Introduction to Health Care Accounting

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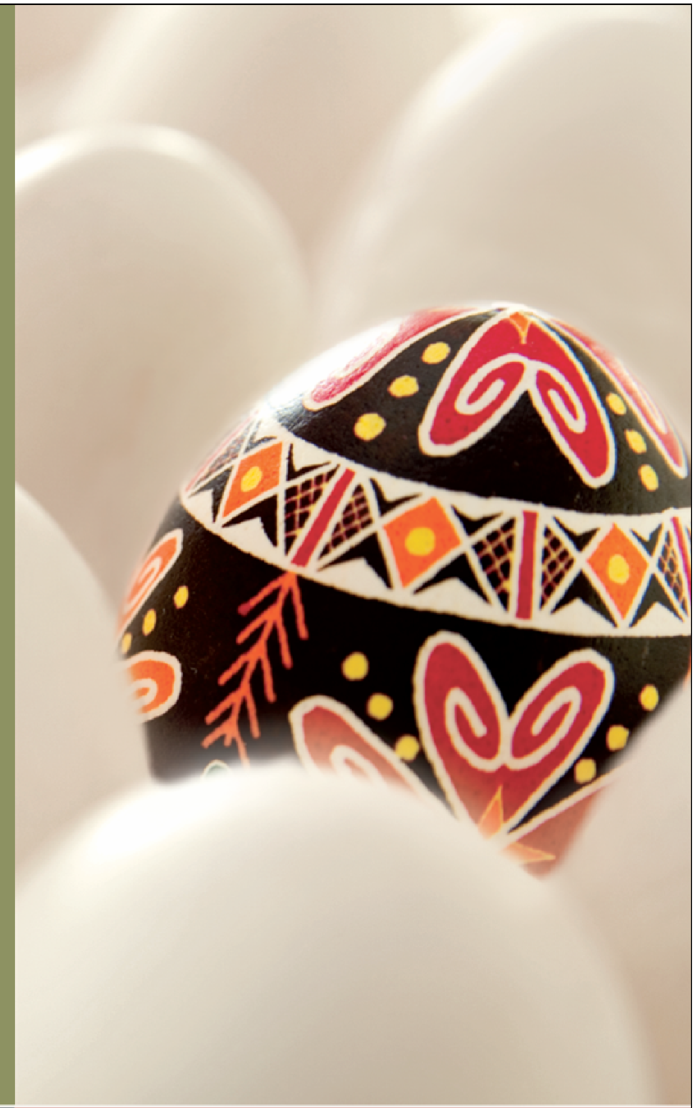

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NOTICEABLY
DIFFERENT

Agenda

- **Basics of a health care financial statement**
  - **Common and important ratios you should understand**
- **Revenue recognition and allowances**
- **Transactions that can significantly impact financial statements**
- **Recent accounting and audit pronouncements affecting health care organizations**
- **Audit / Finance committee responsibilities**

Contents of a Financial Statement

- **Statements and footnotes**
  - Balance Sheet
    - ◊ Financial Position at a “point” in time
  - Statement of Operations
    - ◊ Result of operations for a “period” of time
  - Statement of Changes in Net Assets
    - ◊ Result is “assets less liabilities”
  - Statement of Cash Flows
    - ◊ Basically reconciles the operating cash, indicating the “sources” of cash and “uses” of cash
  - Footnotes to the financial statements
    - ◊ Defines and describes important matters and discloses significant issues of the statements

Balance Sheet - Comparative

	2007	2006
Assets		
Current Assets		
Cash	$ 5,000	$ 2,000
Current Portion of Trustee Investments	150,000	177,000
Patient Accounts Receivable, Net	37,000,000	28,000,000
Other Receivables	2,460,000	1,460,000
Inventory	1,886,000	1,874,000
Prepaid Expenses and Other	2,644,000	2,084,000
Total Current Assets	44,145,000	33,597,000
Trustee Investments (Net of Current Portion)	6,000,000	6,000,000
Property and Equipment		
Property and Equipment	74,084,000	65,552,000
Less: Accumulated Depreciation	(34,426,000)	(30,025,000)
Property and Equipment, Net	39,658,000	35,527,000
Other Assets		
Investment in Joint Venture	8,408,000	7,907,000
Fair Value of SWAP agreement	1,600,000	1,300,000
Deferred Debt Acquisition Costs	1,666,000	1,774,000
Total Other Assets	11,674,000	10,981,000
Total Assets	$ 101,477,000	$ 86,105,000

Balance Sheet - Comparative

Liabilities and Shareholder's Equity	2007	2006
Current Liabilities		
Current Maturities of Long-Term Debt	$ 2,975,000	$ 2,576,000
Accounts Payable	9,034,000	7,137,000
Accounts Salary	6,999,000	3,902,000
Accrued Benefits	3,000,000	1,900,000
Other Payables	138,000	142,852
Third Party Payor Settlements Payable	2,778,000	4,500,000
Accrued Malpractice	729,000	897,000
Total Current Liabilities	25,653,000	21,054,000
Long-Term Debt (Net of Current Maturities)	33,455,000	39,006,000
Total Liabilities	59,108,000	60,060,000
Net Assets		
Total Net Assets	42,369,000	26,045,000
Total Liabilities and Net Assets	$ 101,477,000	$ 86,105,000

Statements of Operations - Comparative

		2007		2006
Revenue				
Net Patient Services Revenue	$	231,058,000	$	179,670,000
Rental Income		795,000		783,000
Other		1,217,000		1,086,000
Total Revenue		233,070,000		181,539,000
Expenses				
Salaries and Benefits		95,142,000		85,339,000
Supplies and Other		49,173,000		32,407,000
Professional Fees		57,419,000		36,876,000
Interest and Financing Costs		4,031,000		3,848,000
Depreciation and Amortization		4,981,000		4,760,000
Provision for Bad Debts		8,200,000		7,846,000
Total Expenses		218,946,000		171,079,000
Operating Income	$	14,124,000	$	10,463,000
Investment Income and Including Joint Ventures And Swap Change		1,200,000		750,000
Total Income	$	15,324,000	$	11,213,000

Statement of Changes in Net Assets

	Unrestricted Net Assets
Balance at December 31, 2005	$ 74,392,000
Operating Income	10,463,000
Investment Income, Including Joint Ventures and Swap Change	750,000
Released from Restrictions for Fixed Assets	500,000
Balance at December 31, 2006	$ 86,105,000
Operating Income	14,124,000
Investment Income, Including Joint Ventures and Swap Change	1,200,000
Released from Restrictions for Fixed Assets	1,000,000
Balance at December 31, 2007	$101,477,000

Statement of Changes in Cash Flows

Increase in Net Assets for 2007	$ 16,324,000
Net Cash provided by Operating Activities	14,000,000
Cash Flow Used by Investing Activities	(27,745,000)
Cash Flow from Financing Activities	**(2,576,000)**
Net Increase in Cash and Cash Equivalents	**3,000**
Beginning Cash	**2,000**
Ending Cash	**$ 5,000**

Footnotes to the Financial Statements

- **Typical footnote disclosures usually contain the following:**
  - Organization and Basis of Presentation
  - Summary of significant accounting policies
    - ◊ Revenue recognition
    - ◊ Basis for investment in joint ventures
    - ◊ Donations
    - ◊ Non-Profit vs. Government vs. For-Profit
  - Significant asset detail
    - ◊ Investments, fixed assets – NP/ FP vs. Governmental
  - Significant liability detail
    - ◊ Long term debt detail and maturity schedules
    - ◊ Capital lease detail and maturity schedules

Footnote to Financial Statements - Continued

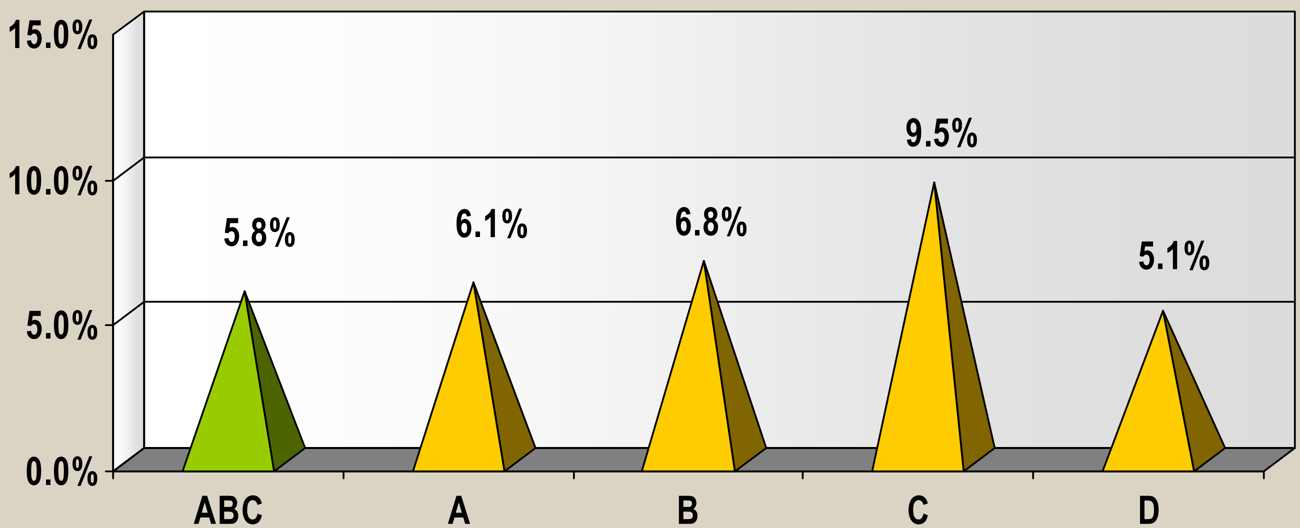
- **Significant footnote disclosures usually contain the following:**
  - **Significant revenue sources or contracts**
  - **Related party disclosures and discussion as to relationships**
  - **Joint venture information that might be significant**
  - **Pension information – defined benefit vs. defined contribution**
  - **Concentrations of risk**
  - **Significant commitments or contingencies**
    - ◊ **Operating leases**
    - ◊ **Litigation**

Percentage Growth in Net Patient Revenues

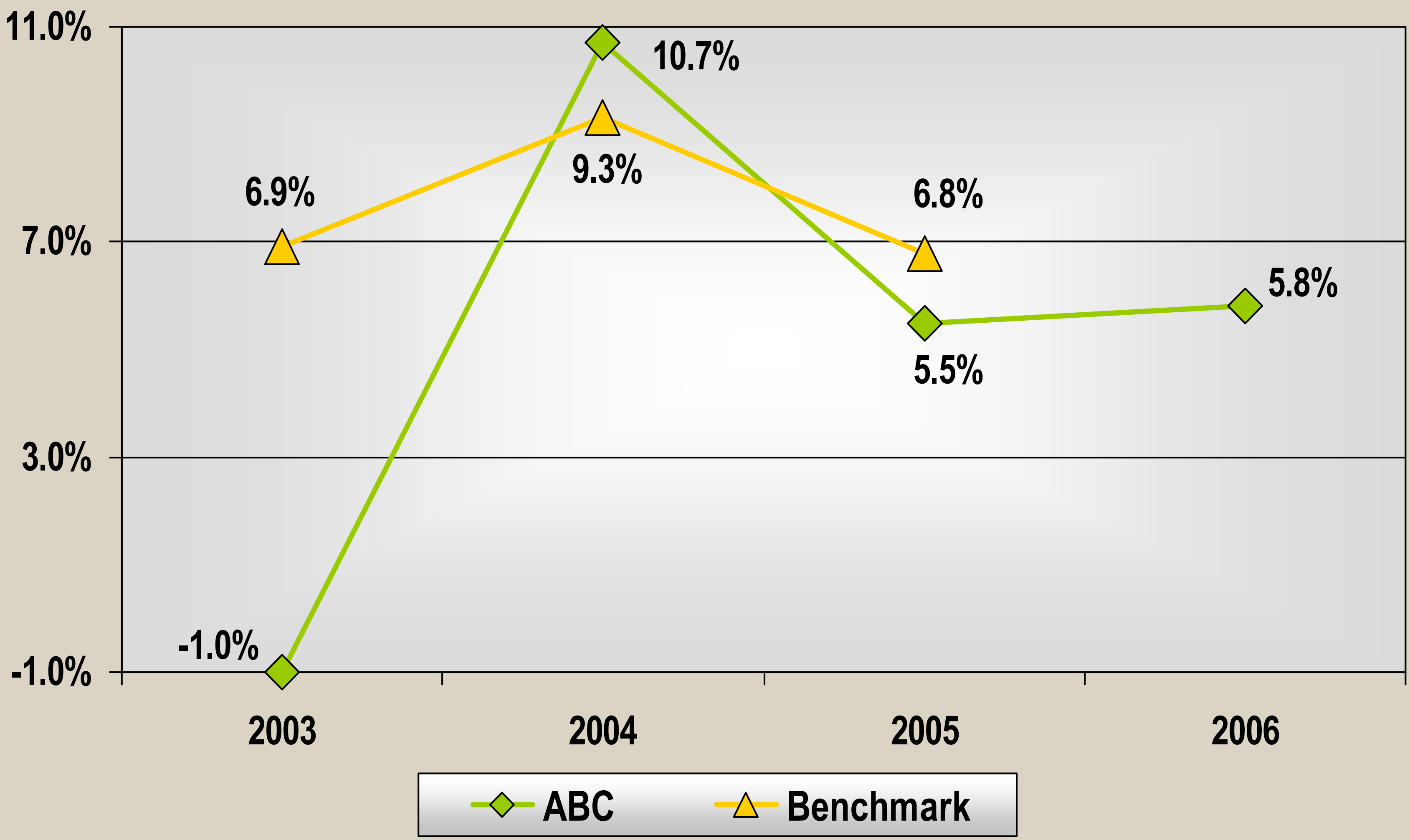
Definition:

This is the percentage increase in net patient service revenues from the prior year. The ratio reflects increases and decreases in charges, volumes and contractual adjustments from the prior year.

Facility Specific Data:



Percentage Growth in Net Patient Revenues

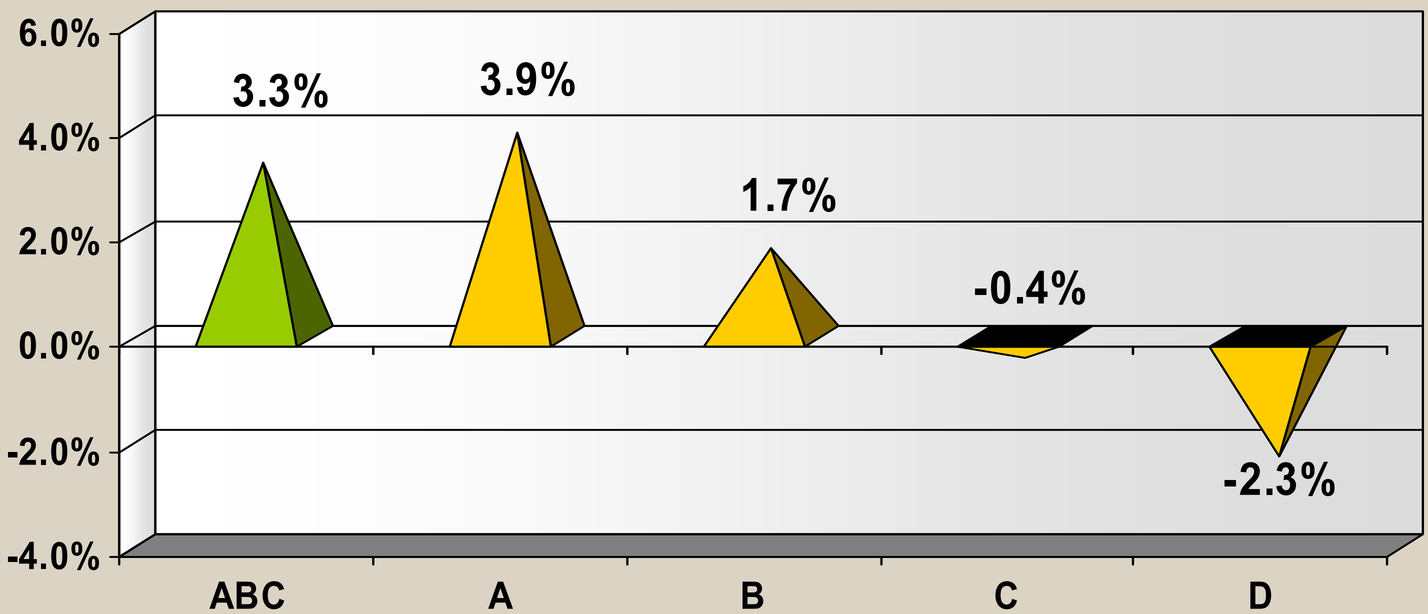


Operating Margin

Definition:

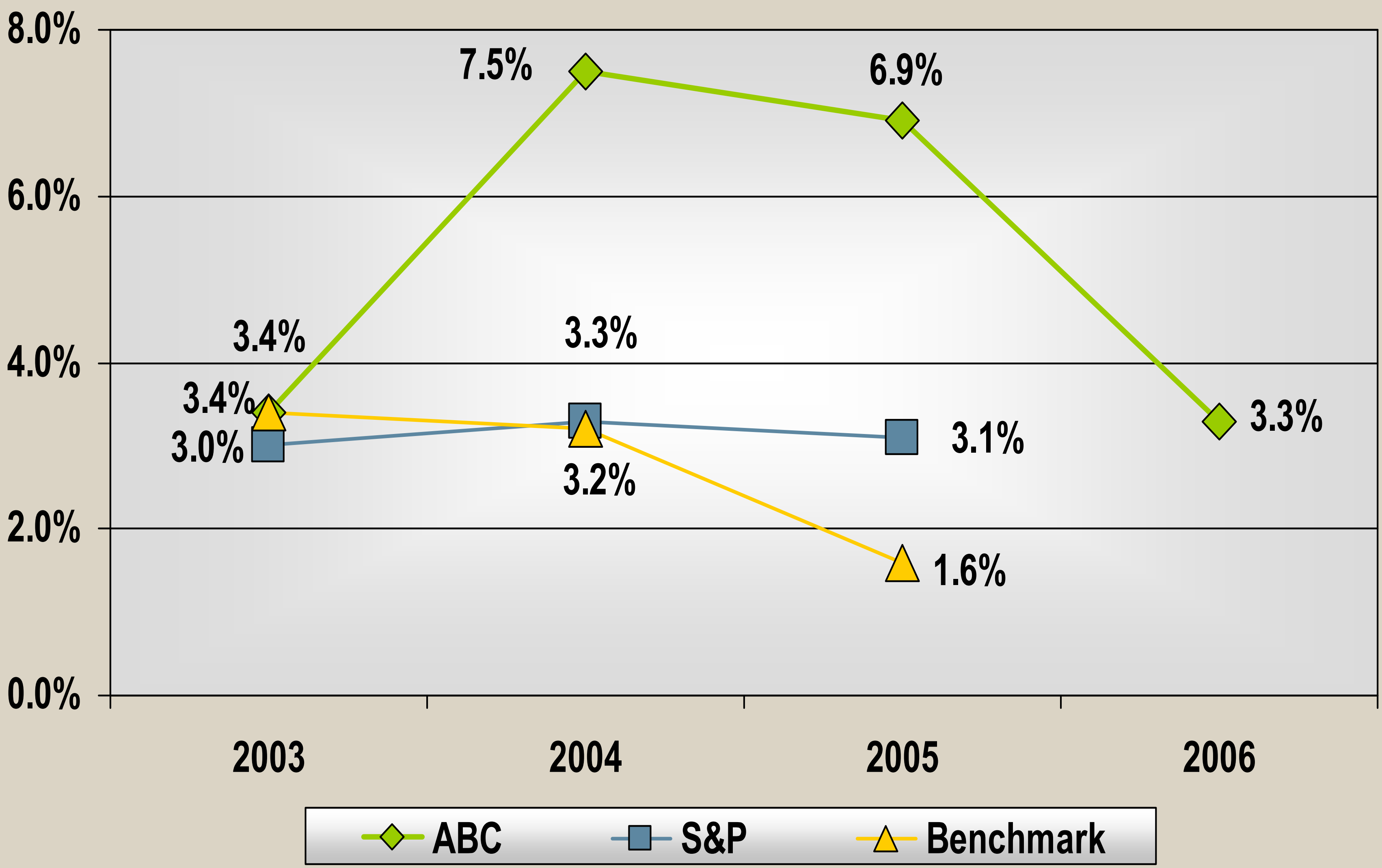
This ratio is operating income as a percentage of net patient service revenues plus other operating revenues. It is used to report the facility's return on revenues which relate to the main purpose of operations.

Facility Specific Data:



ABC Medical Facility
Financial Indicators - Profitability Ratios
Exhibit 2 (2/2)

Operating Margin

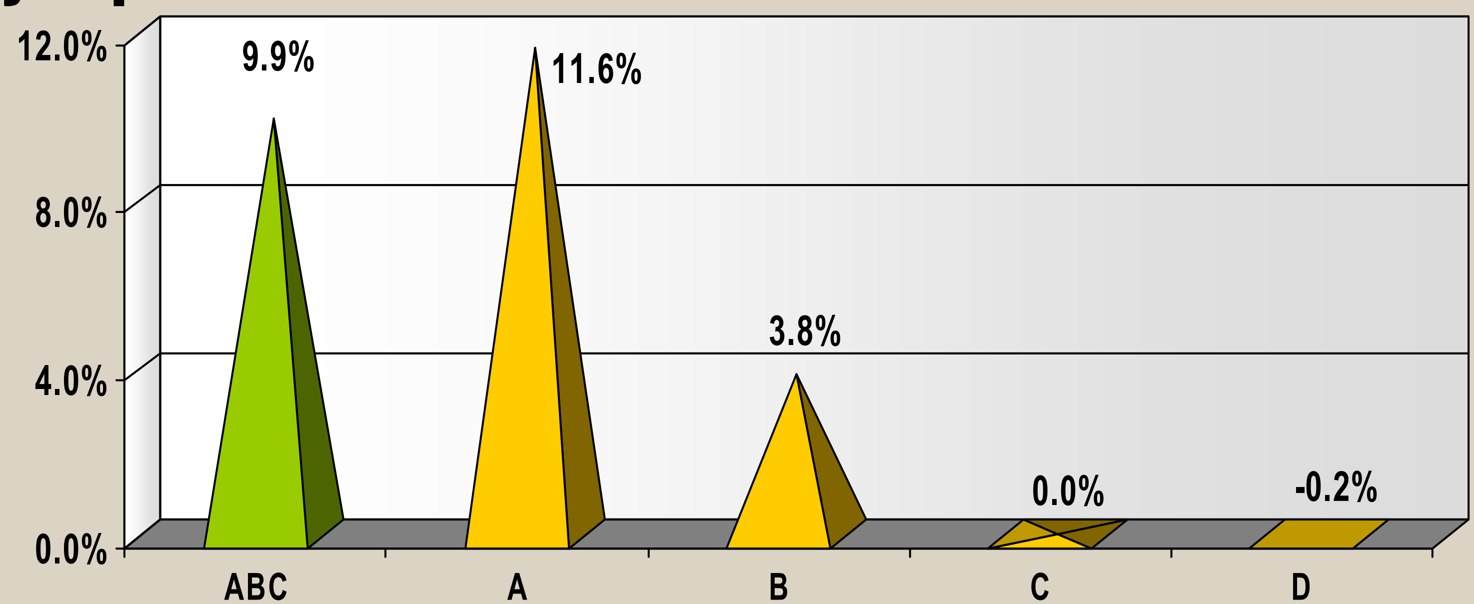


Net Margin

Definition:

This ratio is excess of revenue over expenses as a percentage of all revenue (operating and non-operating).

Facility Specific Data:

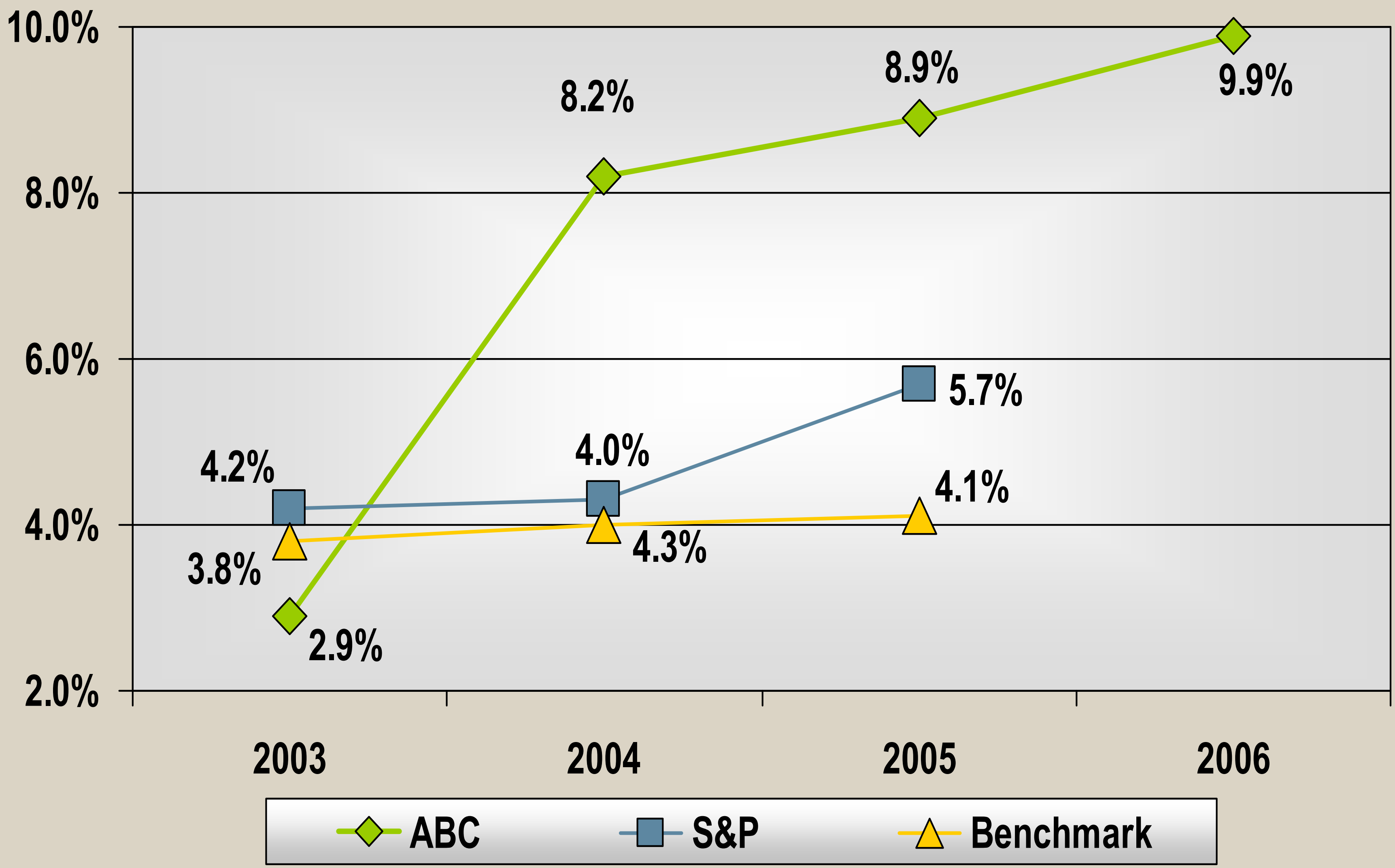


ABC Medical Facility

Financial Indicators - Profitability Ratios

Exhibit 3 (2/2)

Net Margin

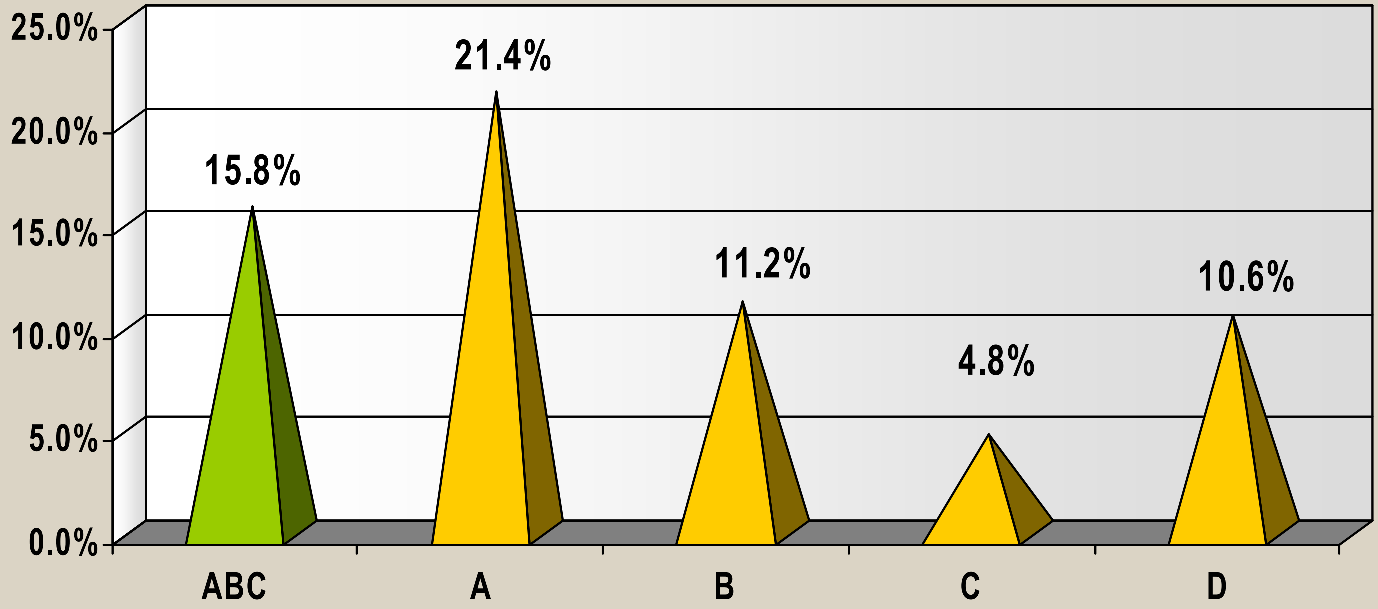


EBIDA

Definition:

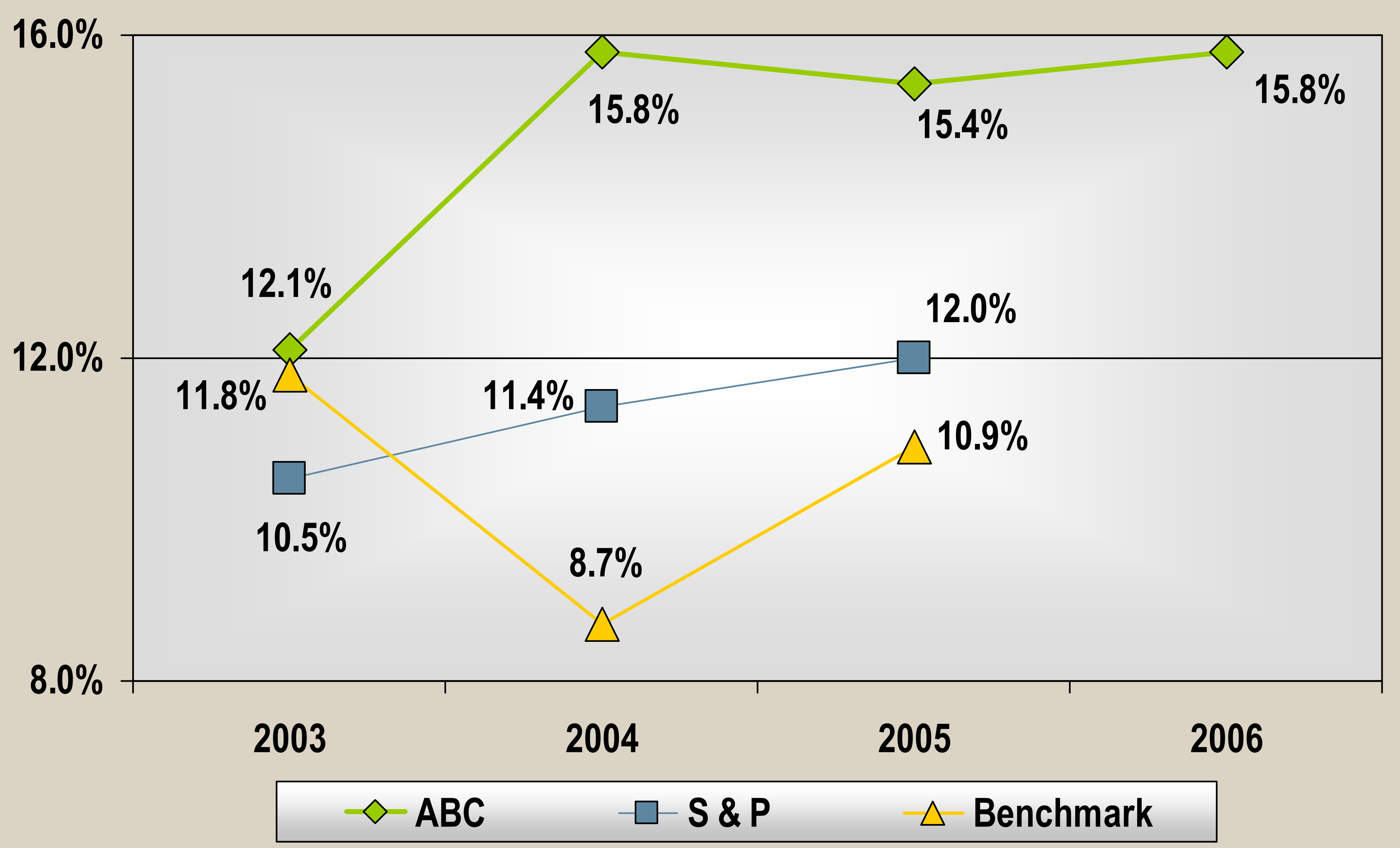
EBIDA represents Earnings (excess of revenue over expenses) Before Interest, Depreciation and Amortization divided by total revenue. It is used as a rough measure of cash flow in a facility. This ratio is often used when evaluating debt capacity.

Facility Specific Data:



ABC Medical Facility
Financial Indicators - Profitability Ratios
Exhibit 4 (2/2)

EBIDA



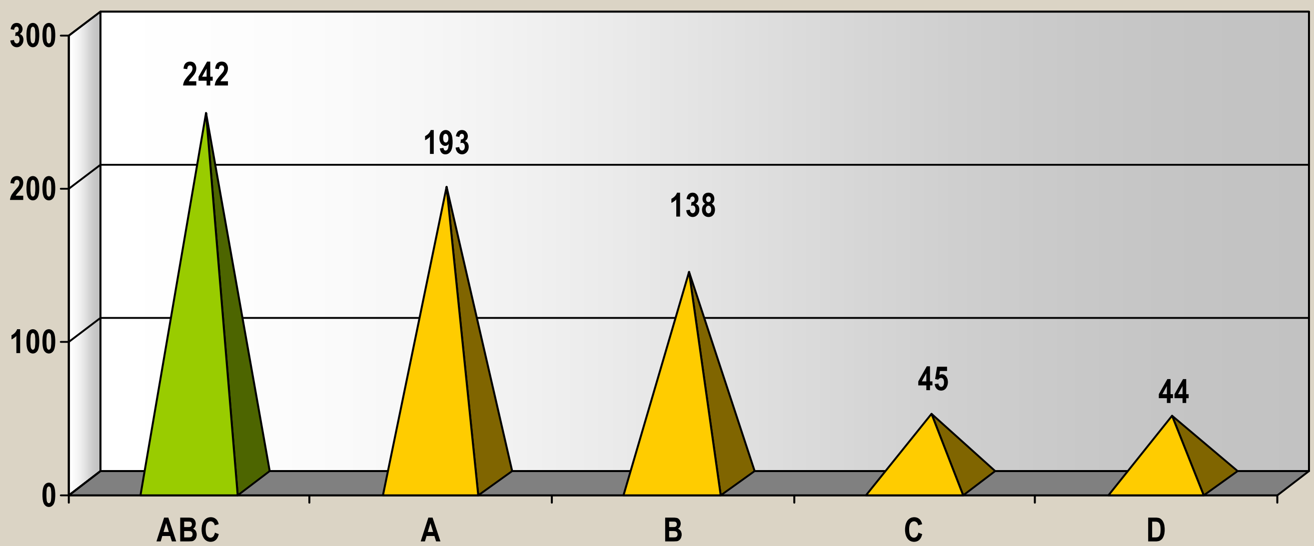
Days Cash on Hand

(All Sources)

Definition:

Days Cash on Hand measures the number of days of average cash expenses that the Facility maintains in cash and amounts reserved for capital improvements. High values usually imply a greater ability to meet both short-term obligations and long-term capital replacement needs.

Facility Specific Data:



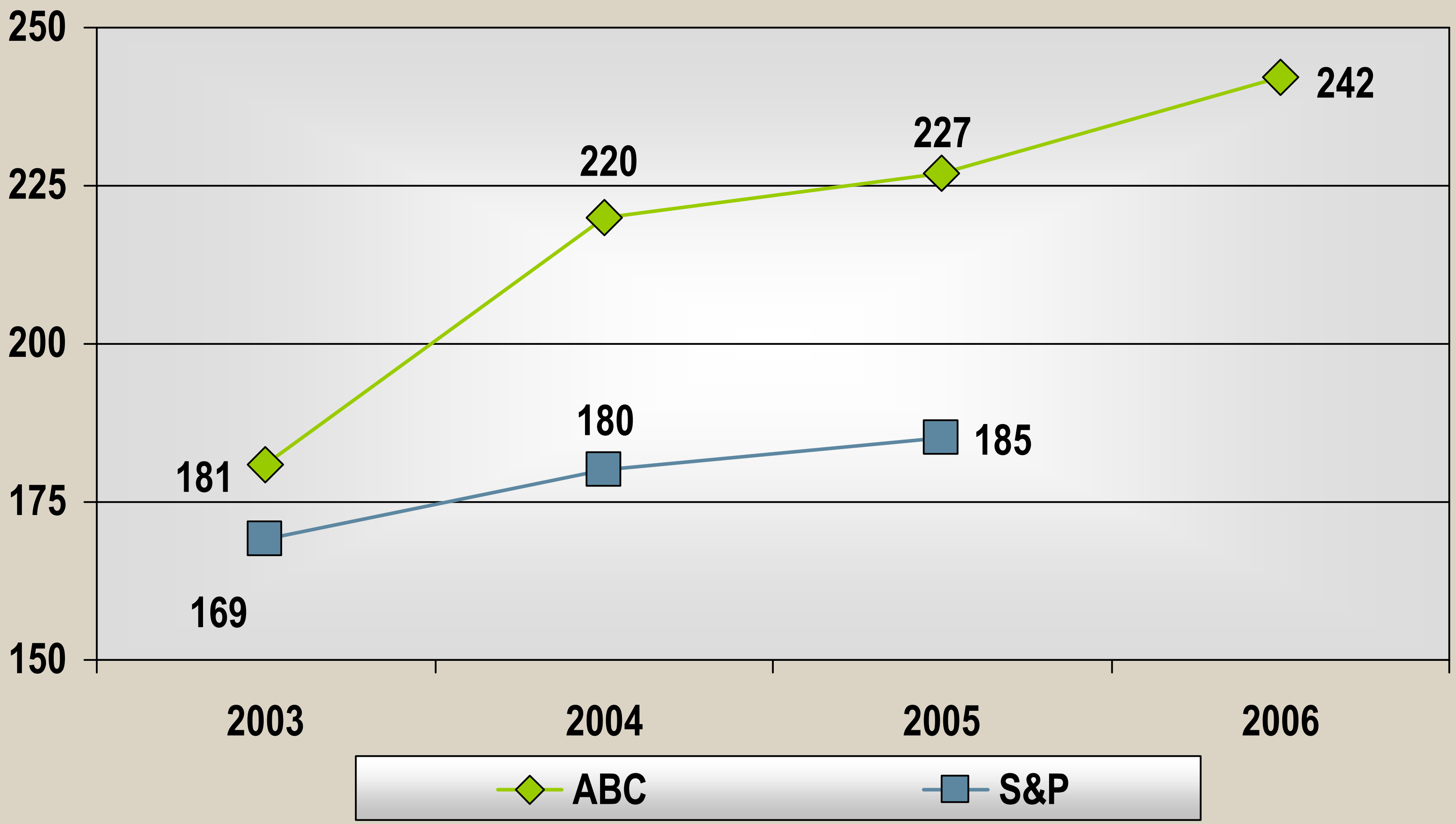
ABC Medical Facility

Financial Indicators - Liquidity Ratios

Exhibit 5 (2/2)

Days Cash on Hand

(All Sources)

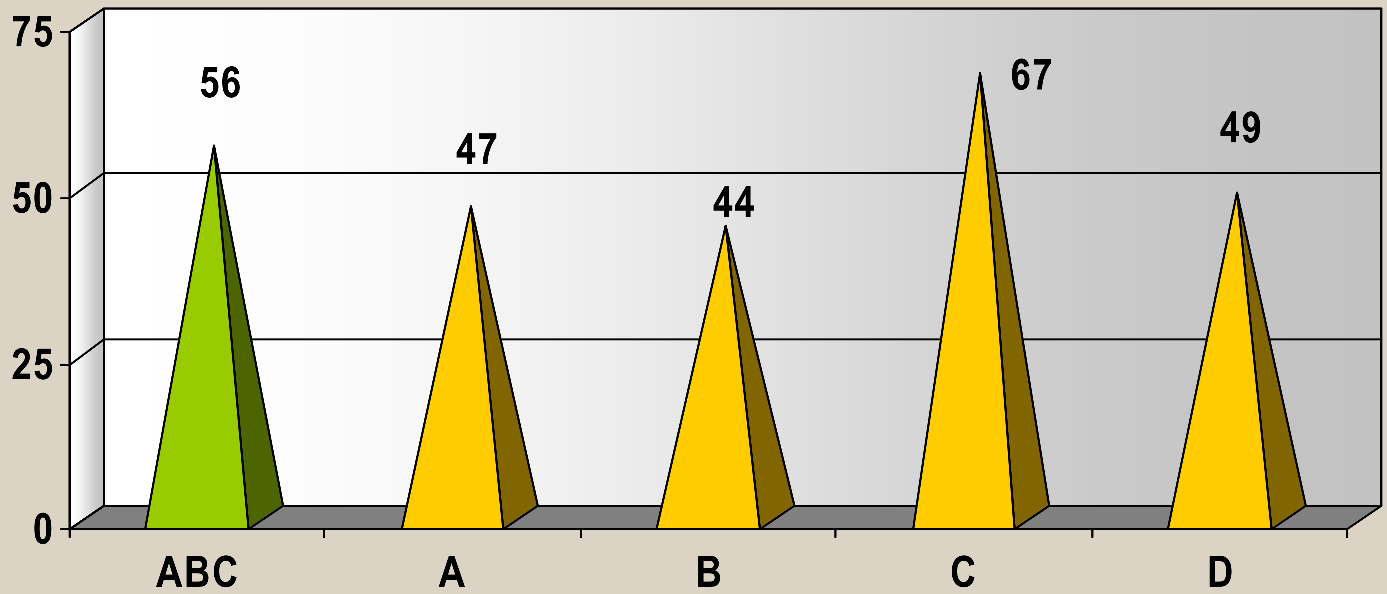


Net Days in Accounts Receivable

Definition:

Days in patient accounts receivable is defined as the average time that receivables are outstanding, or the average collection period.

Facility Specific Data:

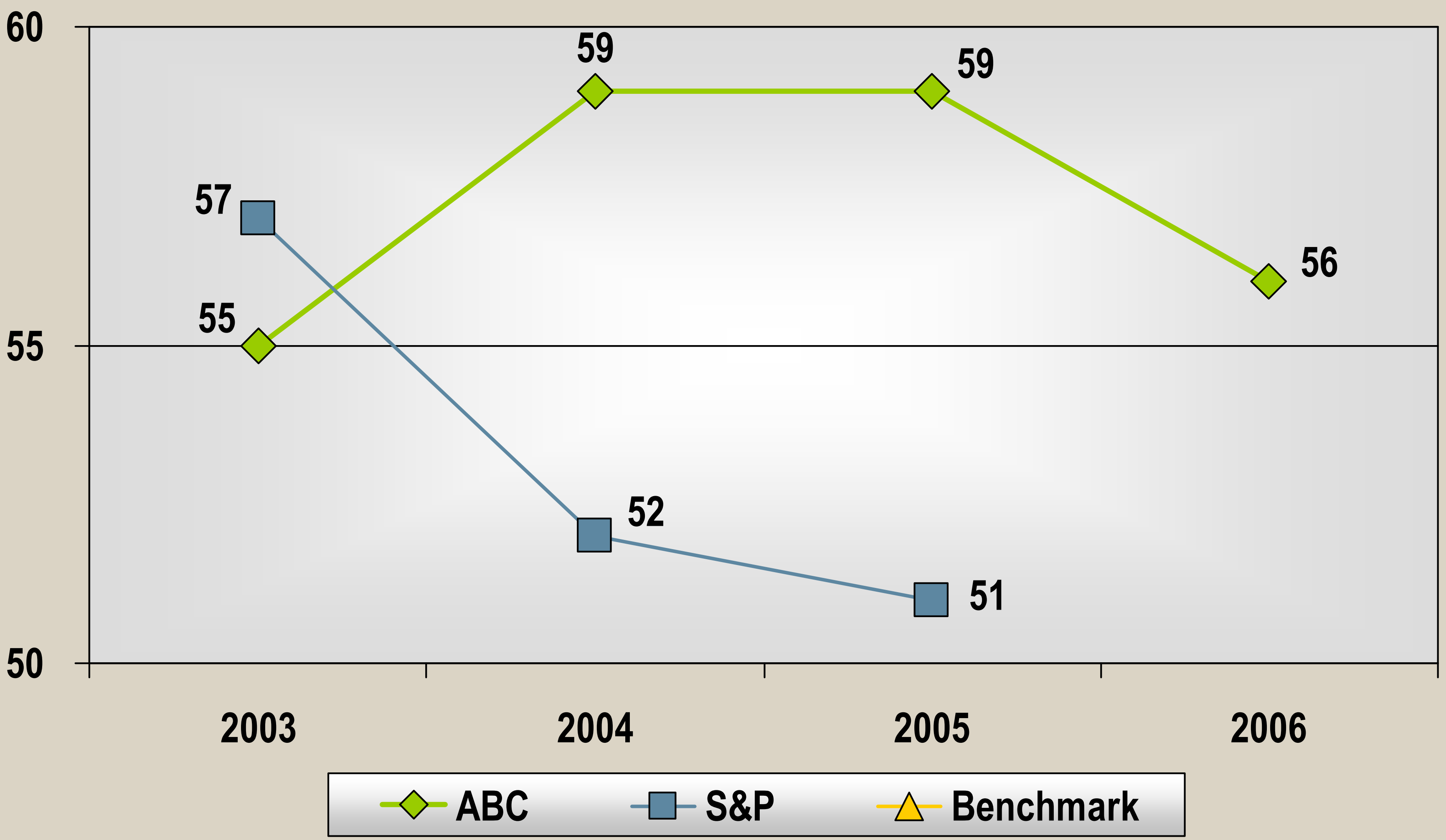


ABC Medical Facility

Financial Indicators - Liquidity Ratios

Exhibit 6 (2/2)

Net Days in Accounts Receivable



Percentage of A/R over 90 Days Old

Definition:

Percentage of A/R over 90 Days Old

This is measured by dividing the amount of patient accounts receivable over 90 days by the total receivables in that payer category. Generally the lower this percentage is the shorter turn around time the facility has for collecting receivables. This may not necessarily be the case as it relates to self pay accounts. Often write-off policies come into play in this situation.

Bad Debts as a percentage of Gross Revenues

This is calculated by dividing the bad debts by the annual amount of gross revenue in that period. A high percentage may indicate that collection efforts are not ideal or that accounts are too aggressively sent to collections.

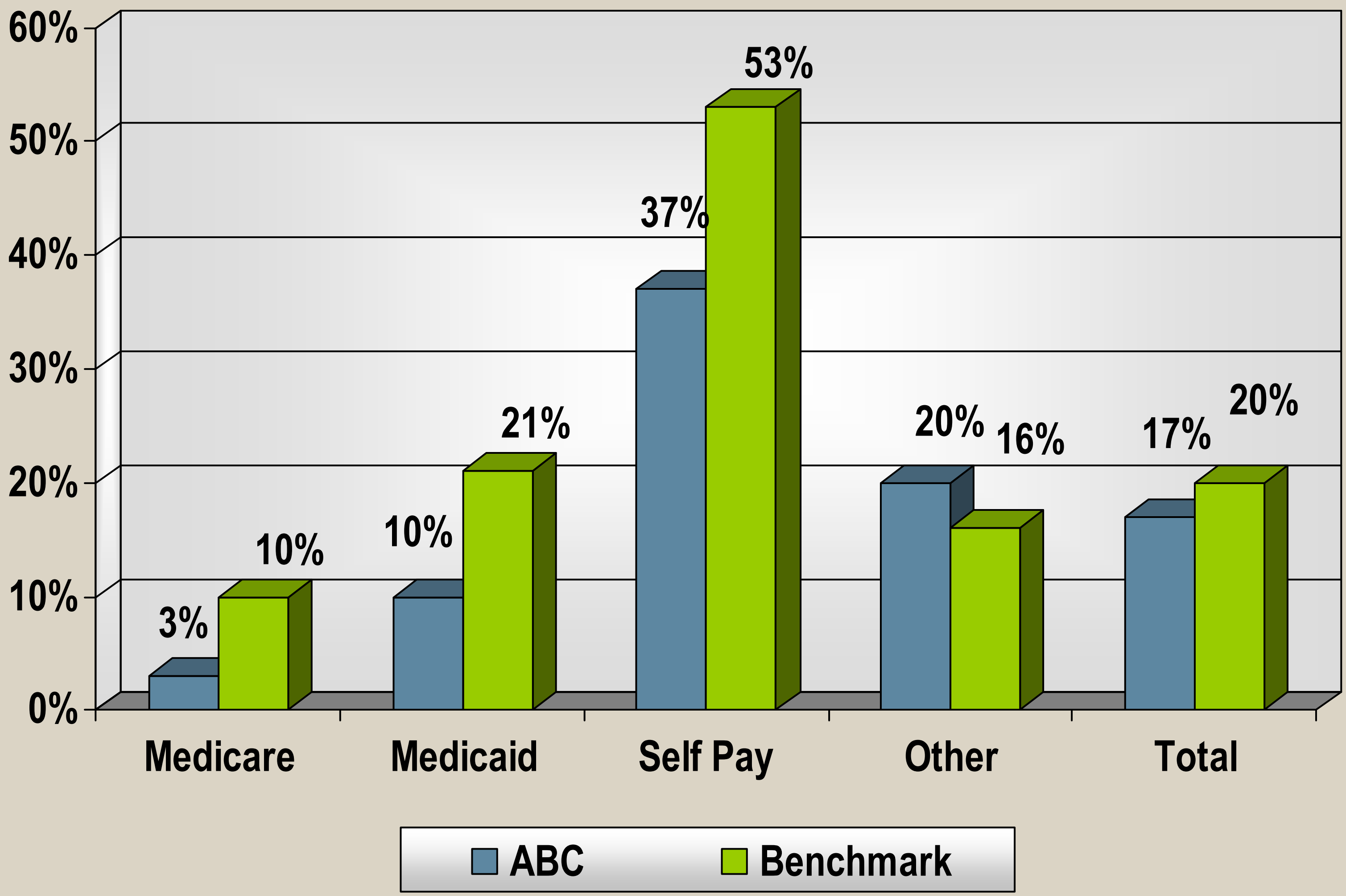
The percentage of accounts over 90 days old is not always the best measure for the business office as it may be deflated due to an unusually high amount of accounts written-off to bad debts. This does not appear to be the case at ABC as amounts written-off as a percentage of gross revenues are reasonable in comparison to similar facilities in the region.

ABC Medical Facility

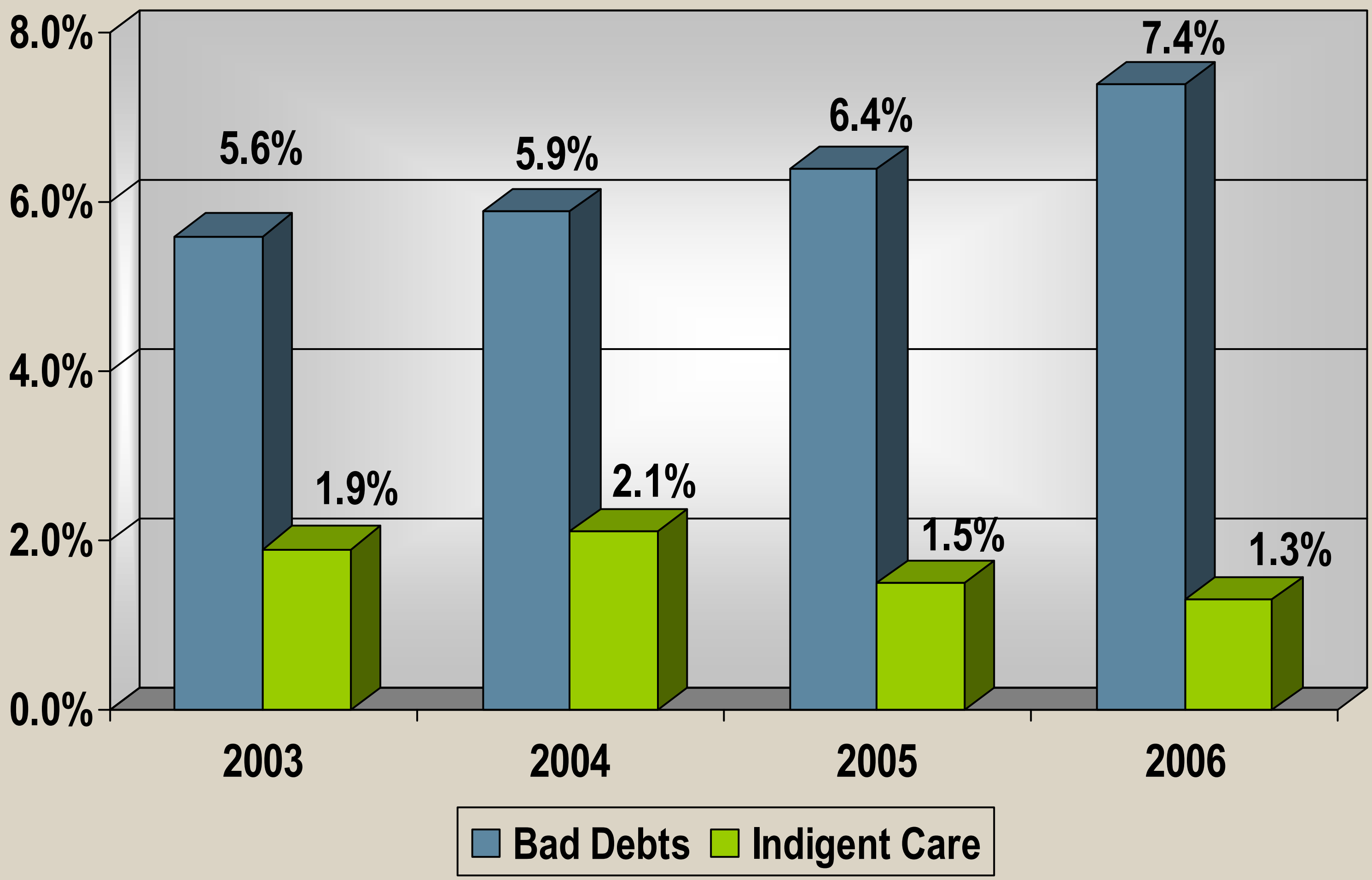
Financial Indicators - Liquidity Ratios

Exhibit 7 (2/3)

Percentage of A/R over 90 Days Old



Bad Debts & Indigent Care as a % of Gross Revenues

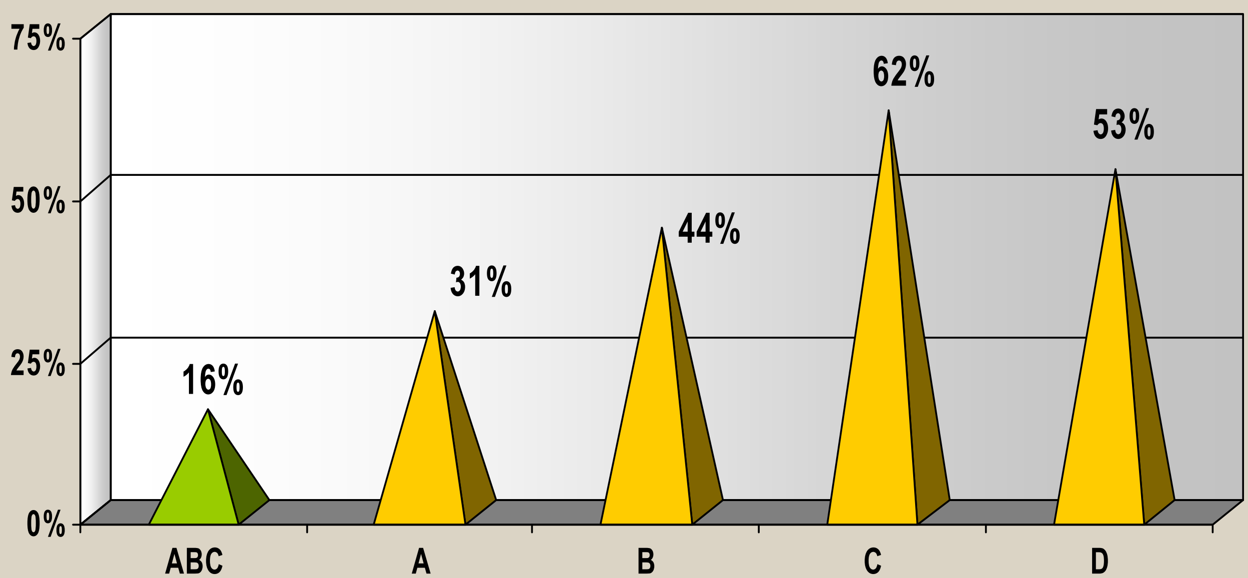


Debt to Capitalization

Definition:

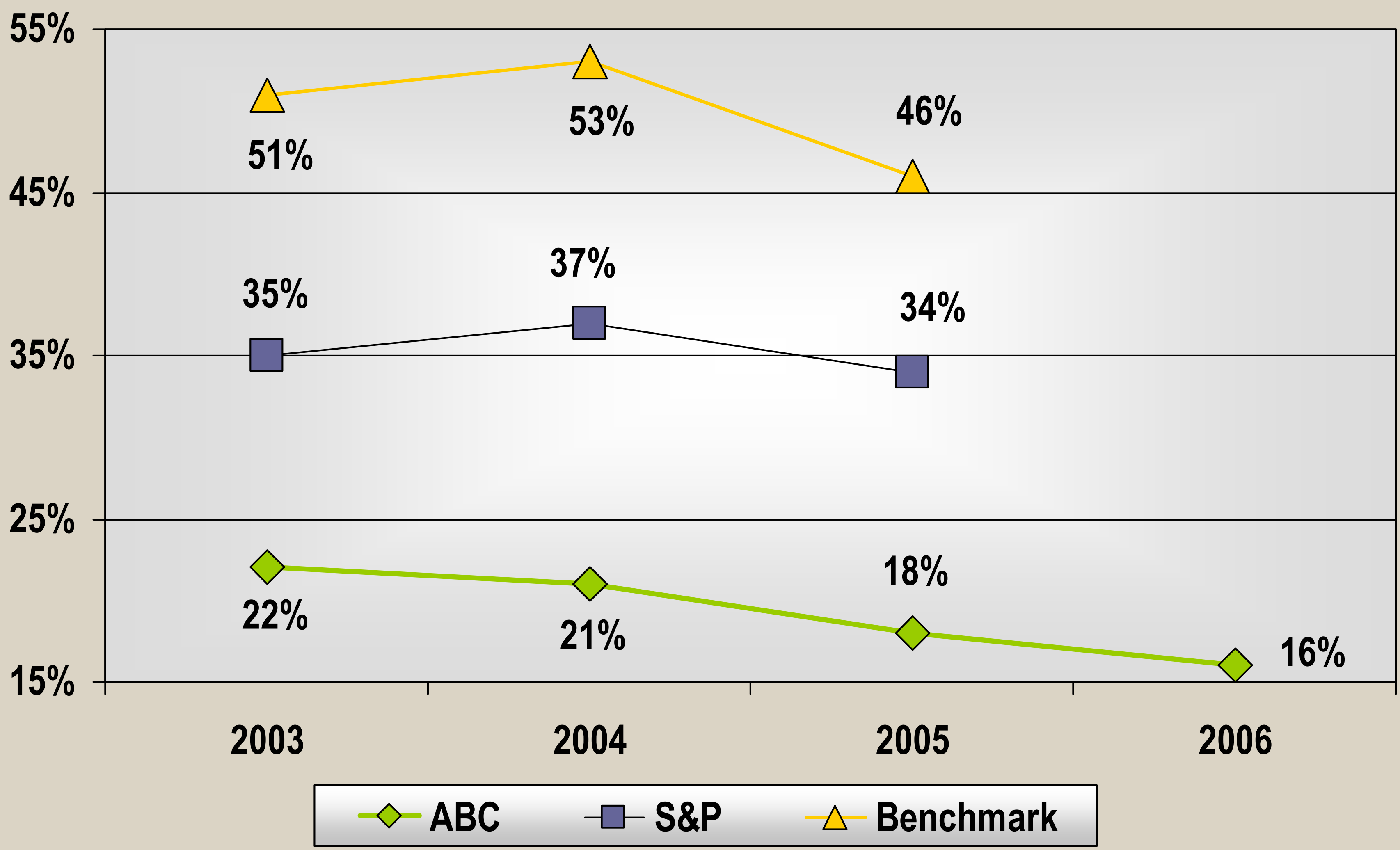
Long-Term Debt to capitalization is defined as the proportion of long-term debt divided by long-term debt plus net assets. Higher values for this ratio imply a greater reliance on debt financing and may imply a reduced ability to carry additional debt.

Facility Specific Data:



ABC Medical Facility
Financial Indicators - Profitability Ratios
Exhibit 9 (2/2)

Debt to Capitalization

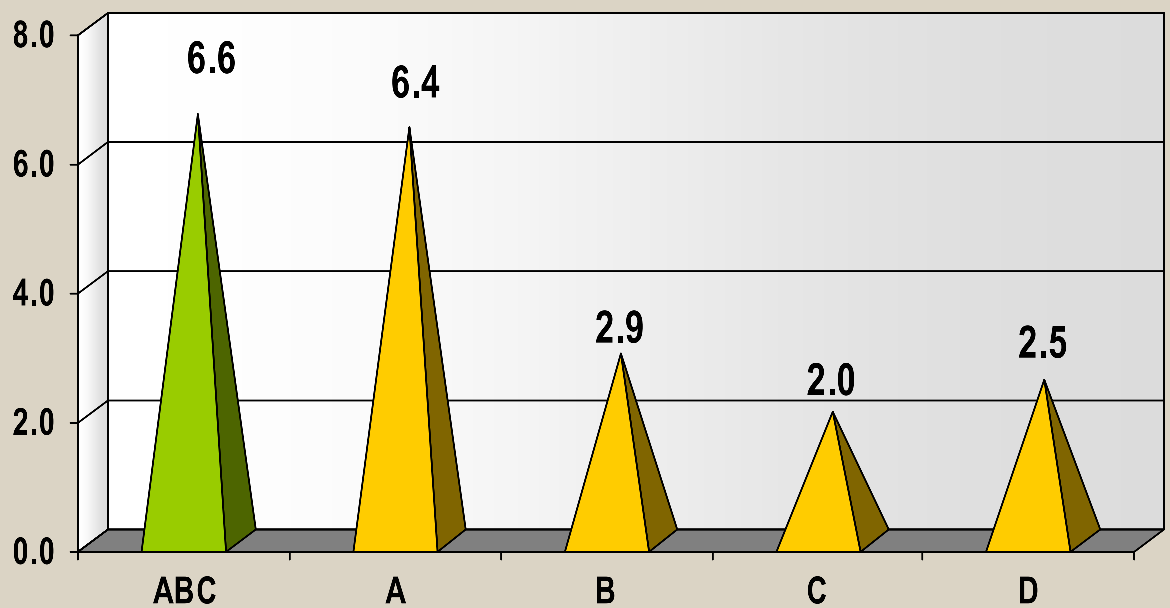


Debt Service Coverage

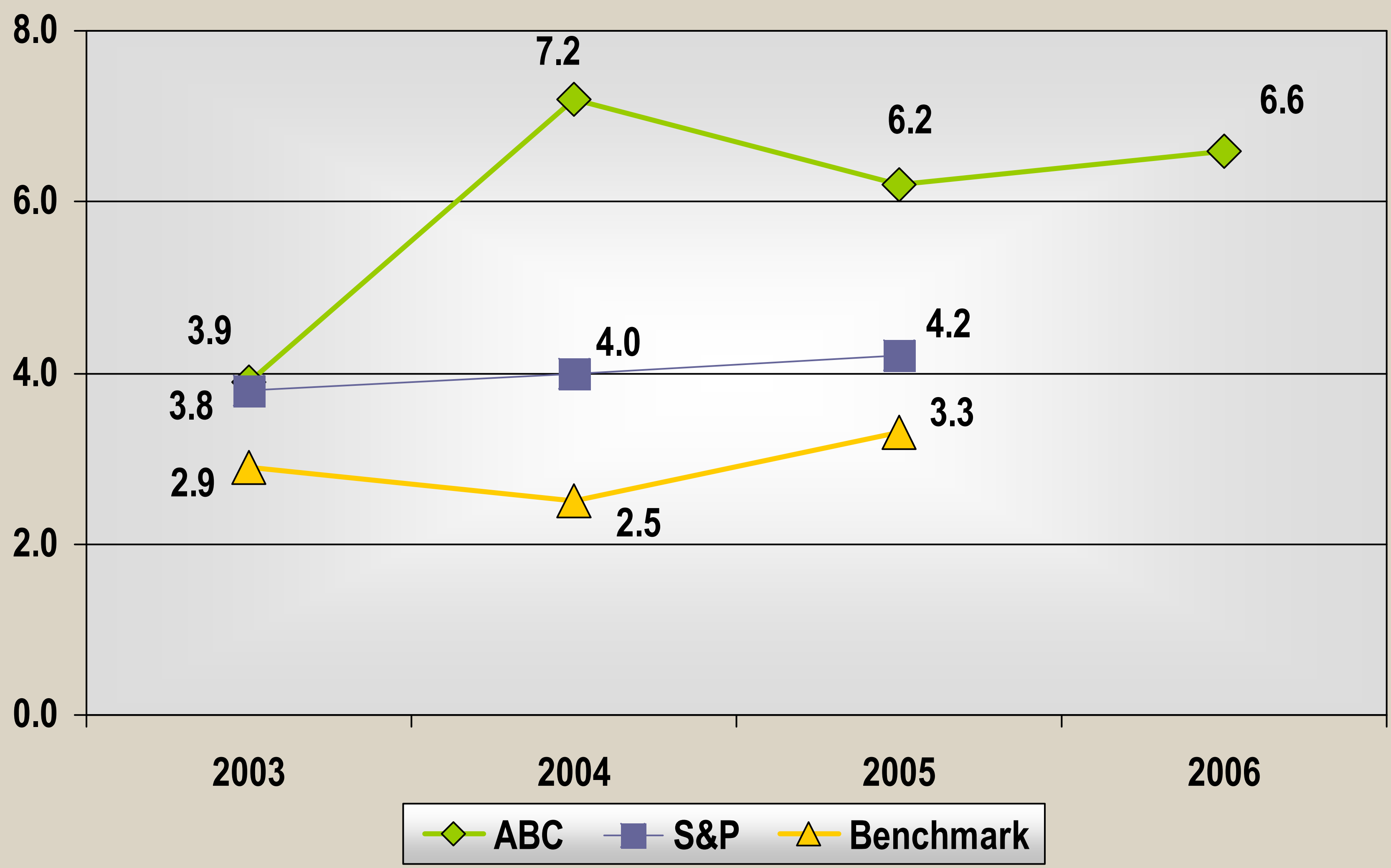
Definition:

Debt Service Coverage is calculated as net income, adjusted for depreciation and interest expense, divided by total annual debt service requirements (total interest cost including enhancement fees plus principle payments). Higher values for Debt Service Coverage indicate better debt repayment ability.

Facility Specific Data:



Debt Service Coverage

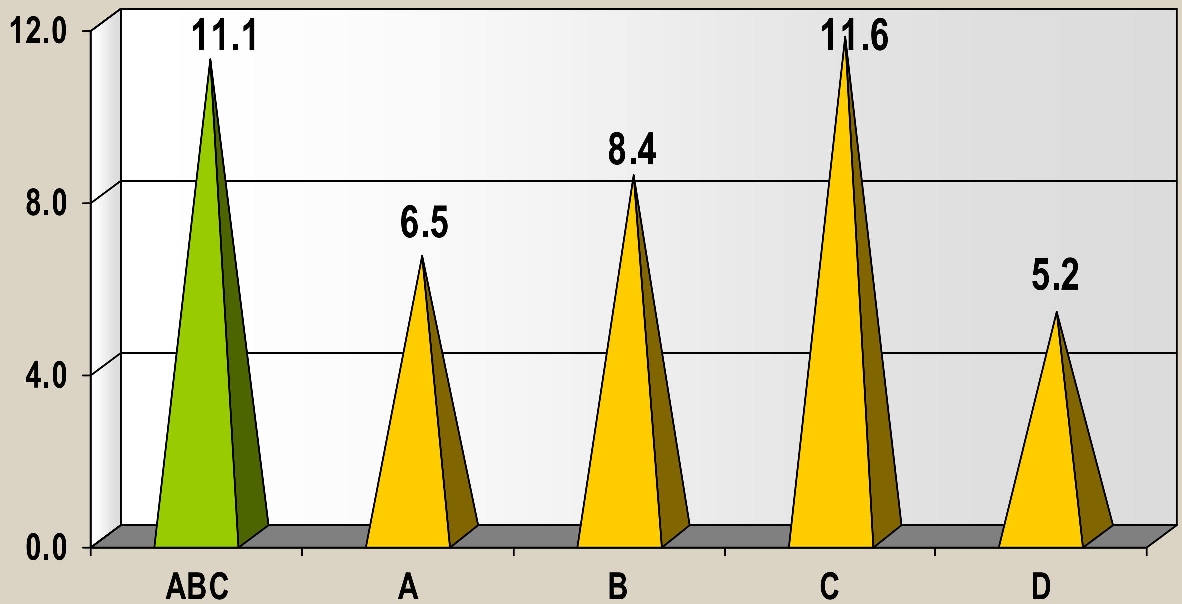


Average Age of Plant

Definition:

Average age of plant attempts to approximate the average age of an organization's fixed assets by dividing depreciation expense into accumulated depreciation.

Facility Specific Data:

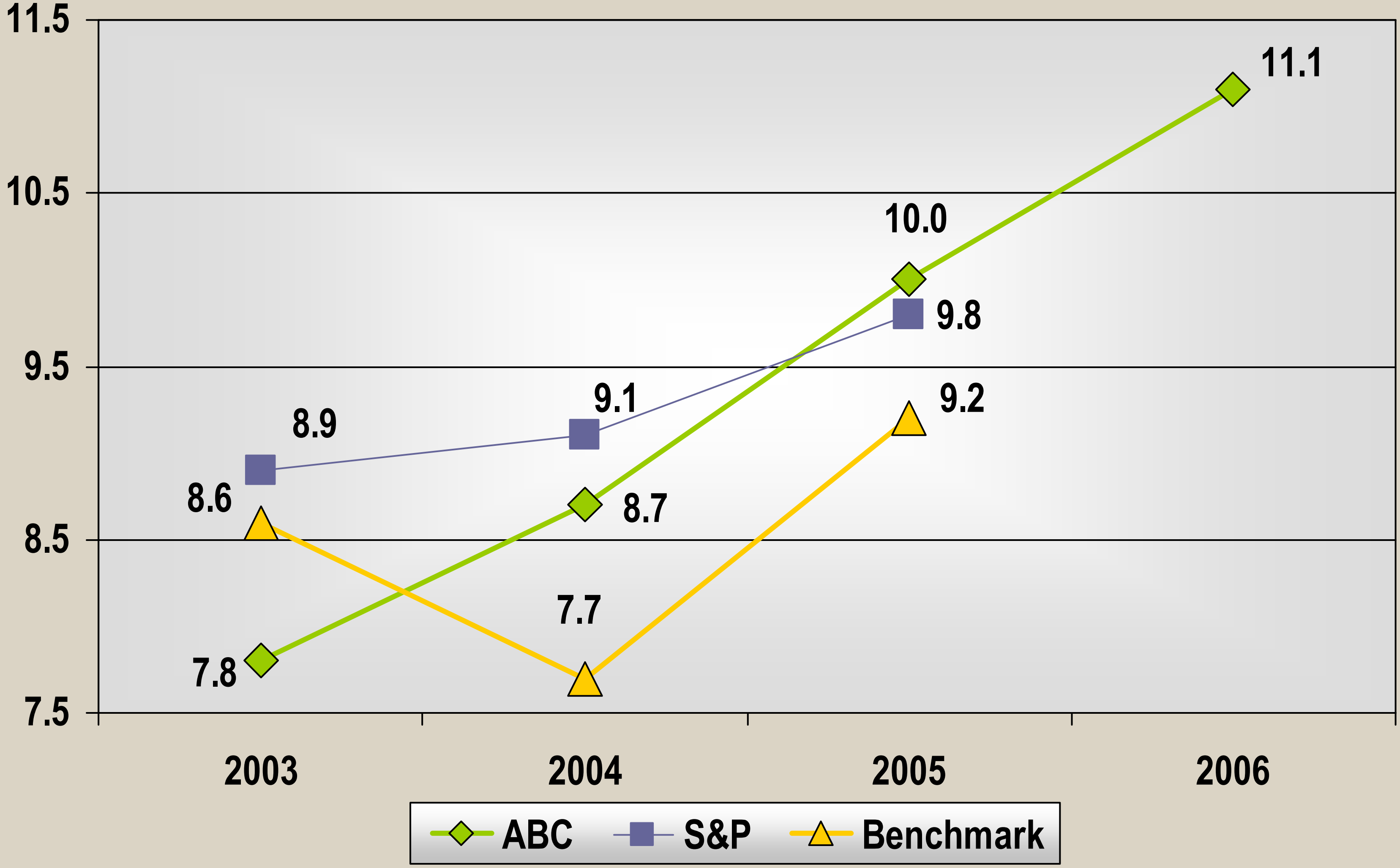


ABC Medical Facility

Financial Indicators – Capital Structure

Exhibit 11 (2/2)

Average Age of Plant



Revenue Recognition

- **Patient revenues are recorded at the gross amount – the specific charge in the charge master per procedure.**
  - **Majority of payers do not pay the gross amount. Examples include:**
    - ◊ **Medicare and Medicaid have specific payment tables**
    - ◊ **Commercial payers have contracts**
    - ◊ **Self pay may have sliding payment rates**
  - **Payments are typically not immediate.**
    - ◊ **Weeks, days, perhaps longer**

Revenue Recognition – Continued

- Results in a high degree of estimation.
  - How long does it usually take for a particular payer
  - Do they pay the specified amount; table, contract, etc?
  - Fluctuations in patient volumes can lead to business office staffing issues.
  - Complex spreadsheets are used to estimate the expected amount that will eventually be paid.

Revenue Recognition – Continued

- **Revenue recorded at gross**
- **Amount expected not to be received is either:**
  - **an "adjustment to revenue" or**
  - **expected "bad debt" and must be "allowed for" on the balance sheet.**

1. **Apply expected payment rates to the significant payer balances at the end of a period.**
2. **Suggest not estimating contractual adjustments or bad debt off of revenue!**

Significant Types of Transactions

- Interest Rate Swaps
  - Net effect of increasing or decreasing interest expense
  - Changes in Value of a Swap
    - ◊ Financial statement impact
    - ◊ Performance indicator vs. Net asset statement

- Issuance of Debt
  - Refinance of old debt vs. new debt
    - ◊ Recording of issue costs
    - ◊ For Gov't - Advance Refunding vs. Crossover Refunding

- Equity Investments in Joint Ventures
  - Equity method vs. Cost method vs. Consolidation

- Foundation – controlled vs. not controlled
  - Non-profit vs. Governmental
  - By-laws

Significant Types of Transactions – Continued

- **Liability for malpractice claims made policies**
  - **Actuary or in-house estimate**
- **Liability for self insurance**
  - **Health insurance**
  - **Workers compensation**
- **Transfers of property between related entities**
  - **At cost or fair market value?**

Recent Accounting Pronouncements

- **SFAS 158 – Defined Pension Liability**
  - Could result in significant increase to liability or reduce the prepaid asset
- **SFAS 157 – Fair Market Value measurements**
  - Defines fair value
  - Requires certain disclosures
- **SFAS 159 – FY's beginning after 11/15/07**
  - Allows reporting of certain assets and liabilities to be reported at fair value
  - Expected to expand the use of fair value measurement
  - Non – Operating types of Assets

Recent Accounting Pronouncements - Continued

- **FIN 45-3 – Minimum Income Guarantees – Not GASB**
  - Specifically mentions non-employee physicians
  - Disclosure requirements – typical disclosures as to amounts, term, etc.
  - Asset and Liability upon contact vs. just an asset when advanced
  - As advances are made liability is reduced
  - Effective for contracts entered into after January 1, 2006
- **FIN 48 – Income Tax Disclosures**

Recent Accounting Pronouncements - Continued

- **GASB 45 – *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions***
  - ***Various effective dates based on revenues***

- ***GASB 49 – Recognition of obligations to remove or remedy pollution.***

New Audit Standards

- SAS 112 – Communication of Internal Control matters
  - Control deficiency
  - Significant deficiency
  - Material weakness
- SAS 104 through 111- Results in a risk based audit
- SAS 114
  - Additional Communication to Audit Committee – prior and subsequent to audit
  - Defines Governance and reporting levels

Audit Committee Responsibilities

- **Appoint, compensate, retain and evaluate external auditor**
- **Oversee external audit plan**
- **Review and discuss annual audited financial statements**

Audit Committee Responsibilities

- **Monitor internal control over financial reporting**
- **Monitor external auditor's independence**
- **Approve audit and non-audit services performed by external auditor**

Audit Committee Responsibilities

- Oversee internal audit function
- Establish code of ethical conduct
- Monitor board activities as it relates to code of ethical conduct
  – Related party transactions
- Monitor special investigations involving possible fraud and related issues

Audit Committee Responsibilities

- Compliance with laws, rules and regulations
- Litigation matters
- Officer and director expense accounts and perks

Finance Committee Responsibilities

- Review internal financial statements
- Review and discuss significant transactions
  - Construction projects
  - Understand financial impact of affiliations with Physicians and other healthcare organizations
- Understand and discuss debt financing, refinancing and equity investments in joint ventures
- Understand revenue generation in a healthcare entity and proper valuation of accounts receivable

Finance Committee Responsibilities

- **Understanding financial ratios and ask questions regarding certain trends**
- **Understand investment activity and return on investments**
- **Communicate their understanding of the issues to the full board**

Questions?

Questions??