fixed or reliably determinable
 - ❖ Amount & timing of cash payments is fixed or reliably determinable
 - ❖ Expected insurance recoveries are also discounted
- Auditor should consider tests of estimates & timing of payments

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Chapter 8 – Contingencies & Other Liabilities

- FinREC believes that if an entity discounts accrued malpractice claims they should disclose in footnotes
 - ❖ Policy on timing of recoveries
 - ❖ Policy for discounting claims
 - ❖ Interest rate used
 - ❖ Undiscounted amount of accrued claims

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Chapter 8 – Contingencies & Other Liabilities

- Claims made insurance accruals – ASC Topic 720-20-25-14 – Recognize an IBNR if loss is probable & reasonably estimable
- 720-20-30-2 states purchasing tail coverage is not relevant in determining loss to be accrued (**cannot** net an insurance receivable)
- Need to consider the need for an IBNR on claims made insurance accruals

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Chapter 8 – Contingencies & Other Liabilities

- Physician minimum revenue guarantees
 - ❖ Evolving industry practice is described in Guide
 - ❖ Record a liability initially measured at fair value
 - ✓ Estimated based on anticipated payments under minimum guarantee
 - ✓ Reduced as cash is paid to physician
 - ❖ At inception of agreement, record offsetting intangible asset that is amortized over life of the contract
 - ❖ Changes in estimated amounts recognized when determined

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Chapter 10 – Health Care Service Revenue & Related Receivables

- Different revenue arrangements (capitated, episodic, fee for service, etc.)
- SOP 00-1 Auditing third-party revenues
 - ❖ Retroactive adjustments – Reasonable estimates should be made based on entity specific information
- 954-605-35-1 requires differences in original estimates & final settlements to be disclosed
- Settlements can only be netted if a right of offset exists

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Chapter 10 – Health Care Service Revenue & Related Receivables

- FinREC recommends additional disclosures
 - ❖ Disclose settlements from each significant third-party payor
 - ❖ Provide a summary of activity for each operating period
 - ❖ Disclose status of third-party settlement claims

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RAC Accruals

- Will not be specifically addressed in the Health Care Audit Guide
- HFMA Principles and Practices Board white paper



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ASU 2011-07 – Net Revenue Recognition

- Not included in draft guide as it was finalized prior to issuance of ASU
- Issued summer 2011 and primarily affects NFP and proprietary entities
- Current practice – Revenue recorded at gross charges, then deducted as an expense (except for GASB)

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ASU 2011-07 Conclusions

- Effective for the first annual period ending after 12/15/2012
 - ❖ Early adoption permitted
- The provision for bad debts should be shown as a separate line item deduction from patient service revenue
 - ❖ Bad debts not related to patient care are still an expense
- New Disclosures
 - ❖ Policies for recognizing bad debts by payor source
 - ❖ Qualitative and quantitative information on significant changes in the allowance

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Chapter 11 – ASU 2010-23

- Charity Care - Current guidance requires disclosure of charity care revenue recognition policy and amount, if material
- EITF issue and ratified at FASB's August 18, 2010 meeting that Charity Care should be reported at cost
- Effective for fiscal years beginning after December 15, 2010, early adoption permitted

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Charity Care Costs

- Costs should be determined on the basis of the direct and indirect costs related to providing the service
- The following are required disclosures:
 - ❖ Subsidies received intended to compensate an entity for providing charity care (i.e., uncompensated care fund)
 - ❖ Description of the method used to determine the costs of providing charity care

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Chapter 12 – Reporting Entities

- ASC Topic 805 (FAS 141) and ASC 350 (FAS 164)



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Chapter 12 – Mergers and Acquisitions

- Mergers and acquisitions by non-profits
ASC Topics 805, 954 & 958 (FASB No. 164)
 - ❖ Diversity in practice
 - ❖ Necessary due to the elimination of pooling of interest method
 - ❖ Subsequent accounting for goodwill and intangibles
 - ❖ Non-controlling interests

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Chapter 12 – Mergers and Acquisitions

- Does not include:
 - ❖ Formation of a joint venture
 - ❖ Acquisition of assets that are not a business
 - ❖ Combination of entities under common control
 - ❖ Transactions in which NFP obtains control but does NOT consolidate
 - ✓ SOP 94-3
 - ✓ HC Audit Guide

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Key Distinction: Merger vs. Acquisition

- Merger transactions include:
 - ❖ Transaction or other event
 - ❖ Governing bodies of both entities **cede control**
 - ✓ Not the same as shared control
 - ❖ New not-for-profit entity created
 - ✓ Newly formed governing body
 - ✓ Not necessarily a new legal entity

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Key Distinction: Merger vs. Acquisition

- Acquisition transaction:
 - ❖ Transaction or other event
 - ❖ Acquirer obtains control of one or more nonprofit activities or businesses & initially recognizes their assets and liabilities in acquirer's financial statements

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Accounting for Mergers

- Carryover basis at merger date
- GAAP assets and liabilities carry over
- Carry forward classification and elections
 - ❖ Exceptions
 - ✓ Merger results in modification of a contract
 - ✓ Reclassification necessary to conform accounting policies

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Acquisition Method

- If a transaction is accounted for as an acquisition:
 - ❖ Same as acquisition under ASC Topic 805 (FAS 141(R))
 - ❖ Steps
 - ✓ Identify acquirer
 - ✓ Determine acquisition date
 - Generally the closing date
 - ✓ Recognize assets acquired & liabilities assumed at FV
 - ✓ Recognize & measure goodwill or contribution received

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Subsequent Measurement

- Goodwill & Identified Intangibles – Follow FAS 142 (ASC 350)
 - ❖ No amortization for goodwill
 - ❖ Test for impairment
 - ❖ Amortize definite lived intangible assets
 - ✓ Non-compete agreements
 - ✓ Licenses
 - ✓ Favorable leases
 - ✓ Customer files

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Disclosures & Effective Date

- Numerous disclosures regarding transaction (almost four pages in the standard)
- Prospective application
 - ❖ Mergers on which merger date is on or after beginning of initial reporting period beginning on or after 12/15/2009
 - ❖ Acquisitions for which acquisition date is on or after the beginning of first annual reporting period beginning on or after 12/15/2009

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Effective Date and Transition

- Following standards applied prospectively in first reporting period beginning on or after 12/15/2009
 - ❖ FAS 142 (ASC 350) – subsequent accounting for goodwill & intangibles
 - ❖ FAS 160 (ASC 810) – Non-controlling interests
 - ❖ Other standards and amendments to FAS 160 and 141(R)

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Practical Implications

- Many mergers will not be as “easy” as they once were
 - ❖ Valuations will be required in many more instances
- Goodwill impairment testing will potentially result in more impairment and increased time and effort
 - ❖ May require a third-party



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Chapter 15 – Unique Consideration of Government Health Care

- GAAP Hierarchy
 - ❖ Category A – GASB statements
 - ❖ Category B – GASB technical bulletins and if cleared by GASB AICPA Audit Guide and SOPs
 - ❖ Category C – AICPA Practice bulletins
 - ❖ Category D – Implementation Guides published by GASB staff

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Chapter 15 – Unique Consideration of Government Health Care

- Consolidates all categories previously discussed, cash, investments, derivatives, etc.
- GASB codification project
- Paragraph 7 option – Pre-1989 FASB
 - ❖ GASB 62 eliminates the election provided in paragraph 7

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FASB and IASB Joint Project – Leases

- Joint project of Financial Accounting Standards Board and International Accounting Standards Board
- Stated Project Objective
 - ❖ To create common lease accounting requirements to ensure that assets and liabilities arising from leases are recognized in the statement of financial position
- Other “Unstated” Reasons
 - ❖ Similar transactions accounted for differently
 - ❖ Ability to structure transactions to achieve desired result
 - ❖ Reduced comparability for users
 - ❖ Complexity of existing standards

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Exposure Draft issued August 2010 Comment period – December 15, 2010

- Lessee
 - ❖ Right to use leased items – asset
 - ❖ Obligation to make payments – liability
- Lessor
 - ❖ Right to receive payments – asset
 - ❖ Obligation to perform under the lease – liability
- Initial measurement
 - ❖ Asset and Liability recorded at the discounted present value of the required payments

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FASB Lease Statement Status

- Rent expense will be replaced with amortization and interest expense
 - ❖ Amortization – straight line
 - ❖ Interest – effective interest method
- Renewal periods recognized if “more likely than not” to be exercised
- Contingent amounts would be probability weighted
- Renewal periods and contingent amounts would have to be continually evaluated as estimates

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Lessor Accounting

- Performance obligation approach (retain significant risks or benefits of the asset) – recognize a lease receivable, right to receive future payments and the performance obligation.
 - ❖ The performance obligation is deferred revenue and the asset remains on the financial statements
- Derecognition approach – recognize a receivable and revenue for future lease payments
 - ❖ Carry amount of the asset is derecognized

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Lease Accounting

- FASB and IASB have not committed to an effective date
- Expect final standard in 2011

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E.H.R Accounting

Accounting for EHR Payments

- No “official” GAAP at this time
 - ❖ Payments will not be subject to A-133 single audit rules
- HFMA and AICPA Health Care Expert Panel White Paper
 - ❖ Currently under review by SEC and others

Disclaimer!

- The SEC, FASB, GASB and other bodies have not approved the AICPA/HFMA task force's conclusions
- The remainder of this presentation discusses the task force conclusions
- These probably will change!

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Key Questions

- What is the appropriate accounting for EHR expenditures?
- What revenue recognition model should apply to incentive payments?
- When should income from incentive payments be recognized?
- How should incentive payments be reported on the income statement?

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Accounting for EHR Expenditures

- Entities should follow FASB ASC 350-40 related to the cost of computer software developed or obtained for internal use
 - ❖ Preliminary project stage
 - ✓ Costs related to strategy and vendor research should be expensed
 - ❖ Application development stage
 - ✓ Most costs are capitalized (direct costs of materials/services; payroll and related costs related to application development; interest costs)
 - ❖ Post implementation and operation stage
 - ✓ Costs are expensed (training costs, maintenance costs)
- Business process reengineering costs
 - ❖ Generally expensed except as allowed by ASC 350-40

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EHR Revenue Recognition Model

- Grant Accounting Model
 - ❖ U.S. GAAP model for non-exchange transactions
 - ✓ Not favored by task force due to close relationship of payments to hospital's ongoing activities
 - ❖ International GAAP (IAS 20) provides guidance when grant payments are based on government grants in return for past or future compliance

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EHR Revenue Recognition Model

- General Revenue Recognition Model
 - ❖ Revenue would not be recognized until recipient has substantially accomplished what it must do to be entitled to benefits
 - ❖ Potentially problematic due to EHR payment basis
 - ✓ In many cases, payment is based on discharges occurring after meaningful compliance is achieved
 - ✓ Could result in significant deferred revenue

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Factors Supporting Each Model

- General Revenue Recognition Model
 - ❖ EHR payments no different than many other Medicare payments
 - ❖ Must provide services to receive payment
 - ❖ Penalties if MU status not achieved, which will affect revenue
- Grant Accounting Model
 - ❖ Payments are intended to further a public policy goal
 - ❖ The source of funding is ARRA, a one-time economic stimulus package
 - ❖ The purpose of payments is to incent providers to behave a certain way
- Ultimately, the task force favors the Grant Model

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When should payments be recognized?

- There must be “reasonable assurance” grant funds will be received and conditions for payment met
- Cliff recognition method
 - ❖ Defer recognition until after the EHR period ends and MU status is assured
- Ratable recognition method
 - ❖ Recognize ratably over the EHR reporting period

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Cliff or Ratable Method?

- Determined in part on when can reasonable assurance be supported by management?
 - ❖ Has the hospital had EHR for years?
 - ❖ How long has the hospital been working on MU status?
 - ❖ How far along is the hospital in CPOE implementation? Have physicians adopted?
 - ❖ How reliable are processes and controls on data entry?
 - ❖ Bare minimum or robust qualification?
 - ❖ How robust is MU documentation?
- Important to discuss these issues with auditors

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Income Statement Presentation - Task Force Conclusions

- Investor-owned hospitals
 - ❖ Operating revenues, but presented separately from net patient revenue
- Not-for-profit hospitals
 - ❖ Must be in performance indicator
 - ❖ Generally operating revenue, but dependent on individual facts/circumstances
- Governmental hospitals
 - ❖ Operating revenue, but separate from net patient revenue

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Questions?

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