Chapter 1

Overview and Unique Considerations of Health Care Entities

Purpose

1.01 This guide has been prepared to assist health care entities in preparing financial statements in accordance with generally accepted accounting principles in the United States of America and to assist independent auditors in auditing and reporting on those financial statements. This guide focuses on accounting and auditing issues that are pervasive in, or unique to, health care entities.

Applicability

1.02 This guide applies to the following types of health care entities:

- Investor-owned businesses, both public business entities[1] and private companies. Refer to the preface for further explanation of public business entities and private companies.
- Not-for-profit (NFP) business-oriented entities that have no ownership interest and are essentially self-sustaining from fees charged for goods and services (the term *not-for-profit entity* is used as defined in the FASB *Accounting Standards Codification* [ASC] Master Glossary).
- Governmental entities. See paragraph 1.08 and chapter 15, "Unique Considerations of State and Local Government Health Care Entities," for further discussion regarding governmental health care entities.

This guide applies to entities whose principal operations consist of providing or agreeing to provide health care services and that derive all or almost all of their revenues from the sale of goods or services; it also applies to entities whose primary activities are the planning, organization, and oversight of such entities, such as parent or holding companies of health care entities.

1.03 This guide does not apply to *voluntary health and welfare entities*, as defined in the FASB ASC glossary. It also does not apply to NFPs that are fund-raising foundations, even if those foundations are included in the consolidated financial statements of a health care entity. Voluntary health and welfare entities and fund-raising foundations follow the AICPA Audit and Accounting Guide *Not-for-Profit Entities*, rather than this guide.

1.04 Thus, this guide applies to the following entities, among others:

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[1] Technical Questions and Answers (Q&A) section 7100, "Definition of a Public Business Entity," can assist in applying the definition of a public business entity. Although not intended to serve as guidance to not-for-profit entities (NFPs), it may assist NFPs in understanding the key terms used in the various definitions of public entity, including the definitions of security, over-the-counter market, and conduit debt obligor.

All Q&A sections can be found in *Technical Questions and Answers*.

- Clinics, medical group practices, individual practice associations, individual practitioners, emergency care providers, laboratories, surgery centers, imaging centers, and other ambulatory care organizations
- Continuing care retirement communities
- Drug and alcohol rehabilitation centers and other rehabilitation facilities
- Health maintenance organizations, or HMOs, and similar prepaid health care plans
- Home health agencies
- Hospice care providers
- Hospitals
- Institutional facilities that provide skilled nursing, intermediate, or less-intensive levels of health care
- Integrated health care delivery systems that include one or more of these entities
- Providers of durable medical equipment and related medical services

1.05 Some entities may have health care as a component of a larger, more diversified operation. For example, some senior independent living facilities are primarily real estate operations with a health care component. The Financial Reporting Executive Committee believes that to the extent such entities have unique transactions of the type covered by this guide, the recognition and measurement guidance of this guide would be applicable. Professional judgment should be exercised in determining the applicability of this guide to transactions entered into by such entities.

1.06 A health care entity may be part of another entity, such as a medical school or university, or a subsidiary of a corporation. The recommendations in this guide apply to the separate financial statements of the health care entity.

Classification of Health Care Entities

1.07 The nature of the entity and its operating structure have a significant effect on the needs of financial statement users. According to paragraph 8 of FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*

> [s]ome organizations have no ownership interests but are essentially self-sustaining from fees they charge for goods and services. Examples are those private nonprofit hospitals ... that may receive relatively small amounts of contributions and grants but finance their capital needs largely from the proceeds of debt issues and their operating needs largely from service charges rather than from private philanthropy or governmental grants. As a result, assessment of amounts, timing, and uncertainty of cash flows becomes the dominant interest of their creditors and other resource providers and profitability becomes an important indicator of performance. Consequently, the objectives of Concepts Statement No. 1 may be more appropriate for those organizations.

1.08 Health care entities usually can be classified into the following categories on the basis of their operating characteristics:

a. *Investor-owned health care entities*. According to FASB ASC 954-10-05-2, these entities are owned by investors or others with a private equity interest and provide goods or services with the objective of making a profit. They include public business entities and private companies. Refer to the preface for further explanation of public business entities and private companies.

b. *NFP business-oriented entities*. According to FASB ASC 954-10-05-2, these entities are characterized by no ownership interests and are essentially self-sustaining from fees charged for goods and services. The fees charged by such entities generally are intended to help the entity maintain its self-sustaining status, rather than maximize profits for the owner's benefit. Such entities often are exempt from federal income taxes and may receive contributions of relatively small amounts from resource providers that do not expect commensurate or proportionate pecuniary return.

c. *Governmental health care entities*. Public corporations[2] and bodies corporate and politic are governmental organizations. Other organizations are governmental if they have one or more of the following characteristics:

i. Popular election of officers or appointment (or approval) of a controlling majority of the members of the entity's governing body by officials of one or more state or local governments;

ii. The potential for unilateral dissolution by a government, with the net assets reverting to a government; or

iii. The power to enact and enforce a tax levy.

Furthermore, organizations are presumed to be governmental if they have the ability to directly issue (rather than through a state or municipal authority) debt that pays interest that is exempt from federal taxation. However, organizations possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.

d. *NFP nonbusiness-oriented entities*. According to FASB ASC 954-10-15-3, these are *voluntary health and welfare entities*, as defined in the FASB ASC glossary. Such entities are within the scope of FASB ASC 958, *Not-for-Profit Entities*. Additional accounting guidance may be obtained in the AICPA Audit and Accounting Guide *Not-for-Profit Entities*, rather than this guide, as discussed in paragraph 1.03.

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[2] *Black's Law Dictionary* defines a *public corporation* as: "An artificial person (for example, [a] municipality or a governmental corporation) created for the administration of public affairs. Unlike a private corporation it has no protection against legislative acts altering or even repealing its charter. Instrumentalities created by [the] state, formed and owned by it in [the] public interest, supported in whole or part by public funds, and governed by managers deriving their authority from [the] state." *Sharon Realty Co. v. Westlake, Ohio Com. Pl., 188 N.E.2d 318, 323, 25, O.O.2d 322*. A public corporation is an instrumentality of the state, founded and owned in the public interest, supported by public funds and governed by those deriving their authority from the state. *York County Fair Ass'n v. South Carolina Tax Commission, 249 S.C. 337, 154 S.E.2d 361, 362*.

Regulatory Environment

1.09 Health care entities operate in a highly regulated environment. These regulations affect the provider's operations, as well as certain estimates in the financial statements, such as patient service revenue, third-party payor settlements, and general and professional liabilities. The Department of Health and Human Services (HHS) is the government's principal agency for protecting the health of all Americans and providing essential human services. The following are some of the more significant agencies operating under the HHS that impact health care entities:

- Administration for Community Living
- Centers for Medicare and Medicaid Services
- Food and Drug Administration
- Health Resources and Services Administration
- National Institutes of Health
- Office of Inspector General

1.10 Some other important agencies include the Civil and Criminal Divisions of the Department of Justice, each state's Office of the Attorney General, each state's Medicaid offices, the IRS, the Drug Enforcement Administration, the Occupational Safety and Health Administration, state insurance agencies or departments, and state and federal health benefit exchanges.

1.11 Some significant regulations affecting health care are the following:

- False Claims Act
- The antikickback statute of the Medicare and Medicaid Patient and Program Protection Act of 1987
- Stark I, II, and III
- Emergency Medical Treatment and Active Labor Act
- The Privacy Rule of the Health Insurance Portability and Accountability Act of 1996
- The State Children's Health Insurance Program of 1997
- The Medicare Prescription Drug Improvement and Modernization Act of 2003
- Health Information Technology for Economic and Clinical Health Act enacted as part of the American Recovery and Reinvestment Act of 2009
- Patient Protection and Affordable Care Act (ACA)
- Health Care and Education Reconciliation Act of 2010

Health Care Reform

1.12 In March 2010, Congress passed two pieces of legislation designed to reform the U.S. health care system. The ACA was enacted on March 23 and was quickly followed by the Health Care and Education Reconciliation Act of 2010, which amended several portions of the first act and added new provisions of its own. One of the goals of the legislation is to reform the health care delivery system to improve its quality while lowering its overall cost. In order to meet this goal, among other things, the ACA

- requires states to create health benefit exchanges, competitive marketplaces where individuals and small businesses can compare policies and premiums, and buy insurance (with a government subsidy if eligible).
- establishes state-based reinsurance and risk adjustment programs and a federal risk corridors program. The overall goal of these programs is to provide certainty and protect against adverse selection in the market while stabilizing premiums in the individual and small group markets as market reforms and health benefit exchanges began in 2014. Two of these programs — the risk corridor and reinsurance programs — ended in 2016 because they failed to collect enough money to cover payments owed.
- authorizes Center for Medicare and Medicaid Services to create the Medicare Shared Savings Program, which encourages accountable care organizations to facilitate cooperation among providers to improve the quality of care provided to Medicare beneficiaries and reduce unnecessary costs.
- adds new requirements for tax-exempt hospitals. To address these requirements for hospitals that want to qualify for tax exemption under IRC Section 501(c)(3), the IRS issued IRC Section 501(r) that provides requirements for charitable hospitals on a facility-by-facility basis. These four general requirements are to
  - — establish written financial assistance and emergency medical care policies,
  - — limit amounts charged for emergency or other medically necessary care to individuals eligible for assistance under the hospital's financial assistance policy,
  - — make reasonable efforts to determine whether an individual is eligible for assistance under the hospital's financial assistance policy before engaging in extraordinary collection actions against the individual, and
  - — conduct a community health needs assessment (CHNA) and adopt an implementation strategy at least once every three years. (These CHNA requirements are effective for tax years beginning after March 23, 2012).
- establishes other requirements, such as employer mandates, that will further affect provider reimbursement for the current uninsured population.

1.13 Health reform measures may affect the way health care entities deliver services to their patients and how they are compensated for those services. The AICPA has dedicated a section on its website to health care reform legislation and its implementation; see www.aicpa.org/research/hcr/pages/default.aspx.