

Preparing Financial Statements in Accordance with Generally Accepted Accounting Principles

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Presented by:

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Balance Sheet

- Also known as a **Statement of Financial Position** (not-for-profits) and as a **Statement of Net Assets** (governments)
- Represents and displays all of an organization's financial assets, liabilities, and net assets at a snapshot in time; usually the end of an accounting period, and conforms to the following equation:
 - **assets = liabilities + net assets**

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Balance Sheet – Liquidity

- Assets and liabilities are listed in the order of their relative liquidity
- Current assets are cash and other assets that may reasonably be expected to be realized in cash or sold or consumed usually within a year or less through normal operations
- Current liabilities are liabilities that will be due within one year and are to be paid out of current assets
- Long-term debt (and any other liability or asset with current and noncurrent portions) is presented on two lines of the financial statements – **current and noncurrent**

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Cash and Cash Equivalents

Cash and cash equivalents should include all cash and highly liquid investments that are both *(a) readily convertible to cash* **and** *(b) so near to maturity that they present insignificant risk of changes in value because of changes in interest rates*

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Balance Sheet – Noncurrent Restricted or Designated Assets

- **The following cash and cash equivalents are reported separately and excluded from current assets:**
 - Restricted as to withdrawal or use for other than current operations
 - Designated for expenditure in the acquisition or construction of noncurrent assets
 - Required to be segregated for the liquidation of long-term debts
 - Required by a donor-imposed restriction that limits their use to long-term purposes

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Balance Sheet – Allowance for Uncollectible Accounts

- Patient accounts receivable presented at net realizable value
- Only the allowance for uncollectible accounts is disclosed
- The allowance for contractual adjustments is not disclosed

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Balance Sheet – Third-Party Settlements

- **Third-party settlements – no right of offset exists between Medicare and Medicaid:**
 - A Medicare receivable is presented on a separate line from a Medicaid payable (and vice versa)
 - A Medicare receivable and Medicaid receivable are presented on the same line (also if both payables)

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Balance Sheet – Net Assets (Government)

- *Invested in Capital Assets, Net of Related Debt* – the sum of capital assets, net of accumulated depreciation less any debt issued to finance those assets
 - *Invested in capital assets, net of related debt* should not include any restricted resources that must be used to acquire capital assets, (such as unexpended debt proceeds, or capital grants and contributions), or debt attributable to significant amounts of unexpended debt proceeds
 - Capitalized costs of issuance are included with the same category as the related debt
- *Restricted* – constraint placed on the use of assets that are either externally imposed (such as by creditors through debt covenants) or imposed by law through constitutional provisions or enabling legislation
- *Unrestricted* – remaining net assets

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Balance Sheet – Net Assets (Not-for-Profit)

- **Permanently Restricted** – restricted by donor forever – restriction never expires
- **Temporarily Restricted** – restricted by donor for a specific purpose and/or time
- **Unrestricted** – remaining net assets

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Statement of Revenue, Expenses, and Changes in Net Assets

- Also known as an **income statement** and **statement of activities**
- A summary of all revenues and expenses of an organization for a period of time

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Operating Revenues

- **Operating revenue** results from exchange transactions associated with providing healthcare services

- **Operating revenues include:**
 - Net patient service revenue
 - Premium revenue
 - Grants
 - Other revenue

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Net Patient Service Revenue

- **Net patient service revenue** – gross patient revenue less contractual adjustments and charity care
 - **Governments** – also net of provision for bad debts

 - **Not-for-profit** – provision for bad debts is presented as an operating expense

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Charity Care vs. Bad Debts

- **Charity care** – healthcare services that never were expected to result in cash inflows. Charity care results from a provider's policy to provide healthcare services free of charge to individuals who meet certain financial criteria
- **Bad-debt expense** – the current period charge for actual or expected doubtful accounts resulting from the extension of credit

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Operating Grants

- Generally, grants that are for specific projects or purposes related to the hospital operating activities are reported as operating revenue
- Examples include trauma grants, bioterrorism grants, WIC, counseling services, and other healthcare-related services that are funded through federal, state, and other governmental contracts
- Typically, these grants would have matching expenses reported as operating expenses
- Grant expenses should not be netted against grant revenue

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Other Grants

- Grants for capital purposes are reported separately after nonoperating revenue and expenses
- Grants that are subsidies for operating deficits should be reported as nonoperating revenue
- Grants that are not for operating purposes are reported in the nonoperating revenue and expenses section

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Operating Expenses

- Salaries and wages
- Employee benefits
- Professional fees
- Purchased services
- Supplies
- Depreciation
- Rental and leases
- Insurance
- Other

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Nonoperating Revenue and Expenses

- Taxation
- Contributions
- Investment income
- Gains/losses on disposal of assets
- Nonoperating grant revenues and expenses
- Interest expense (operating in a not-for-profit)

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Statement of Cash Flows

- A summary of where the organization's cash came from and where it went
- A cash basis presentation compared to the accrual basis presentation of the statement of revenue, expenses, and changes in net assets

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Statement of Cash Flows – Government

- **Cash receipts and cash payments are presented in four categories:**
 1. **Operating activities**
 2. **Noncapital financing activities**
 3. **Capital and related financing activities**
 4. **Investing activities**

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Statement of Cash Flows – Government *(continued)*

- Governments must use the direct method of presenting cash flows from operations
- Cash and cash equivalents at the beginning and end of the year must be easily traceable to the balance sheet
- Accounting policy for determining which items are treated as cash and cash equivalents to be disclosed

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Statement of Cash Flows – Government *(continued)*

- **Operating activities include:**
 - Cash receipts from customers (patients)
 - Other operating cash receipts
 - Cash payments to suppliers of goods and services
 - Cash payment to employees for services
 - Other operating cash payments

- A separate schedule reconciling operating income to net cash flow from operating activities

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Statement of Cash Flows – Government *(continued)*

- **Noncapital financing activities include:**
 - Tax receipts for operations
 - Contributions for operations (not capital)
 - Nonoperating grants
 - Proceeds from operating debt (long-term or short-term)
 - Principal payments on operating debt
 - Interest payment on operating debt

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Statement of Cash Flows – Government *(continued)*

■ **Capital and related financing activities include:**

- Grants and contributions for capital assets
- Proceeds from long-term debt
- Payments on long-term debt and/or capital leases for capital assets
- Interest payments on long-term debt and/or capital leases for capital assets
- Purchase of capital assets
- Proceeds from sale of capital assets
- Taxes received for capital assets or repayment of related debt

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Statement of Cash Flows – Government *(continued)*

■ **Investing activities include:**

- Purchase of investments
- Proceeds from sale of investments
- Investment income received
- Rental income (if not an operating activity)
- Rental expenses (if not an operating activity)

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Statement of Cash Flows – Government *(continued)*

- Noncash financing and investing activities are separately disclosed

- **Examples include:**
 - **Capital leases and the related assets acquired**
 - **Capital donations**

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Statement of Cash Flows – Not-for-Profit

- **Cash receipts and cash payments are presented in three categories:**
 1. **Operating activities**
 2. **Financing activities**
 3. **Investing activities**

- Restricted and Board-designated cash and cash equivalents are not considered “cash and cash equivalents” for statement of cash flow purposes in a not-for-profit hospital
 - These are considered “cash and cash equivalents” in a governmental hospital

- Interest expense and interest income are operating activities in a not-for-profit hospital

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Notes and Disclosures – Reporting Entity and Significant Accounting Policies

- **Reporting entity** (NPO and Government similar but different)
 - Description of legal structure and related applicable laws
 - Description of services offered and location
- **Component units** (Government only)
 - Discretely presented component unit
 - Relationship and criteria for including
 - Condensed financial statement information
- **Use of estimates**
- **Enterprise fund accounting** (Government only)

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Notes and Disclosures – Reporting Entity and Significant Accounting Policies *(continued)*

- **Cash and cash equivalents**
- **Patient accounts receivable**
- **Compensated absences**
(NPO and Government similar but different)
- **Grants and contributions**
(NPO and Government similar but different)
- **Restricted resources** (Government only)
- **Net assets** (NPO and Government similar but different)
- **Operating revenues and expenses**
(NPO and Government similar but different)

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Notes and Disclosures – Reporting Entity and Significant Accounting Policies *(continued)*

- **Inventories**
- **Assets limited as to use**
- **Bond issuance costs**
- **Patient service revenue**
- **Charity care**
- **Risk management** *(Government only)*
- **Risk transfer pools** *(NPO and Government similar but different)*

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Notes and Disclosures

- **Stewardship, Compliance
and Accountability:** *(Government only)*
 - Optional boilerplate on possible noncompliance due to complex regulatory nature
 - Disclose violation of finance-related legal or contractual provisions including a description of the violation and the action taken to address the violation

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Notes and Disclosures *(continued)*

■ **Deposits and Investments:** *(Government only)*

- Description of types of investments allowed by law

- Describe policies (or that no policy exists) for the following risks that the hospital is exposed to – credit risk, custodial credit risk, concentration of credit risk, interest rate risk, or foreign currency risk

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Notes and Disclosures *(continued)*

■ **Deposits and Investments:** *(Government only)*

- **Custodial credit risk** – state that bank balances are all insured or the amounts that fall into the following categories:
 - Insured
 - Uncollateralized
 - Collateralized by securities held by the pledging institution in the government's name
 - Collateralized by securities held by the pledging institution not in the government's name

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Notes and Disclosures *(continued)*

- **Deposits and Investments:** *(Government only)*

- **Investment disclosures include:**

- By investment type
 - Credit risk information
 - Repurchase and reverse repurchase agreements
 - Fair value

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Notes and Disclosures *(continued)*

- **Property Taxes:** *(Government only)*

- Tax calendar
 - Levy rates
 - Due dates
 - Lien dates
 - Collection dates

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Notes and Disclosures *(continued)*

■ **Net Patient Service Revenue:**

- Schedule of gross patient service revenue, contractual adjustments, charity care, and provision for bad debts
- Description of significant contracts with third-party payors
- Concentration of revenue from major payors
- Effect of material changes in estimates of amounts due from third-party payors

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Notes and Disclosures *(continued)*

■ **Assets Limited or Restricted as to Use:**

- Schedule detailing limitations and or restrictions
- Could be combined with investment disclosures

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Notes and Disclosures *(continued)*

■ Accounts Receivable by Payor

- Medicare
- Medicaid
- Patients and other payors

Notes and Disclosures *(continued)*

■ Capital Assets: *(Government only)*

- Capitalization policy
- Depreciation method
- Asset lives
- Major classes of capital assets
- Capital assets being depreciated separately presented from capital assets not being depreciated
- Beginning and ending balances with accumulated depreciation presented separately from historical cost
- Capital acquisitions
- Capital dispositions
- Current depreciation expense
- Estimated cost to complete construction projects

Notes and Disclosures *(continued)*

■ **Capital Assets:** *(NPO only)*

- Capitalization policy
- Depreciation method
- Major classes of capital assets
- Total accumulated depreciation
- Total depreciation expense
- Estimated cost to complete construction projects

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Notes and Disclosures *(continued)*

■ **Short-term Debt:** *(Government only)*

- Purpose for which it was issued
- Beginning and ending balances
- Increases and decreases presented separately

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Notes and Disclosures *(continued)*

■ Long-term Debt, Capital Lease Obligations, and Other Noncurrent Liabilities:

- Rollforward schedule with beginning balance additions, reductions, and ending balances **(government only)**
- Ending balances **(NPO only)**
- Description of terms
- Terms by which variable interest rates change
- Scheduled debt service:
 - Includes interest for governments; principal only for NPOs
- Future minimum capital lease obligations and net book value of capital leases

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Notes and Disclosures *(continued)*

■ Defined Contribution Plans: **(NPO only)**

- Cost recognized during period
- Description of plan

■ Defined Contribution Plans: **(Government only)**

- Name of plan
- Plan administrator
- Single-employer, agent multiple-employer, etc. identification
- Description of benefits provided
- Contribution rates
- Employer contributions (expense)
- Employee contributions

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Notes and Disclosures *(continued)*

■ **Medical Malpractice:**

- Type of coverage (claims-made or occurrence)
- Insurer
- Coverage limits
- Deductibles

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Notes and Disclosures *(continued)*

■ **Concentration of Credit Risks:**

- Patient accounts receivables by payor
- Admitting physicians

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Notes and Disclosures *(continued)*

■ Other possible disclosures include:

- Commitments
- Contingencies
- Subsequent events
- Unused lines of credit
- Commitments under noncancelable operating leases
- Related-party transactions
- Self-insurance

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Management's Discussion and Analysis *(Government only)*

■ Required supplemental information

■ Optional to include – if not included, a statement that it is not included will be included in the independent auditors' report:

- The District has not presented a management's discussion and analysis that accounting principles generally accepted in the United States of America have determined is necessary to supplement, although not required to be part of, the basic financial statements.

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Management's Discussion and Analysis (Government only) (continued)

■ Required elements:

- Brief discussion of the financial statements
- Condensed balance sheet
- Condensed statement of revenue, expenses, and changes in net assets
- An analysis of the overall financial position and results of operations to assess whether financial position has improved or deteriorated during the year, including reasons for the significant changes and important economic factors

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Management's Discussion and Analysis (Government only) (continued)

■ Required elements:

- Description of significant capital assets and long-term debt activity, including capital commitments, changes in credit ratings, and debt limitations
- Description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations
- Other analysis to meet the requirement for an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, and conditions

Resources

- *AICPA Audit and Accounting Guide for Healthcare Organizations*
- Washington State Auditor's Office's *Annual Financial Reporting Package – Public Hospital Districts*
- Disclosure checklists – independent auditor can provide.

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The End

- Questions?



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