Accounting & Auditing
An Update
What This Is

This presentation is a one hour presentations of key Audit & Accounting (A&A) updates effecting health care entities.
What This Is Not

This is not a full update of all A&A issues. Such a presentation takes 4 to 8 hours and requires a lot of coffee for all involved.
Accounting Update

GASB and FASB

• Summary of Due Dates

AICPA

• Auditing
<table>
<thead>
<tr>
<th>Topics</th>
<th>Effective Dates</th>
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</thead>
</table>
| Leases (ASC 842 and GASB 87)      | Public: Periods starting after 12/15/2018  
                                        Other: Periods starting after 12/15/2019 |
| Revenue Recognition (ASU 2014-09 ASC 606) | Public: Periods starting after 12/15/2017  
                                        Other: Periods starting after 12/15/2018 |
| Tax Abatements (ASU 2018-02)      | Periods starting after 12/15/18       |
| Going Concern (SAS 132)           | Periods starting after 12/15/17       |
| Fiduciary Activities (GASB 84)    | Periods starting after 6/15/18        |
| Asset Management (GASB 83)        | Periods starting after 6/15/18        |
Leases FASB GASB Differences

The key difference between the standards is the treatment of operating leases. Under GASB 87, operating leases and capital leases are combined and are treated as financings, while FASB maintains a distinction between the two types of leases.
Because the FASB standards have been out since 2016, FASB has released modifications and practical expedients to ASC 842. In brief, for the year of adoption, companies have the option to apply the new lease standard either retrospectively for all prior years reported or to just the year of adoption.
Leases GASB 87

Implementation guidance isn’t out yet. From the standard itself, the limited transition guidance says: “Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases.”
ASC 842 Quiz

- ASC 842 requires all leases be treated as capital leases.
- ASC 842 requires an asset and liability be created for all leases.
- After ASC 842 – the accounting or all leases is the same.
- Before ASC 842 hits is a good time to retire.
The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term.
The lessee first identifies its leases as discussed above, then determines whether the leases, based on five lease classification criteria, should be classified as operating or finance. These criteria are similar to the four criteria under the old guidance, but require greater judgment because they do not include explicit bright lines. A lease meeting any of the following five criteria is classified as a finance lease:

- Ownership is transferred at the end of the lease term.
- A bargain purchase option (i.e., one that is reasonably certain to be exercised) for the leased asset exists.
- The lease term, which does not commence near the end of the economic life of the leased asset, is primarily for the remaining economic life of the leased asset.
- The present value of the lease payments and residual value guarantees is equal to, or more than, substantially all of the fair value of the leased asset.
- The leased asset has no alternative use to the lessor at the end of the term because of its specialized nature.
ASC 842

- Major part = 75% or more
- Substantially all of an asset’s fair value = 90% or more
- Near the end of economic life = 25% or less of economic life remains
ASC 842 Example One

- The lessee, A, signs an agreement with the lessor, B, to lease a building on Jan. 1, Year 1
- The lease period (no renewal options) is 10 years
- The annual lease payment, due on Dec. 31, is $162,745
- The lessee’s incremental borrowing rate is 10%
- The present value of lease payments is $1 million
- Initial direct costs are $0
- The remaining economic life of the asset is 20 years
- The estimated fair value of the building is $2 million
- The underlying asset is transferred back to lessor at end of the lease term.
### ASC 842 Example One

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Description</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/Year 1</td>
<td>Right-of-Use Asset</td>
<td>1,000,000</td>
<td></td>
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<tr>
<td></td>
<td>Lease Liability</td>
<td></td>
<td>1,000,000</td>
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<tr>
<td></td>
<td><strong>Lease Liability at 1/1/Year 1:</strong> Present value of ordinary annuity for $162,745 per year at 10% for 10 years = $1,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12/31/Year 1</td>
<td>Lease Expense</td>
<td>162,745</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Lease Liability</td>
<td></td>
<td>100,000</td>
</tr>
<tr>
<td></td>
<td>Right-of-Use Asset</td>
<td></td>
<td>62,745</td>
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<tr>
<td></td>
<td><strong>Lease Expense:</strong> $162,745 × 10 years/10 years (straight-line method) = $162,745</td>
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<tr>
<td></td>
<td>Accrued Interest On Lease Liability: $1,000,000 × 10% = $100,000</td>
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<tr>
<td></td>
<td><strong>Right-of-Use Asset at 12/31/Year 1:</strong> $1,000,000 − $62,745 = $937,255</td>
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<tr>
<td></td>
<td>Lease Liability</td>
<td>162,745</td>
<td></td>
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<tr>
<td></td>
<td>Cash</td>
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<td>162,745</td>
</tr>
<tr>
<td></td>
<td><strong>Lease Liability at 12/31/Year 1:</strong> $1,000,000 + $100,000 − $162,745 = $937,255</td>
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<tr>
<td>12/31/Year 2</td>
<td>Lease Expense</td>
<td>162,745</td>
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<td>Lease Liability</td>
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<td>93,726</td>
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<td>Right-of-Use Asset</td>
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<td>69,019</td>
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<td><strong>Lease Expense:</strong> $162,745 × 10 years/10 years (straight-line method) = $162,745</td>
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</tr>
<tr>
<td></td>
<td>Accrued Interest on Lease Liability: $937,255 × 10% = $93,726</td>
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<tr>
<td></td>
<td><strong>Right-of-Use Asset at 12/31/Year 2:</strong> $937,255 − $69,019 = $868,236</td>
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<tr>
<td></td>
<td>Lease Liability</td>
<td>162,745</td>
<td></td>
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<td></td>
<td>Cash</td>
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<td></td>
<td><strong>Lease Liability at 12/31/Year 2:</strong> $937,255 + $93,726 − $162,745 = $868,236</td>
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</tbody>
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ASC 842 Example Two

- Company A leases machinery from Company B on Jan. 1, Year 1
- The lease period is for 15 years
- The cost of the machinery is $1 million, purchased by the lessor on Jan. 1, Year 1
- The estimated economic life of the machinery is 15 years
- The depreciation method is straight-line
- There is no residual value
- The rate implicit in the lease, of which the lessee has knowledge, is 10%
- The lease payments, due at Dec. 31, are $131,473.
<table>
<thead>
<tr>
<th>Date</th>
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<th>Dr.</th>
<th>Cr.</th>
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</thead>
<tbody>
<tr>
<td>1/1/Year 1</td>
<td>Right-of-Use Asset</td>
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</tr>
<tr>
<td></td>
<td>Lease Liability</td>
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</table>

Lease Liability at 1/1/Year 1: Present value of ordinary annuity for $131,473 per year at 10% for 15 years = $1,000,000

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<th>Dr.</th>
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</tr>
</thead>
<tbody>
<tr>
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<td>Right-of-Use Asset</td>
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Amortization Expense: $1,000,000/15 years = $66,667
Right-of-Use Asset at 12/31/Year 1: $1,000,000 – $66,667 = $933,333

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<th>Cr.</th>
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</thead>
<tbody>
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<td>Interest Expense</td>
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<td>Lease Liability</td>
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<tr>
<td></td>
<td>Cash</td>
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<td>131,473</td>
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</table>

Interest Expense: $1,000,000 x 10% = $100,000
Lease Liability at 12/31/Year 1: $1,000,000 – $31,473 = $968,527

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<th>Dr.</th>
<th>Cr.</th>
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</thead>
<tbody>
<tr>
<td>12/31/Year 2</td>
<td>Amortization Expense</td>
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<tr>
<td></td>
<td>Right-of-Use Asset</td>
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<td>66,667</td>
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</tbody>
</table>

Amortization Expense: $1,000,000/15 years = $66,667
Right-of-Use Asset at 12/31/Year 2: $933,333 – $56,667 = $866,667

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<th>Dr.</th>
<th>Cr.</th>
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<tbody>
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<td></td>
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<td>Cash</td>
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<td>131,473</td>
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</tbody>
</table>

Interest Expense: $968,527 x 10% = $96,853
Lease Liability at 12/31/Year 2: $968,527 – $34,620 = $933,907
Practical Expedients

• Applicable to leases that have commenced before the effective date
• Must elect all three together
  1) No need to reassess the existence of a lease
  2) No need to reassess lease classification
  3) No need to reassess initial direct costs
Practical Expedients

Lessees and lessors are permitted to make an election to apply a package of practical expedients that allow them not to reassess:

1. Whether any expired or existing contracts are or contain leases.
2. Lease classification for any expired or existing leases.
3. Initial direct costs for any expired or existing leases (i.e., whether those costs qualify for capitalization under FASB ASC 842).
## Property Plant & Equipment:

- Finance Lease Right-of-Use Asset: $108,237
- Less: Accumulated Depreciation — Finance Lease Right-of-Use Asset: 21,647
- Finance Lease Right-of-Use Asset (net): 86,590
- Operating Lease Right-of-Use Asset: 18,595

## Current Liabilities:

- Finance Lease Liability: 20,568
- Operating Lease Liability: 9,070

## Long-Term Liabilities:

- Finance Lease Liability: 68,081
- Operating Lease Liability: 9,525

*Pike Industries, Inc.
Schedule of Items Appearing on the Balance Sheet
12/31/Year 1

*CPA Journal December 2018*
Pain Points in Healthcare

• Embedded leases (OMG they are everywhere):
  – IV Pumps.
  – Heart monitors.
  – MRI and Cat Scan machines.

• Determination of IDC or “Initial Direct Costs.”
  – Initial Direct Costs Incremental costs of a lease that would not have been incurred if the lease had not been obtained.
ASC 842 “To Do” List

• Review the computation of existing capitalized leases. If there are errors in the computations you may not be able to use “Practical Expedients.”

• Review contracts for supplies and look for possible embedded leases.

• Review supply and pharmacy expenses to see if there are possible embedded leases.

• Discuss presentation of leases with your accountants and see if they have specific data they require for the next audit period.

• Talk with your internal auditors and make sure they have lease costs included in the work plan for the year.

• Consider outside help.
Revenue Recognition
ASU 2014-09 ASC 606

FASB provides five steps for determining how to recognize revenue from customers:

• Identify the contract(s) with a customer.
• Identify the performance obligations in the contract.
• Determine the transaction price.
• Allocate the transaction price to the performance obligations in the contract.
• Recognize revenue when (or as) the entity satisfies a performance obligation.
Revenue Recognition
ASU 2014-09 ASC 606

FASB provides five steps for permit revenue recognition:

• Approval and commitment of the parties.
• Identification of the right so the parties.
• Identification of payment terms.
• The contract must have commercial substance.
• It is probable the entity will collect from customers.
Healthcare Issues

• Who is the contract with (Is it with the patient?);
  – Charity care (No contract no revenue?).
  – Self pay that never agree to pay (No contract no revenue?).
  – Medicaid pending.
  – SDI Pending.
  – Government shutdowns.
• Inpatients “in house.”
• Prepaid care (Continuing Care Retirement Communities or CCRCs).
• Grouping into “Portfolios.”
• Bad debts and contractual allowances vs non recognition of revenue.
ASU 2014-09 Portfolio Types

• Type of service
• Type of payors—insurance contract
• Type of patient responsibility
• Size of co-pay or deductible
Tax Abatement
ASU 2018-02

Chance

PAY YOUR TAXES
SO CORPORATIONS
DON’T HAVE TO.
Tax Abatement

On December 22, 2017, the U.S. federal government enacted a tax bill, H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act). Stakeholders in the banking and insurance industries submitted unsolicited comment letters to the FASB about a narrow-scope financial reporting issue that arose as a consequence of the Tax Cuts and Jobs Act.
Tax Abatement

Those stakeholders asserted that because the adjustment of deferred taxes due to the reduction of the historical corporate income tax rate to the newly enacted corporate income tax rate is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (referred to as stranded tax effects for purposes of this Update) do not reflect the appropriate tax rate.
ASU 2018-02 Tax Abatement

The amendments in this Update allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act.
The Board decided that an entity should disclose whether it elects to reclassify stranded tax effects from accumulated other comprehensive income to retained earnings in the period of adoption and, more generally, a description of the accounting policy for releasing income tax effects from accumulated other comprehensive income. The Board also decided that if an entity elects to reclassify its stranded tax effects, the entity should disclose in the period of adoption information about the other income tax effects related to the application of the Tax Cuts and Jobs Act that are reclassified from accumulated other comprehensive income to retained earnings.
Tax Abatement

The Board decided that the amendments in this Update should be applied either:

(a) at the beginning of the period (annual or interim) of adoption or

(b) retrospectively to each period (or periods) in which the income tax effects of the Tax Cuts and Jobs Act related to items remaining in accumulated other comprehensive income are recognized.
Laventhol & Horwath to Seek Bankruptcy Shield, Dissolve Firm

November 21, 1990 | NANCY RIVERA BROOKS | TIMES STAFF WRITER

Laventhol & Horwath fired most of its 3,400 employees and confirmed Tuesday that it will file for bankruptcy court protection and dissolve the nation's seventh-largest accounting firm.

Now begins a legal headache that is sure to last for years, as courts determine the depth of the firm's problems, for which all its partners and even some retired partners potentially are liable.

The dissolution also set off a scramble for clients as many of Laventhol's 350 or so partners form new partnerships or look to affiliate with other accounting firms.

"A series of tragic circumstances brought this proud firm to this sad day," said Robert Levine, chief executive of Laventhol & Horwath. "Now, the proud name of Laventhol & Horwath will exist no more."
Going Concern

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for a reasonable period of time. A complete set of general purpose financial statements is prepared using the going concern basis of accounting, unless the liquidation basis of accounting is appropriate.
SAS 132 Going Quiz

To be considered a going concern under SAS 132-the auditor must opine that the entity can continue for:

- One year
- Three years
- Five Years
- Until they have paid all the audit fees
SAS 132 – Four Change Drivers

• The Public Interest Is Better Served
• There Are New Rules on Financial Support
• The Standard Is Based on the FASB Definition of Substantial Doubt
• There’s Been a Change in time frames
Required Review Of Measures

..requires management to consider quantitative and qualitative information about the following conditions and events:

a. The entity’s current financial condition, including its liquidity sources at the date that the financial statements are issued (for example, available liquid funds and available access to credit)

b. The entity’s conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity’s financial statements)

c. The funds necessary to maintain the entity’s operations considering its current financial condition, obligations, and other expected cash flows within one year after the date that the financial statements are issued

d. The other conditions and events, when considered in conjunction with the preceding items, that may adversely affect the entity’s ability to meet its obligations within one year after the date the financial statements are issued.
Financial support by third parties or the entity’s owner-manager

SAS No. 132 includes a new requirement with respect to financial support by third parties or the entities’ owner-manager. When management’s plans include financial support by third parties or the entity’s owner-manager, the auditor is required to obtain sufficient appropriate audit evidence about the intent and ability of such parties to provide the necessary financial support if that evidence is necessary to support management’s assertion about the entity’s ability to continue as a going concern for a reasonable period of time.
Going Concern Objectives

a. To obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management’s use of the going concern basis of accounting, when relevant, in the preparation of the financial statements

b. To conclude, based on the audit evidence obtained, whether substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time exists

c. To evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity’s ability to continue as a going concern for a reasonable period of time

d. To report in accordance with this SAS
Going Concern for How Long?

The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).
Going Concern Risk Assessment

Performing risk assessment procedures as required by AU-C section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AICPA, Professional Standards), the auditor should consider whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time. In doing so, the auditor should determine whether management has performed a preliminary evaluation of whether such conditions or events exist:
If such an evaluation has been performed, the auditor should discuss the evaluation with management and determine whether management has identified conditions or events that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time and, if so, understand management’s plans to address them.
Risk Assessment Not Performed

If such an evaluation has not yet been performed, the auditor should discuss with management the basis for the intended use of the going concern basis of accounting and inquire of management whether conditions or events exist that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time.
After Establishing Risk Concern

a. Requesting management to make an evaluation when management has not yet performed an evaluation

b. Evaluating management’s plans in relation to its going concern evaluation, with regard to whether it is probable that (Ref: par. A29) i. management’s plans can be effectively implemented and ii. the plans would mitigate the relevant conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time

c. When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in evaluating management’s plans, (Ref: par.A30–A31) i. evaluating the reliability of the underlying data generated to prepare the forecast and ii. determining whether there is adequate support for the assumptions underlying the forecast, which includes considering contradictory audit evidence

d. Considering whether any additional facts or information have become available since the date on which management made its evaluation
Representation Letter

If the auditor believes, before consideration of management’s plans pursuant to paragraph 16, that substantial doubt exists about the entity’s ability to continue as a going concern for a reasonable period of time, the auditor should request the following written representations from management.
Representation Letter

a. A description of management’s plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time and the probability that those plans can be effectively implemented

b. That the financial statements disclose all the matters of which management is aware that are relevant to the entity’s ability to continue as a going concern for a reasonable period of time, including principal conditions or events and management’s plans
Financial Disclosures

Use of emphasis paragraphs when substantial doubt is alleviated: SAS No. 132 includes application material to explain situations when an auditor decides to include an emphasis paragraph to highlight the liquidity issues related to management disclosures when the auditor concludes that substantial doubt has been alleviated by management’s plans (this is sometimes referred to as “close-call” situations).
GASB 84

..establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.
An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.
This Statement describes four fiduciary funds that should be reported, if applicable:

(1) employee benefit trust funds,

(2) investment trust funds,

(3) private-purpose trust funds, and

(4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.
GASB 84

Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.
GASB 84

Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.
GASB 83

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.
This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities.
This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.
This Statement requires the current value of a government’s AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.
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