



Accounting for Health Care Organizations

Learning Objectives

After studying Chapter 17, you should be able to:

- ⚡ Identify different organizational forms and the related authoritative accounting literature for health care organizations
- ⚡ Describe financial reporting for health care organizations



Learning Objectives (Cont'd)

- ⚡ Explain unique accounting and measurement issues in health care organizations, including accounting for revenues, assets, expenses, and liabilities
- ⚡ Journalize transactions and prepare the basic financial statements for not-for-profit and governmental health care organizations

Learning Objectives (Cont'd)

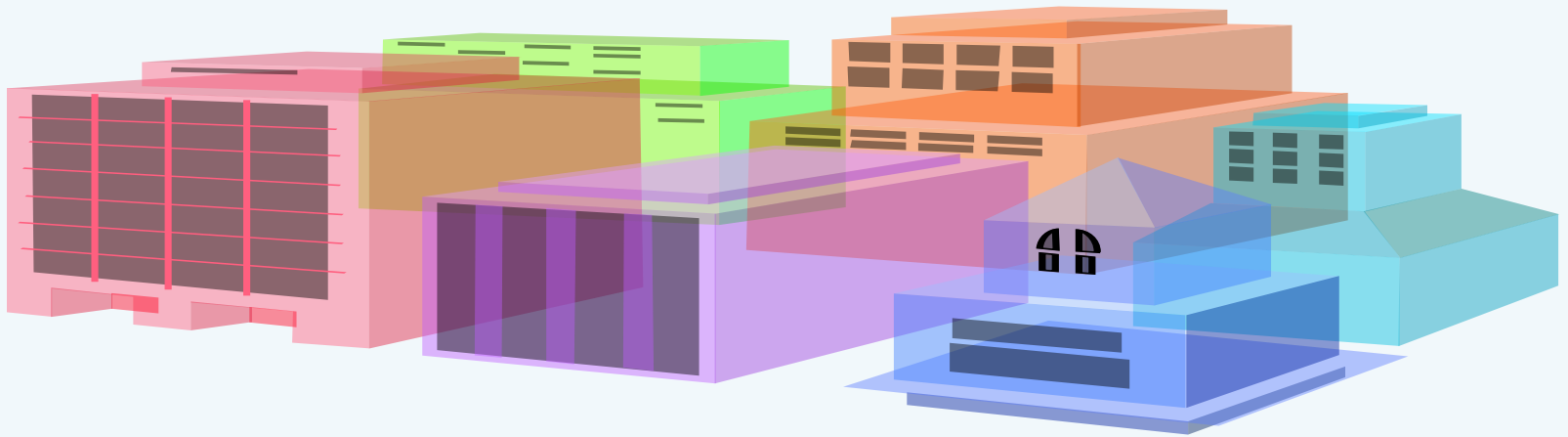
- ⚡ Describe other accounting issues in the health care industry:
 - Budgeting and costs
 - Auditing
 - Taxation and regulation
 - Prepaid health care services
 - Continuing care retirement communities
- ⚡ Explain financial and operational analysis of health care organizations

Health Care Organizations, Such As Hospitals, Can be Structured As

**For-Profit:
Proprietary**

**Not-for-Profit:
Business
Oriented**

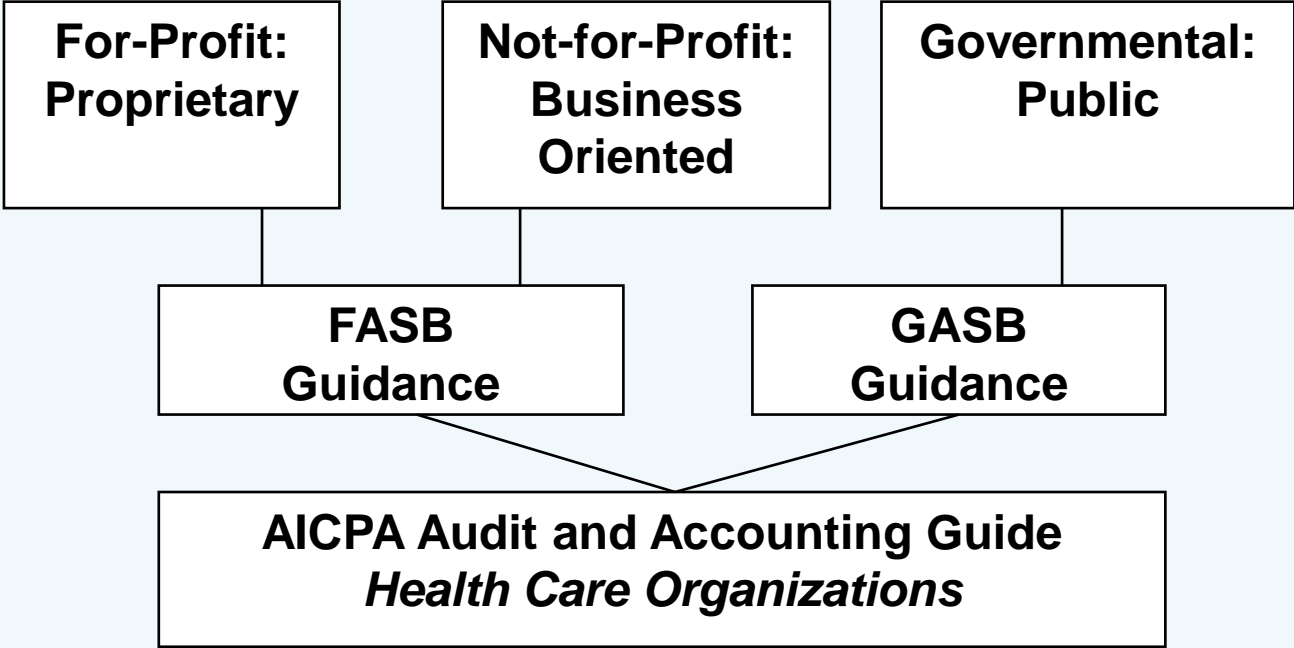
**Governmental:
Public**



Health Care Organizations (HCOs)— Types of Services

- ❖ Clinics and individual or group practices
- ❖ Continuing care retirement communities (CCRCs)
- ❖ Health maintenance organizations (HMOs)
- ❖ Home health agencies
- ❖ Hospitals
- ❖ Nursing homes
- ❖ Rehabilitation centers
- ❖ Parent companies that oversee health care services

GAAP for a HCO Depends Upon Its Organizational Structure



GAAP for HCOs

- ❖ Governmental health care organizations follow GASB standards and are considered special purpose governments that may be:
 - component units of another government, or
 - stand-alone governmental entities
- ❖ These governmental entities may be engaged in either governmental or business-type activities or both

GAAP for HCOs

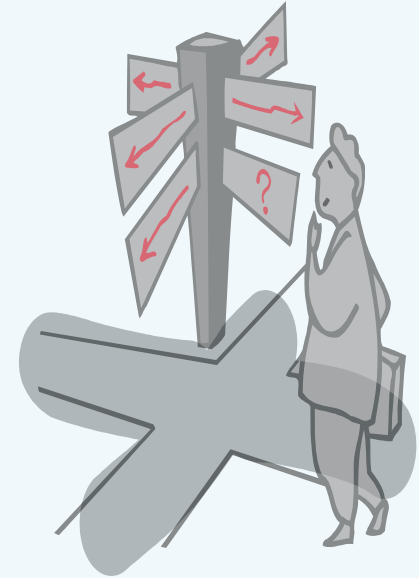
- ❖ Not-for-profit (NPO) health care organizations report using *SFAS No. 117*
- ❖ All health care organizations also follow the AICPA Audit and Accounting Guides, as category (b) authority after appropriate FASB and GASB statements which are category (a) authority

Optional Fund Accounting—For NPOs and Business-type Governmental HCOs

- ❖ HCOs may choose to use fund accounting for internal purposes
- ❖ The following funds are used for internal purposes:
 - General Unrestricted Funds
 - Donor-Restricted Funds:
 - Specific Purpose Fund
 - Plant Replacement and Expansion Fund
 - Endowment

Accounting Issues that Differ Depending Upon Organizational Structure

- ❖ Reporting entity
- ❖ Contributions
- ❖ Financial statement displays
- ❖ Cash flows
- ❖ Deposits and investments
- ❖ Compensated absences
- ❖ Debt refunding; risks and uncertainties
- ❖ Pensions and other post retirement benefits
- ❖ Fair value measurements



Financial Statements for HCOs

- ❖ Balance sheet or statement of net assets (see III. 17-3)
- ❖ Statement of operations (see III. 17-4)
- ❖ Statement of changes in net assets (see III. 17-4)
- ❖ Statement of cash flows (see III. 17-5 and 17-6)

Equity Reported on the Balance Sheet

NPO—unrestricted net assets; temporarily restricted net assets; and permanently restricted net assets

Governmental—unrestricted net assets; restricted net assets; invested in capital assets, net of related debt

For-Profit—capital stock and retained earnings

Performance Indicator



- ❖ Nonprofit health care entities must include a *performance indicator* in their operating statement
- ❖ The purpose of reporting a performance indicator is to provide an operating measure comparable to income from continuing operations of a for-profit health care entity
- ❖ Aids in comparing the performance across health care organizations with different organizational forms

Performance Indicator (Cont'd)

- ❖ Examples of a performance indicator include:
 - Excess of revenues over expenses
 - Excess of revenues and gains over expenses and losses
 - Earned income
 - Performance earnings

Performance Indicator (Cont'd)

- ❖ *Include* in the performance indicator: investment income, realized gains and losses, unrealized gains and losses on trading securities
- ❖ *Exclude* from the performance indicator (among others): transactions with owners, receipt of restricted contributions, restricted investment income

Principle Sources of Revenue for a HCO

- ❖ Patient service revenue
- ❖ Government (e.g., Medicare/Medicaid)
- ❖ Third party payors (e.g., BC/BS)
- ❖ Premium revenue from capitation fees (i.e., fixed fees per person paid periodically regardless of services provided)
- ❖ Resident service revenue (e.g., maintenance or rental fees)
- ❖ Other revenue (e.g., auxiliary services, investment income, unrestricted contributions)
- ❖ Net assets released from restrictions (for NPOs)



Revenue (Cont'd)

- ❖ Patient service revenue is reported net of contractual adjustments (i.e., differences between gross charges and the amount to be paid by third party payors)
- ❖ Charity service to indigent patients for which payment is never expected is *not* recorded, but may be reported in the notes to the financial statements

Revenue (Cont'd)

- ❖ Prepaid health care plans that earn revenue from *agreements to provide* service record revenue at the point agreements are made, not when services are rendered
- ❖ Payment often comes from *third-party payors*, Medicare, or Blue Cross or private insurance companies according to allowable costs or predetermined (prospective) rates for services

Revenue (Cont'd)

Government organizations must report operating and nonoperating activities, NPOs may optionally report

- ❖ Operating income, which arises from ongoing major activities, such as service revenue
- ❖ Nonoperating income, which arises from transactions peripheral or incidental to the delivery of health care, such as investment income and unrestricted contributions

Revenue (Cont'd)

- ❖ NPOs report donated services and supplies at their fair value, if material and criteria are met
- ❖ NPOs and governmental organizations report donated noncash assets at their fair value

Assets

- ❖ Current assets (including receivables with related allowance accounts for contractual adjustments and bad debts)
- ❖ Assets limited as to use — assets of NPOs limited by contracts or agreements with outside parties other than donors or grantors, as well as limitations placed on assets by the board
- ❖ Investments (at fair value)
- ❖ Noncurrent assets (e.g., plant, property and equipment)

Expenses

- ❖ Use accrual accounting
- ❖ Bad debts
 - An expense for not-for-profit and for-profit organizations
 - A reduction of gross revenue for governmental organizations
- ❖ Depreciation is recorded on capital assets
- ❖ Expenses can be reported by natural classification (e.g., line items such as salaries and supplies) or functional categories, such as inpatient services and fiscal and administrative services

Commitments and Contingencies

- ❖ Malpractice claims
- ❖ Risk contracting
- ❖ Third-party payor payments
- ❖ Obligations to provide uncompensated care
- ❖ Contractual agreements with physicians
- ❖ As well as others incurred in any business

Budgeting and Costs

- ❖ All health care organizations should use comprehensive budgets for managerial purposes
- ❖ Only governmental health care organizations using governmental funds record budgets in the fund accounts (see Chapter 3)
- ❖ Costing of services has become more important due to diagnosis-related groups (DRGs), which classify Medicare in-patients for prospective payments

Diagnosis-Related Groups

- ❖ In 1983, Medicare (the largest purchaser of hospital services) began a system of *prospective* payment to providers based on DRGs
- ❖ Average payments for many different DRGs are determined at the federal level and made to providers regardless of the provider's actual cost of treatment

Auditing

Particular auditing issues facing HCOs relate to:

- ❖ Contingencies
- ❖ Third-party payors
- ❖ Related entities
- ❖ Restructuring
- ❖ Health care fraud and illegal acts
- ❖ Application of the Single Audit Act Amendments of 1996 and OMB *Circular A-133*

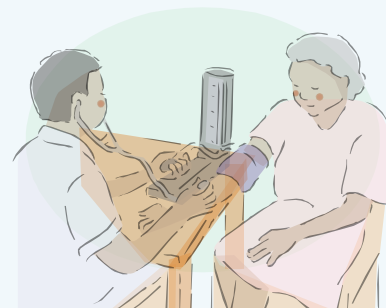


Taxation and Regulation

- ❖ Tax-exempt HCOs must conform to IRC sections and IRS regulations
 - Intermediate sanctions
 - Unrelated business income
- ❖ The IRS also investigates:
 - Physician recruiting incentives
 - Joint operating agreements
 - Private activity bonds
 - Independent contractor vs. employee status
 - Distribution of assets of NPOs that restructure

Prepaid Healthcare Plans

- ❖ Health maintenance organizations (HMOs) and preferred provider organizations (PPOs) function as brokers between the patient demanding the service and the providers of the service (hospitals and health care professionals)
- ❖ Accounting issues relate to:
 - Revenue recognition
 - Accounting for risk contracts to cover when premium revenue does not cover agreed-upon costs



Continuing Care Retirement Communities (CCRCs)

- ❖ CCRCs provide residential care in a facility, along with some level of long-term medical care that is less intensive than hospital care
- ❖ Accounting issues relate to:
 - Entrance fees that include future health care
 - The obligation to deliver future health services
 - Periodic fees to cover operating costs
 - Refundable advance fees

Financial and Operational Analysis of HCOs

Decision makers evaluate HCOs for different reasons:

- ❖ Managers are accountable for performance
- ❖ Financial analysts determine the creditworthiness of organizations issuing debt
- ❖ Third-party payors determine appropriate payment for service
- ❖ Patients assess quality of health care services, such as success rate of certain procedures

HCO Performance Measures Can Be Categorized By

- ❖ Patient volume (e.g., occupancy rate or daily census and average length of stay)
- ❖ Patient and payout mix (e.g., Medicare, commercial, private pay)
- ❖ Productivity and efficiency (e.g., personnel per average daily census)
- ❖ Quality of care (e.g., process and outcome measures for major medical conditions and procedures)

Concluding Comments

- ❖ Health care accounting and auditing is complex
- ❖ Complexity is due in large measure to “patient service revenue” being provided by third-party payors
- ❖ Competency in managerial cost accounting is critical for managers of health care providers

END