

Financial Statements– NFP Healthcare Entities

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Polling Question #1

How much knowledge do you have of healthcare financial reporting?

A

I don't know much about healthcare financial reporting.

B

I think I might be in the wrong session.

C

I know the basics and have a bit of experience with financial reporting in the workplace.

D

I actively work in healthcare financial reporting and have a lot of experience.

Healthcare Financial Reporting

Internal Financial Reporting

- Not a one size fits all approach
 - Monthly Financial Reporting
 - Annual Financial Statements
 - Other Reporting

Basics

- Statement of Financial Position (the Balance Sheet)
- Statement of Operations (the Income Statement or Profit & Loss)
- Statement of Changes in Net Assets
- Statement of Cash Flows

Best Practices

- Key financial and operating indicators
- Statistics by department reflecting the levels of activity
 - (Actual vs. Budget / PY)
- Additional reporting
 - 12 month rolling trend (BS, SOO & SCF)
 - Narrative(The Story Behind The Numbers)

Report of Independent Auditors
Consolidated Financial Statements
Consolidated Balance Sheets
Consolidated Statements of Operations and Changes in Net Assets
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

Balance Sheet

Health System, Inc. Consolidated Balance Sheet

September 30,	202X
Assets	
Current Assets:	
Cash and cash equivalents	\$ 7,106,045
Investments, at fair value	2,257,437
Patient accounts receivable, net	16,203,313
Grants receivable, net	564,170
Prepaid expenses and other current assets	2,674,368
Total Current Assets	28,805,333
Other Assets:	
Long-term investments	30,271,539
Property and equipment, net	77,381,894
Right-of-use operating lease assets	2,502,354
Other assets	11,439,300
Total Non-Current Assets	121,595,087
Total Assets	\$ 150,400,420

Balance Sheet Key Items

- Total Cash/Investments Position
- Working Capital/Current Ratio
- Debt to Equity
- Net Assets Without Restrictions

Health System, Inc. Consolidated Balance Sheet

September 30,	202X
Liabilities and Net Assets	
Current Liabilities:	
Accounts payable and accrued expenses	\$ 11,143,264
Accrued employee compensation and benefits	9,429,226
Current portion of long-term debt	817,232
Current portion of operating lease liabilities	368,682
Unexpended funds on research grants	540,476
Estimated settlements with third-party payors	4,382,528
Total Current Liabilities	26,681,408
Other Liabilities:	
Long-term debt	39,758,386
Operating lease liabilities, net of current portion	3,054,327
Accrued malpractice liabilities	2,058,756
Accrued pension liabilities	2,453,521
Estimated settlements with third-party payors	1,238,374
Accrued other	4,583,290
Total Non-Current Liabilities	53,146,654
Net Assets:	
Without donor restrictions	63,972,456
With donor restrictions	6,599,902
Total Net Assets	70,572,358
Total Liabilities and Net Assets	\$ 150,400,420

Financial statement presentation

Consolidated Balance Sheets (in 000's) As of December 31, 2020 and 2019

Assets

Current assets

Cash and cash equivalents
Patient accounts receivable
Estimated third-party payor settlements receivable
Inventories
Other accounts receivable
Other current assets

Total current assets

Assets limited as to use

Board-designated funds
Reinsurance trust assets

Property, plant and equipment, net
Investments in unconsolidated affiliates
Capitalized software, net
Right of use operating assets
Other assets

Total assets

Balance sheet

Classification

- NFP healthcare entities are required to classify assets and liabilities as current and noncurrent.
- Normally, an operating cycle of 12 months is used to distinguish current and noncurrent.
- NFP healthcare entities often sequence assets and liabilities within each balance sheet section in order of liquidity (i.e., within current assets, cash precedes accounts receivable);
- Liquid assets that are subject to limitations on use that override their natural liquidity should be reported as noncurrent assets. For example, funds designated by the governing board to acquire noncurrent assets must be classified as noncurrent.
- NFP healthcare entities are required to present internally designated funds separately from externally restricted funds either on the face of the balance sheet or in the notes. These funds are typically referred to as assets limited as to use.

Financial statement presentation

Assets
Current assets
Cash and cash equivalents
Patient accounts receivable
<u>Estimated third-party payor settlements receivable</u>
Inventories
Other accounts receivable
Other current assets
Total current assets
Assets limited as to use
Board-designated funds
Reinsurance trust assets
Property, plant and equipment, net
Investments in unconsolidated affiliates
Capitalized software, net
Right of use operating assets
Other assets
Total assets
Liabilities and net assets
Current liabilities
<u>Current portion of long-term debt</u>
Accounts payable
Accrued salaries and wages
<u>Estimated third-party payor settlements payable</u>
Self-insured liabilities
Lease liabilities
Other current liabilities
Total current liabilities

Balance sheet

Classification, continued

- Classification considerations of debt.

Offsetting

- Balance sheet offsetting is permitted when a right of setoff exists.
- GAAP specifically prohibits offsetting for certain activities and transactions (e.g., insurance recoveries may not be netted with insurance liabilities).

Financial statement presentation

Net assets

Net assets without donor restrictions

 Network net assets without donor restrictions

 Noncontrolling interest

 Total net assets without donor restrictions

Net assets with donor restrictions

 Total net assets

Balance sheet

Net asset presentation

- NFPs must distinguish between net assets without donor restrictions and with donor restrictions.
- NFPs must present the total of each net asset class and total net assets on the face of the balance sheet.
- GAAP requires NFPs to provide further detail about each net asset classification, either on the face of the balance sheet or in the notes.
 - For example, if net assets without donor restrictions contain board-designated funds, the nature of those board designations must be presented on the face or in the notes.
 - NFP healthcare entities normally present this information in the notes.

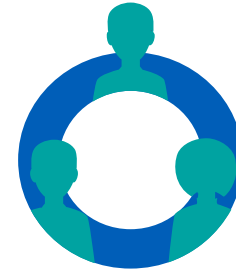
Common errors or diversity in practice

Balance sheet

Improper aggregation of accounts within balance sheet captions



Improper display of current or noncurrent assets and liabilities



Improper presentation of Medical Malpractice accounts



Property held for investment purposes not presented as part of investments

Improper netting of assets and liabilities



Inappropriate recognition and/or classification of donor-restricted assets and expiration of restrictions



Failure to capitalize leasehold improvements



Misclassification of assets limited or restricted as to use



Failure to correctly and/or timely adopt new accounting standards

Statement of Operations

Statement of Operations Key Items

- Comparison to budget and understanding differences
- Annual budgetary process

Health System, Inc.	
Consolidated Statements of Operations	
Years ended September 30,	202X
Revenue and Other Support:	
Net patient service revenue	165,568,558
Research revenue	11,822,910
Other revenue	709,459
Total operating revenues	178,100,927
Expenses:	
Salaries and wages	100,984,801
Supplies and other expenses	51,277,970
Research expenses	11,822,910
Depreciation and amortization expense	9,672,737
Interest expense	2,840,293
Total operating expenses	176,598,711
Income from operations	1,502,216
Non-operating Income, Gains and (Losses)	
Unrealized gains and losses on investments	517,226
Interest and dividends	17,618
Contribution revenue	50,016
Other nonoperating income	168,942
Total nonoperating gains, net	753,802
Excess of revenues over expenses	2,256,018
Net assets released from restriction used for purchases of Property and Equipment	680,285
Cumulative effect of accounting change	(542,808)
Increase in Net Assets without Donor Restrictions	2,393,495

Financial statement presentation

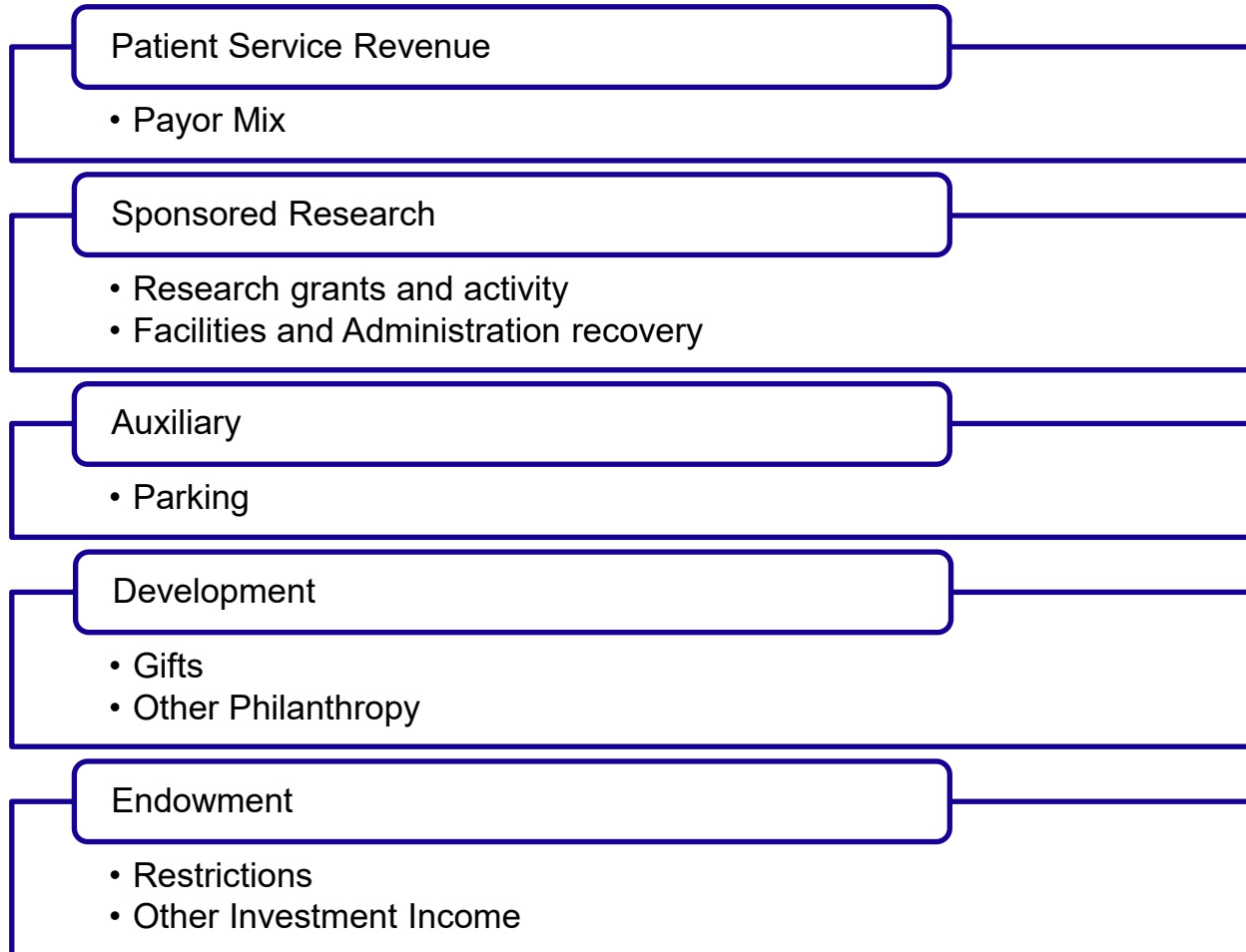
Revenues:
Patient service revenue
Service fee revenue
Other revenue
Cares Act provider relief funding
Earnings from unconsolidated affiliates
Total operating revenues
Operating expenses
Salaries, benefits and pension
Supply expenses
Other expenses
Depreciation and amortization
Interest and financing costs
Total operating expenses
Income from operations
Excess of net assets acquired in Fairbanks acquisition
Investment income and other, net
Loss on extinguishment of debt
Excess of revenues over expenses before income taxes
Provision for income taxes
Excess of revenues over expenses
Excess of expenses over revenues attributable to noncontrolling interest
Excess of revenues over expenses attributable to the Network

Statement of operations

Revenue

- Major revenue streams with dissimilar characteristics may be presented in separate line items

Traditional Operating Model/Revenue Drivers



Financial statement presentation

Revenues:
Patient service revenue
Service fee revenue
Other revenue
Cares Act provider relief funding
Earnings from unconsolidated affiliates
Total operating revenues
Operating expenses
Salaries, benefits and pension
Supply expenses
Other expenses
Depreciation and amortization
Interest and financing costs
Total operating expenses
Income from operations
Excess of net assets acquired in Fairbanks acquisition
Investment income and other, net
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Excess of revenues over expenses before income taxes
Provision for income taxes
Excess of revenues over expenses
Excess of expenses over revenues attributable to noncontrolling interest
Excess of revenues over expenses
attributable to the Network

Statement of operations

Expense

- NFP healthcare entities may present expenses using natural, functional, or other classifications.
 - Most NFP healthcare entities use natural classifications.
- Regardless of presentation on the face, GAAP requires NFP healthcare entities to present an analysis of expenses by natural and functional classification.
 - This analysis could be provided on the face, but most NFP healthcare entities present it in the notes.

Financial statement presentation

Revenues:
Patient service revenue
Service fee revenue
Other revenue
Cares Act provider relief funding
Earnings from unconsolidated affiliates
Total operating revenues
Operating expenses
Salaries, benefits and pension
Supply expenses
Other expenses
Depreciation and amortization
Interest and financing costs
Total operating expenses
Income from operations
Excess of net assets acquired in Fairbanks acquisition
Investment income and other, net
Loss on extinguishment of debt
Excess of revenues over expenses before income taxes
Provision for income taxes
Excess of revenues over expenses
Excess of expenses over revenues attributable to noncontrolling interest
Excess of revenues over expenses attributable to the Network

Statement of operations

Intermediate subtotals

- NFP healthcare entities may present intermediate subtotals to highlight certain activities or provide information deemed useful to financial statement users.

Performance indicator

- NFP healthcare entities are required to present a performance indicator. The measure is similar to income from continuing operations of a business entity.
 - The term ‘net income’ cannot be used because NFP healthcare entities present certain activities outside of the performance indicator that business entities would include in net income.
- Certain activities must be excluded from the performance indicator (i.e., presented after the performance indicator).
 - Contributions and net assets released from donor restrictions for long-lived assets
 - Unrealized gains and losses on ‘other than trading’ debt securities
 - Actuarial changes of pension and OPEB plans
 - Gains and losses on derivatives designated as cash flow hedging instruments
- GAAP requires note disclosure of the nature and composition of the performance indicator.

Common errors or diversity in practice

Statement of operations

- 1 Improper netting of transactions.
- 2 Total balances included in consolidated/combined statements of operations do not reconcile to notes or to supplemental consolidating schedules.
- 3 Improper classification of items included in other changes in net assets without donor restrictions (e.g. capital grants and contributions should be included in other changes in net assets).
- 4 Change in net assets does not reconcile to statement of cash flows and/or statement of changes in net assets.
- 5 Consistency of reporting items (such as initial recognition and subsequent measurement of a business combination) within and outside of a reported intermediate measure of operations.



Polling Question #2

Which is an example of the performance indicator included on the Statement of Operations?

A

Income from operations

B

Excess revenues over expenses

C

Net income

Financial statement presentation

Change in net assets without donor restrictions
Excess of revenues over expenses attributable to the Network
Change in noncontrolling interest
Other changes, net
Increase in total net assets without donor restrictions
Change in net assets with donor restrictions
Increase in net assets with donor restrictions
Increase in total net assets
Total net assets, beginning of year
Total net assets, end of year

Statement of changes in net assets

Presentation

- The statement of changes in net assets normally begins with the performance indicator.
- When presented as a separate statement, the first section of the statement of changes in net assets (i.e., changes in net assets without donor restrictions) repeats the activity presented at the end of the statement of operations.

Required subtotals

- The statement of changes in net assets must present the following three subtotals:
 - Change in net assets without donor restrictions
 - Change in net assets with donor restriction
 - Total change in net assets

Financial statement presentation

Cash flows from operating activities

Increase in net assets

Adjustments to reconcile increase in net assets to net cash provided by operating activities

Depreciation and amortization

Deferred tax benefit provision

Excess of net assets acquired in Fairbanks acquisition

Earnings from unconsolidated affiliates

Unrealized and realized gains on investments

Distributions received from unconsolidated affiliates

Loss on extinguishment of debt

Other

Changes in operating assets and liabilities

Patient accounts receivable

Other assets

Accounts payable

Estimated third-party payor settlements

Other liabilities

Net cash provided by operating activities

Statement of cash flows

- Need to understand where cash comes from and where it is going
- Should explain everything you spent cash on during the year

Presentation

- NFPs present the statement of cash flows similar to business entities.
- The statement of cash flows is separated into three sections:
 - Operating
 - Investing
 - Financing
- GAAP allows both the direct and indirect method of presenting operating activities.
 - Most NFPs use the indirect method.
 - Unlike business entities, if an NFP uses the direct method, the NFP does not have to also present the indirect method.
- Noncash investing and financing activity must be presented either on the face or in the notes.
- NFPs generally follow the same guidance on classification and presentation of cash flows as business entities.

Common errors or diversity in practice

Statement of cash flows

- Improper netting of items (e.g. purchases and sales of certain types of investments)
- Cash flow line items do not agree to specific line items on the statements of operations and changes in net assets
- Restricted cash contributions for long term purposes (e.g. capital purposes or donor-restricted endowment) should be excluded from cash flows from operating activities and be classified as financing activities
- Reporting cash, restricted cash and amounts generally described as restricted cash and restricted cash equivalents
- Missing supplemental disclosure of interest paid, income tax paid, and non-cash investing and financing activities such as accrued fixed asset additions
- Adjusting operating activities for gains/losses on fixed asset disposals



Common errors or diversity in practice

Statement of cash flows

- Improper classification of cash flows (or classification as cash and cash equivalents) where a subsidiary shares a common treasury function (stand alone subsidiary financial statements)
- Rollforward of accounts from the footnotes do not agree to the activity within the cash flow statement
- Positive cash flow totals should be presented as “provided by” where as negative cash flows should be presented as “used in”
- Missing presentation of cash flows attributable to noncontrolling interest (financing activities) and discontinued operations



More common errors - Disclosures



Redundant disclosures



Incomplete disclosures



Failure to include the appropriate disclosures for business combinations



"Combined" versus "consolidated" financial statements



Dollars in 000's consistency



Missing "public entity" required disclosures for health care entities that are conduit bond obligors



Disclosure amounts do not reconcile to the financial statements



Missing or inappropriate disclosure of functional expense classification

Key Operating and Financial Metrics - Non Financial Statement Metrics

Profitability Indicators

- Charity Care %
- Bad Debt %
- Collection Ratio
- Revenue per Patient Days, Discharges, and Units
- Cost per Patient Days, Discharges, and Units
- Ratio of Cost to Charges

Cost Indicators

- Number of full-time employees
- Full-time employees per occupied beds/visits
- Salary per full-time employee
- Benefits as a percentage of salary

Volume Indicators

- Discharges/admissions
- Patient Days
- Observation Days
- Average Length of Stay
- Average Daily Occupancy
- Outpatient Visits

Key Operating and Financial Metrics

Monitor Trends, Benchmark Against Peers, Assess Budget vs. Actual Results

Balance Sheet Metrics

Liquidity

- Days cash on hand (Measures how long an organization can cover operating expenses from liquid assets)
- Working Capital: Current Assets less Current Liabilities
- Days in Patient AR: $\text{Net Patient AR} / (\text{Net Patient Rev}/365)$ (Indicates the number of days in average collection period)

Leverage & Capital Structure

- Debt to Equity
- Equity Financing: $\text{Net Assets} / \text{Total Assets}$ (Measures the % of total assets that has been financed with sources other than debt)
- Debt Service Coverage
- Debt Covenant Compliance

Endowment Spending Policy/Distribution Rate

- Best Practice: Spending Rate plus Inflation Allowance to preserve purchasing power should not exceed expected Total Long-Term Return

Profitability Indicators

Operating Margin

- $\text{Net Operating Income} / \text{Total Operating Revenue}$
- Measures the operating profit retained per dollar of sales

Total Margin

- $\text{Net Income} / \text{Total Operating Revenue}$
- Measures the net profit retained per dollar of sales inclusive of operating and non operating sources

Bad Debt Percentage

- $\text{Provision for Bad Debt} / \text{Total Net Patient Service Revenue}$
- Measures bad debts for trending and comparative purposes

Payer Mix

- Visits / Providers

Non-Recurring Items – Asset sales, extraordinary gifts/grants

Polling Question #3

What is an example of a balance sheet metric to monitor and benchmark against peers?

A

Operating margin

B

Working capital

C

Number of employees

D

Payor mix

Other Reporting Requirements

IRS Reporting

- IRS Form 990, Form 990-EZ, Form 990-T, Form 990-PF (due 4.5 months after fiscal year-end)
 - Validating exempt status of NFP
- Massachusetts Form PC (due 4.5 months after year-end)
- Massachusetts Annual Report (due by November 1st)

Cost Reporting

- Support for reimbursable claims submitted
- Detail cost and allocation of cost to specific service centers
- Information of types of services provided

Uniform Guidance

- States, local governments and non-profit organizations with \$1,000,000+ of Federal awards during the fiscal year
- Preparation of the Schedule of Expenditures of Federal Assistance “SEFA” by government sponsor and contract

Other

- MA Uniform Financial Report (entities receiving \$100,000+ in state contracts)
- Department of Education filing requirements for all healthcare entities that have a higher education component

Thank you