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Internal Control Environment
Policies, Procedures, and Accounting & Reporting Manual

- Promotes consistent accounting standards and fosters best practices
- Develops a network of strong internal controls to prevent material internal control weaknesses
- Minimize risk of providing material false or misleading financial statements to external investor community, System Governance, and System Leadership
- Accounting & Reporting Manual (ARM) includes the following topics:
  - Financial Reporting Standards
  - Financial Accounting Practices
  - GAAP Interpretations
Quarterly Tools & Representations

- Closing Checklist
  - Tool to facilitate closing process and evaluate status of internal controls
  - High risk items:
    - Days in AR (high or growing)
    - Net patient revenue adjusted for bad debt compared to cash collections
    - Unsigned contracts
    - Instances of Accounting & Reporting Manual non-compliance
    - Status of OIG inquiries/investigations
    - Status of IRS audits
    - Variances between budget and actual
    - Incomplete balance sheet account reconciliations
Quarterly Tools & Representations

- Internal Representation Letter
  - Assists System management in evaluating whether consolidated financial statements are presented fairly and accurately
Quarterly Tools & Representations

- Quality of Earnings Summary
  - Valuation allowance changes
  - Prior year third party settlement activity
  - Corrections of prior year estimates
  - Restructuring costs
  - Intangible asset write offs
  - Fixed asset impairments
  - Other “one-time” adjustments
Revenue Valuation Standardization Process

- All AR allowances and third party settlements estimated and recorded using a standard approach
- Standard general ledger structure for AR accounts (including Medicaid pending, denial allowances, charity allowances)
- Standard payor categories
- Use of “zero balance account” analysis for contractual allowance estimation
- Hindsight analysis required for bad debt allowances and overall adequacy of historical amounts
- “Reminders” for service line changes, price changes, contract changes, new contracts
- Specific settlement accounts by year in general ledger
  - Must equal filed cost report +/- cash payments
  - Unspecified reserves isolated in separate general ledger account
- Emphasis on cash as % of NPSR, days in AR, updated collection %, large accounts, proper aging, timely billing, credit balances isolated & resolved
Current Accounting & Reporting Standards
In October 2006, the Financial Accounting Standards Board issued FASB Staff Position 126-1 (FSP 126-1) which clarifies the definition of a public entity in certain accounting standards to include entities that are conduit bond obligors for conduit debt securities that are traded in a public market.
Quarterly Reporting Standards

- FSP 126-1 will result in the applicability of APB No. 28
- APB No. 28 stresses that each interim period should be viewed as an integral part of an annual period
- APB No. 28 states that extraordinary, unusual, infrequent and contingent items should be disclosed and included in the determination of income for the interim period in which they occur
- Significant 4th quarter adjustments will be disclosed in the annual financial statements
Uncertain Tax Positions

- In July 2006, Financial Accounting Standards Board Interpretation No. 48, “Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109,” (FIN 48) was issued
- FIN 48 provides guidance on:
  - Identifying tax positions
  - Evaluating whether the tax position are ‘more likely than not’ to be upheld by taxing authorities and the appropriate amounts to be recognized in the financial statements based on this assessment
Uncertain Tax Positions

- This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure requirements for uncertain tax positions.
- Tax-exempt status is considered a tax position which must be adequately supported and documented under this Statement.
Uncertain Tax Positions

- The first stage of FIN No. 48 implementation is to perform an inventory of tax positions (including certain and uncertain tax positions).
- This generally consists of evaluating revenue sources and reasons the revenues are considered tax exempt or non-exempt under the Tax Code.
Uncertain Tax Positions

- Upon completion of the inventory of tax positions, stage two of the implementation will require the entity to evaluate whether it is ‘more likely than not’ that the tax positions will be sustained upon examination by the IRS.
- The entity must then determine the amounts to recognize in the financial statements depending on whether a tax position meets the ‘more likely than not’ recognition threshold.
- Areas of sensitivity include disclosure of issues and matters under attorney-client privilege.
Pension Accounting

- The FASB has issued SFAS No. 158, “Employers Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans” (FAS 158)
- FAS 158 requires plan sponsors to:
  - Recognize the funded status of their postretirement benefit plans on the Balance Sheet
  - Measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end Balance Sheet
  - Provide additional disclosures
Investments

- Topics covered:
  - ‘Trading’ investments
  - Alternative investments
In February 2007, the SEC clarified existing guidance on asset impairment contained within SEC Staff Accounting Bulletin 59, "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities (SAB 59)"

- Applicable to non-registrants as well as registrants
- Although SAB 59 contains several factors which must be considered in any determination of an “other than temporary” impairment, one key factor centers on an entity’s intent and ability to hold an investment whose fair value is below cost (“impaired securities”) for a sufficient period of time to allow for a potential recovery in that investment’s fair value
The SEC has made it clear that for any investment managed by an external portfolio manager, where restrictions are not placed on that manager with regard to selling impaired securities, an entity can no longer assert that it has both the positive intent and ability to hold impaired securities through potential recovery.

This clarification has a potentially significant impact on any entity’s accounting for investments and generally requires unrealized losses to be immediately reported as a component of net income (performance indicator).
Investments - Trading

- “Trading” investments = unrealized gains / (losses) within performance indicator (Excess revenues over expenses).
- Many entities have re-designated the majority of their investments as “trading” vs. “available for sale”
Investments - Alternatives

- Entities may invest in alternative investments through limited partnerships.
- Examples of alternative investments include:
  - Commodities
  - Private equity investments
  - Real estate investments
  - Hedge funds
- Entities need to evaluate consolidation vs. equity method accounting of limited partnerships.
- Risk surrounding the existence and valuation of alternative investments.
- Entity records proportionate share of the investment gains and losses.
Many healthcare real estate sale and development transactions fall within the guidance of FAS 66, FAS 98 and/or EITF 97-10.

FAS 66 applies to straight sales of real estate; FAS 98 applies to sales of real estate coupled with a leaseback of space within the property sold.

EITF 97-10 applies to lessee involvement in real estate development transactions; specifically, this guidance applies any time space leases are executed prior to completion of asset construction.
Accounting for Real Estate Transactions – FAS 98

- FAS 98 places restrictions, beyond guidance provided in FAS 66, on when assets can be considered “sold” for accounting purposes, and whether or how much gain can be recognized.
- Two primary criteria must be met to record assets as sold for accounting purposes:
  - Transaction must meet “normal” leaseback requirement
  - There must be NO forms of continuing involvement in the property sold
- Continuing involvement can take many forms, including ownership by related party physicians and options to repurchase property sold
- Impact of failure = realizing cash gains on sale, but inability to record all or a portion of those gains for accounting purposes.
EITF 97-10 significantly restricts the level of involvement and funding that can be made by a lessee in a “build to suit” development transaction.

Guidance requires that a 90% maximum guarantee test be met, and that none of six special provisions are violated. Any violation of these tests result in the asset and related liability being recorded by the lessee. The only way to remove that asset and liability is to meet the requirements of FAS 98.

The six special provisions generally limit indemnifications the lessee can make to the developer/lessor and limit the type of costs that can be incurred by the lessee.

Impact of failure = gross up of balance sheet; recognition of an asset that is not a managed asset of the lessee and a liability that generally will not result in cash payments.
Discontinued Operations

- A ‘component of an entity’ is defined under FAS 144 as comprising operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

- The sale or closure (abandonment) of a component of an entity may be treated as discontinued operations under FAS 144 if the following criteria are met:
  - The operations and cash flows of the “component of an entity” have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction.
  - The entity will not have significant continuing involvement in the operations of the component after the disposal transaction.
Discontinued Operations

- Income or loss from sale, abandonment and operations of the component disposed of should be reported as a line item in unrestricted net assets within the Statement of Changes in Net Assets
- Remaining assets and liabilities collapsed into held for sale line item on the Balance Sheet
- Reclassification required for all periods presented
In September 2000, the FASB issued SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities”

This statement establishes rules for determining whether a transfer of financial assets constitutes a sale.

Under SFAS No. 140, following a transfer of financial assets, an entity recognizes the assets it controls and liabilities it has incurred, and derecognizes financial assets for which control has been surrendered and all liabilities that have been extinguished.

New emphasis recently placed on escrowed assets:
- To remove escrowed assets from an entity’s financial statements the entity must have no interest in the escrow and the escrow must be beyond the reach of creditors.
Accounting for Donations Received or Made

- Governing standards:
  - Statement of Financial Accounting Standards No. 136 (FAS 136), “Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others”
  - Statement of Financial Accounting Standards No. 116 (FAS 116), “Accounting for Contributions Received and Contributions Made”

- First Dollar Rule
  - Temporarily restricted donations must be released when qualifying expenditure is made (construction one possible exception)
  - Not contingent on cash transfer from consolidated foundation

- Pledges are always restricted

- Donations for construction is a grey area
  - Release when spent or placed in service?
  - Depends on donor specifications

- Donations made are always at fair value
  - Write up or down prior to donation
On the Horizon
Fair Value Measurements (FAS 157)

- In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements”
- Applicable for fiscal year ends beginning after November 15, 2007
- Prior to this Statement there were different definitions of fair value and limited guidance for applying those definitions
- Expanded disclosures about fair value are also a focus of this Statement
- FV = The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at a measurement date
- The following valuation techniques shall be used to measure fair value:
  - Market approach
  - Income approach
  - Cost approach
- Numerous implementation issues are being identified
In February 2007, the FASB issued SFAS No. 159 “The Fair Value Option for Financial Assets and Financial Liabilities” Applicable for fiscal year ends beginning after November 15, 2007 The FV option established by this Statement permits all entities to choose to measure eligible items at FV at specified election dates A business entity shall report unrealized gains and losses on items in which the FV option has been elected in earnings at each subsequent reporting date The FV option:

- May be applied instrument by instrument, with a few exceptions such as investments otherwise accounted for by the equity method
- Is irrevocable (unless a new election date occurs)
- Is applied only to entire instruments and not to portions of instruments
A FASB Exposure Draft (ED) entitled “Not-for-Profit Organizations: Mergers and Acquisitions” has been released (comment period has ended).

This proposed Statement would provide guidance on the accounting and reporting for a not-for-profit organization upon initial recognition of another entity in its financial statements as a result of a merger or acquisition.
The Exposure Draft will require a NFP entity to:

- Recognize the identifiable assets acquired and liabilities assumed that compose the business or nonprofit activity acquired in a merger or acquisition
- Measure those assets and liabilities at their fair values as of the acquisition date
- Recognize goodwill of the acquired business or nonprofit activity or the contribution inherent in the merger or acquisition
- Disclose information to enable users of the financial statement to evaluate the nature and financial effects of the merger or acquisition

ED eliminates pooling of interest method
Consideration may be given to “fresh start” for “true mergers”
Currently being re-written (about once every 10 years)
Only four chapters remaining to be cleared by AcSEC
Several issues awaiting FASB clearance
  - Revenue recognition
    ● Proposed Guide would require substantially all bad debts to be revenue deduction
    ● HFMA P&P Board has issued similar guidance
    ● Need FASB approval
  - Charity disclosures to be more restrictive
  - Self-insurance accounting changes may be significant
  - Gain / (loss) on sale of fixed assets
    ● All gains or losses on the sale of long lived assets or disposal groups which do not qualify for discontinued operations treatment should be classified as operating gains/losses
    ● Based on AICPA Expert Panel & FASB staff interpretation of paragraph 45 of FAS 144
  - Timing for release?