Accounting Update

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DISCUSSION OUTLINE

- OVERVIEW OF THE REVENUE STANDARD
- MERGERS AND AQUISITIONS
- STATE TAX FOR HEALTHCARE
- Q&A

Revenue Recognition ASC 606

EFFECTIVE DATES

Effective Dates:

- Public entities - First interim period within annual reporting periods beginning after December 15, 2017.
- Private entities – First interim period within annual reporting periods beginning after December 15, 2018.
- Early adoption is permitted for reporting periods beginning after December 15, 2016.

Applies to:

- Applies to all industries with certain specific transactions excluded: leases, insurance contracts, financial instruments, guarantees, certain nonmonetary exchanges.

METHODS OF ADOPTION

Application Guidance: 2 ways

- ASC 606 is required to be applied retrospectively by one of the following methods:
  - Retrospective application to each reporting period presented in accordance with ASC 250-10-45-5 through 45-10 (i.e. full restatement of comparative figures).
  - Modified retrospective with one or more practical expedients (i.e., completed contracts, use of hindsight for variable consideration, etc.), reflected as a cumulative effect in retained earnings at beginning of period of adoption.
  - Cumulative effect of change at adoption date (disclose effect of applying new standard).

THE FIVE STEP MODEL

Core Principle:

Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity *expects to be entitled* in exchange for those goods or services.

Steps to Apply the Core Principle Are:

STEP 1:	STEP 2:	STEP 3:	STEP 4:	STEP 5:
Identify The Contract	Identify Separate Performance Obligations	Determine Transaction Price	Allocate Transaction Price to Performance Obligations	Recognize Revenue Once Performance Obligation Satisfied

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OVERVIEW OF THE FIVE STEP MODEL

STEP 1:

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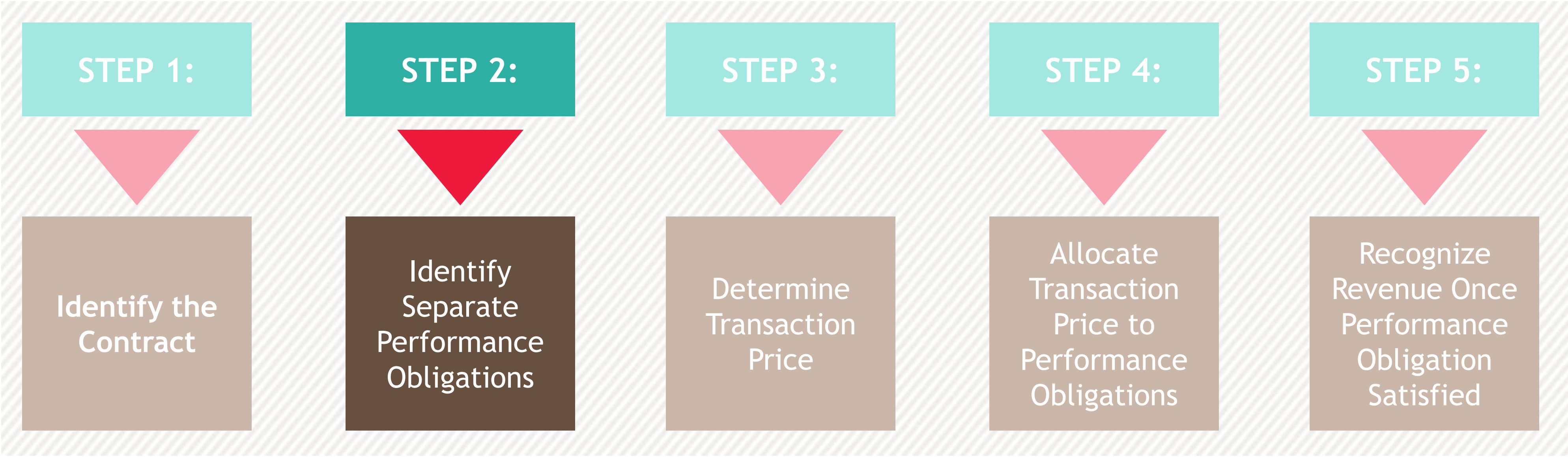
STEP 2: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Identify the Contract
STEP 2:
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Determine Transaction Price
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STEP 5:
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STEP 3:

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STEP 5: RECOGNIZE REVENUE

- The principle of revenue recognition has moved from a ‘transfer of risks and rewards’ to ‘the transfer of control of the goods or services to the customer’.
  - The transfer of risks and rewards is now simply an indicator for revenue recognition.
- For healthcare entities, this may result in a significant change in:
  - The amount of revenue recognized, and/or
  - The timing of revenue recognition.

New Definition of Revenue

- Revenue: Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.

OTHER CONSIDERATIONS

AICPA Healthcare Taskforce - Areas of Focus

- Self-pay patients
  - Implicit price concessions
  - Application of a portfolio approach
  - Medicaid spending
- Third-party payors
  - Third-party settlement estimates
- Principal versus Agent
- CCRCs
  - Various issues regarding entrance and other fees, contract costs, etc.
- Disclosures

Continuing Care Retirement Communities ("CCRC")

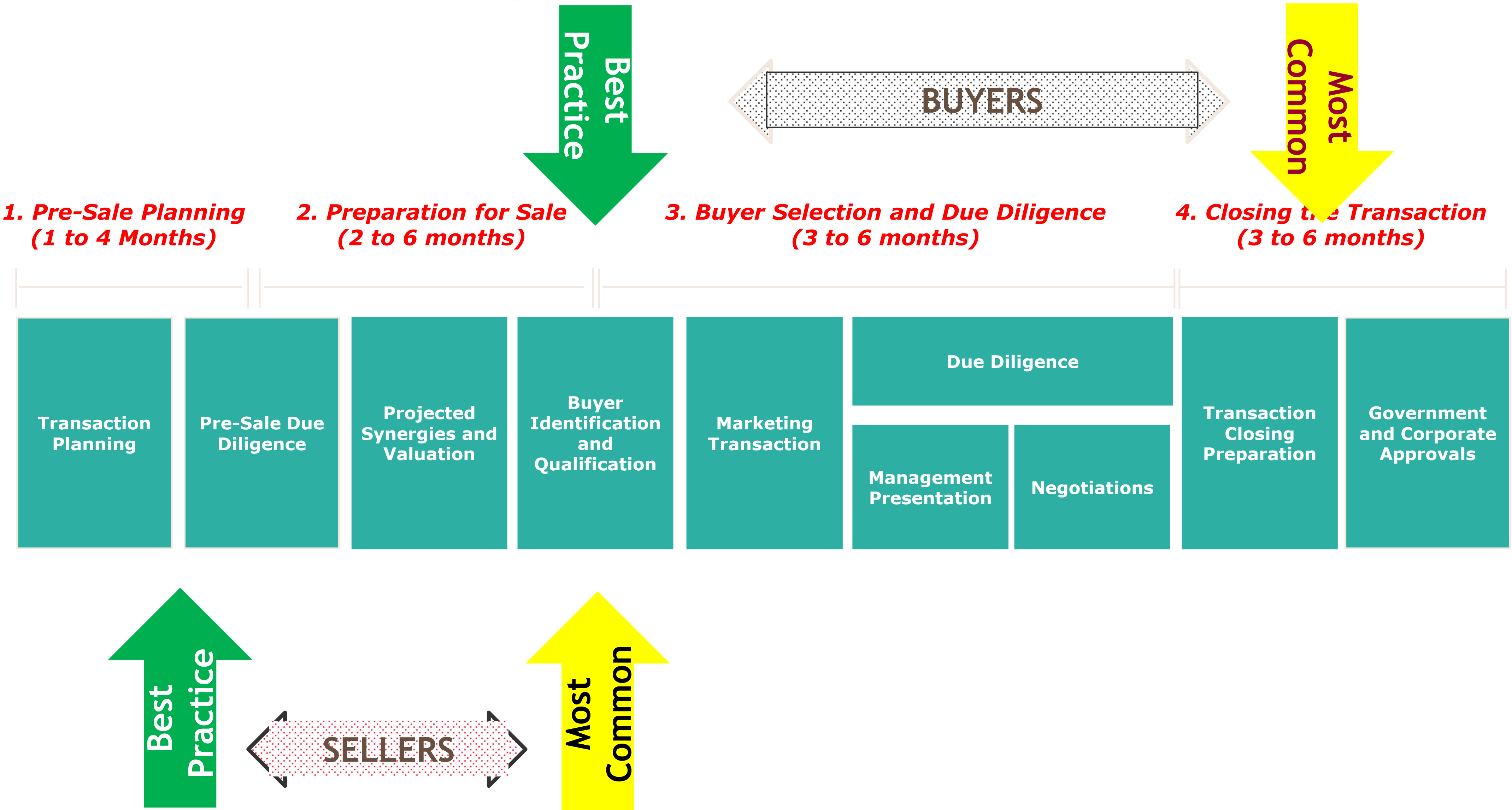
- Identifying and satisfying the performance obligation(s) and recognizing the monthly/periodic fees and nonrefundable entrance fees under Type A or "life care" contracts for continuing care retirement communities.
- Identifying the performance obligation(s) and recognizing the performance obligation(s) to provide future services and use of facilities.
- Significant financing components.

Disclosures

- Disclose sufficient information to enable user of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.
- A healthcare entity should also consider whether these matters are impacted by factors such as geographical considerations, market or type of customer, types of contracts, and whether the healthcare entity has operating segments or service lines.
- For each significant third-party payor, provide a summary of activity for each operating period. The summary would distinguish settlements relating to prior years from those relating to the current year's activity and would identify current-year changes to settlement amounts estimated in prior periods

MERGERS AND ACQUISITIONS

The Actual Transaction — When Should a Buyer or Seller Start to Prepare?



Key Issues in Healthcare M&A - Part of preparing

- *Availability of historical financial information*—At least three years of *audited* financials are essential
- *Payer mix (providers)*—Commercial ↑, Medicare ↕, Medicaid ↓
- Deferred capex—can be significant
- *Stranded assets*—FMV < book value
- *Regulatory oversight*—Increasing FTC oversight of provider and payer transactions (e.g. Hershey-Pinnacle, Aetna-Humana)
- *Tax considerations*—Not-for-profit property tax exemption under increasing scrutiny (e.g. the Morristown case); The Affordable Care Act added IRC Section 501(r) containing 4 community benefit requirements to IRC Section 501(c)(3)
- *Future governance model*—Co-CEO model common, although can be less than ideal; and board structure
- *Compatibility of IT and other systems*—Interoperability could entail major future capex

Key Issues in Healthcare M&A

- Revenue recognition, incl. methodology for contractual allowances and bad debt
- Billing and collection practices for major payors
- Accounts receivable estimates
- Hindsight analysis comparing cash collections to net revenue and A/R
- Accounting for other types of revenue
  - Disproportionate share (“DSH”) payments
  - Provider Taxes - (California) Quality Assurance Fees (“QAF”)
  - Electronic Medical Records (“EMR”)
- Aligning financial statement activity to KPIs such as payor mix, admissions, ALOS, avg. daily census, procedure mix, case mix index, outpatient statistics
- Self-insurance
  - Medical Malpractice, Workers Comp, Employee Health
  - Incurred But Not Reported (“IBNR”)
  - Reinsurance (“Stop Loss”)
- Defined Benefit Plans (aka Pensions)
- Ownership Structure
- Recovery Audit Contractor (“RAC”) Audits

Employment Tax Considerations in M&A, Reorganizations and Divestures

- Due Diligence - Employment taxes are increasingly a focus of exam initiatives and can trigger significant liability issues
  - Buyer side: Review to identify liability issues before transaction closes
  - Seller side: Pre-deal process reviews to identify potential issues and remediate before they are identified during the transaction
- Transaction issues - Employees moving between EINs can trigger employment tax compliance obligations and savings/refund opportunities
  - Compliance obligations
    - Notification to state DOLs of acquisition of employees (SUTA dumping)
    - Form W-2 and information reporting options and obligations
    - Form 941 Schedule D and state withholding tax reconciliations
    - Vendor coordination
    - Account terminations (Seller)
  - Savings/refund opportunities (Buyer)
    - Successor wage base carryover opportunities (FUTA, SUTA, and Social Security)
    - State unemployment tax rates savings opportunities and obligations

Tax Considerations
Ordinary Income under Section 751(c)

- Under section 751(c), the term “unrealized receivables” includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for:

    1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

    2) services rendered, or to be rendered.

Tax Considerations
Ordinary Income under Section 751(c)

- If the partnership has a service agreement that is not cancelable by the party for whom the services are to be performed, it is now settled that payments with respect thereto are unrealized receivables.

  United States v. Woolsey, 326 F2d 287 (5th Cir. 1963); *Blacketor v. United States*, 204 Ct. Cl. 897 (1974); *John W. Ledoux*, 77 TC 293 (1981) , aff'd per curiam, 695 F2d 1320 (11th Cir. 1983); Rev. Rul. 79-51, 1979-1 CB 225; and *Roth v. Commissioner*, 321 F2d 607 (9th Cir. 1963)

- Payments attributable to the value of service contracts that are cancelable at will or upon thirty or sixty days' notice have been excluded from the definition of "unrealized receivables."

  Charles F. Phillips, 40 TC 157 (1963); *Harlan E. Baxter*, 28 TCM 487 (1969), aff'd, 433 F2d 757 (9th Cir. 1970); and *Miller v. United States*, 181 Ct. Cl. 331 (1967)

Tax Considerations
Ordinary Income under Section 751(c)

- Based on the foregoing:
  - Sale of a partnership interest holding a non-cancellable management contract is likely to generate ordinary income under section 751(c)
  - Sale of assets including a non-cancellable management contract is likely to generate capital gain under normal income tax accounting principles.

- *Before deciding to structure an asset sale, however, consider section 197(f)*

Tax Considerations
Anti-Churning Rules under Section 197(f)

- Under section 197(f)(9), The term “amortizable section 197 intangible” shall not include any goodwill or going concern value (or for which depreciation or amortization would not have been allowable but for this section) and which is acquired by the taxpayer after the date of the enactment of this section, if

    i. the intangible was held or used at any time on or after July 25, 1991, and on or before such date of enactment by the taxpayer or a related person,

    ii. the intangible was acquired from a person who held such intangible at any time on or after July 25, 1991, and on or before such date of enactment, and, as part of the transaction, the user of such intangible does not change, or

    iii. the taxpayer grants the right to use such intangible to a person (or a person related to such person) who held or used such intangible at any time on or after July 25, 1991, and on or before such date of enactment.

Tax Considerations
Anti-Churning Rules under Section 197(f)

- Notwithstanding the foregoing rule, section 197(f)(9)(E) provides:

  > With respect to any increase in the basis of partnership property under section 732, 734 , or 743, determinations under this paragraph shall be made at the partner level and each partner shall be treated as having owned and used such partner's proportionate share of the partnership assets.

- Consequently, an acquisition of a partnership interest may avoid the anti-churning rules.
- Taxpayers may therefore be faced with a conundrum:
  - The purchase of a partnership interest may create ordinary income to the selling member and an amortizable asset to the purchaser
  - The purchase of assets may create capital gain to the seller but a non-amortizable asset to the purchaser

Investor Accounting

Consolidation Accounting (ASC 810)	• Variable Interest Entities (VIE)
	• Voting Interest Entities
	  • C-Corps
	  • LP's and Similar

If not consolidated, then what?	• Equity Method Accounting, including JVs • Debt and Equity Securities • Cost Method • Derivative Instruments • Other

Applying ASC 810 VIE Guidance

Applying ASC 810 VIE consolidation guidance involves the following steps:

Step 1	Determine if the reporting enterprise's arrangement with another entity is within the scope of ASC 810 VIE guidance.
Step 2	Determine whether the reporting enterprise holds a variable interest in the entity.
Step 3	Determine whether the entity is a VIE.
Step 4	Determine whether the reporting enterprise is the primary beneficiary of the entity.

Potential Variable Interests

There are many types of variable interests. For example:

- Equity interests
- Beneficial interests
- Debt interests
- Guarantees (for instance, on the residual value of leased property or debt of the entity, in which the guarantor is exposed to negative variability in the entity's assets or liabilities)
- Certain purchase options at other than fair value (commonly held by a lessee, they provide the lessee with the right to receive positive variance in the fair value of leased property by purchasing the property at a fixed price below the future fair value of the property).
- Licensing or royalty arrangements
- Put and call options to sell or purchase assets, liabilities or equity of the entity
- Management or service contracts
- Certain franchise arrangements
- Co-marketing arrangements
- Forward contracts to sell assets
- Certain long-term supply contracts at a fixed price per product or unit of service
- Certain long-term purchase contracts for fixed quantities of product or units of service
- Certain research and development funding arrangements

Sales Tax for Health Care

With You Today!

- **Experience**
- More than 24 years of SALT experience
- Texas Sales and Use Tax Auditor
- Coopers & Lybrand, Tulsa
- Ernst & Young (Memphis and Atlanta)
- KPMG LLP (Tulsa and Dallas)
- HoganTaylor LLP
  BDO USA, LLP

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So What…

- We are currently working a project where a non-profit acute care hospital over paid $4 million in sales tax.

- Most non-profits sell taxable products…

  Cafeteria
- Gift shops
- Health clubs
- Supplies to first responders and doctors offices

- Joint Ventures with Docs and Taxable Groups

How to Find Out if Your Nonprofit Is in Danger of Losing Tax-Exempt ...
https://trust.guidestar.org/.../how-to-find-out-if-your-nonprofit-is-in-danger-of-losing...
Aug 19, 2010 - In response to our article earlier this month on filing relief for smaller **nonprofits** facing automatic revocation of **tax-exempt** status, a number of ...

Pushing Back on Non-Profit Property Tax Exemptions - Coates' Canons
canons.sog.unc.edu/pushing-back-non-profit-property-tax-exemptions/
Nov 15, 2016 - $19 billion. That's the rough market value of **exempt property** owned by **non-profit** educational institutions and charitable hospitals throughout ...

New Jersey tax court denies property tax exemption for nonprofit hospital
https://www.nixonpeabody.com/.../new-jersey-tax-court-denies-property-tax-exempti...
Jul 15, 2015 - New Jersey tax court denies **property tax exemption** for **nonprofit** hospital; sets **dangerous** precedent in the state and possible ripple effect ...

Are Churches and Nonprofits in Danger of Losing Tax Exempt Status?
punchingbagpost.com/are-churches-and-nonprofits-in-danger-of-losing-tax-exempt-s...
Jun 30, 2015 - Are Churches and **Nonprofits** in **Danger** of Losing Tax **Exempt** Status? ... state also enjoy an **exemption** from state income tax and **property tax**.

Warning - dangerous claws: property tax exemption claw-back can ...
https://clarknuber.com/articles/property-tax-exemption/
Sep 5, 2014 - Many Washington **not**-for-**profits** benefit substantially from the various **property tax exemptions** provided in state law. However, a relatively ...

The Property Tax Exemption and Washington State Nonprofit Hospitals
www.wahcnews.com/articles/02-2016/wa-pcarr-0216.php
Feb 9, 2016 - Is the **property tax exemption** for **nonprofit** hospitals in **danger** in Washington State? For profit hospitals have only a third of the market share in ...

Health Care Issues

- There are many different taxability issues in Healthcare.
- The taxability of items vary by state.
- Hospitals are big taxpayers.

Health Care Issues

- Some items when bought for a specific person are exempt, however, when purchased by a hospital, are taxable.

- Example: Wheel Chairs
  Hospital Beds

What is a drug?

- IV Fluids
- Contrast
- Prostate Seeds
- Gases

Common Issue

- Renting / Leasing Equipment:
  - Without an Operator – Generally Taxable
  - With an Operator – is viewed as a Service, and you need to look at the taxability of the service

Health Care Issues

- Services vs. Rentals
- Liptotripsy
- Mobile Image Equipment
-

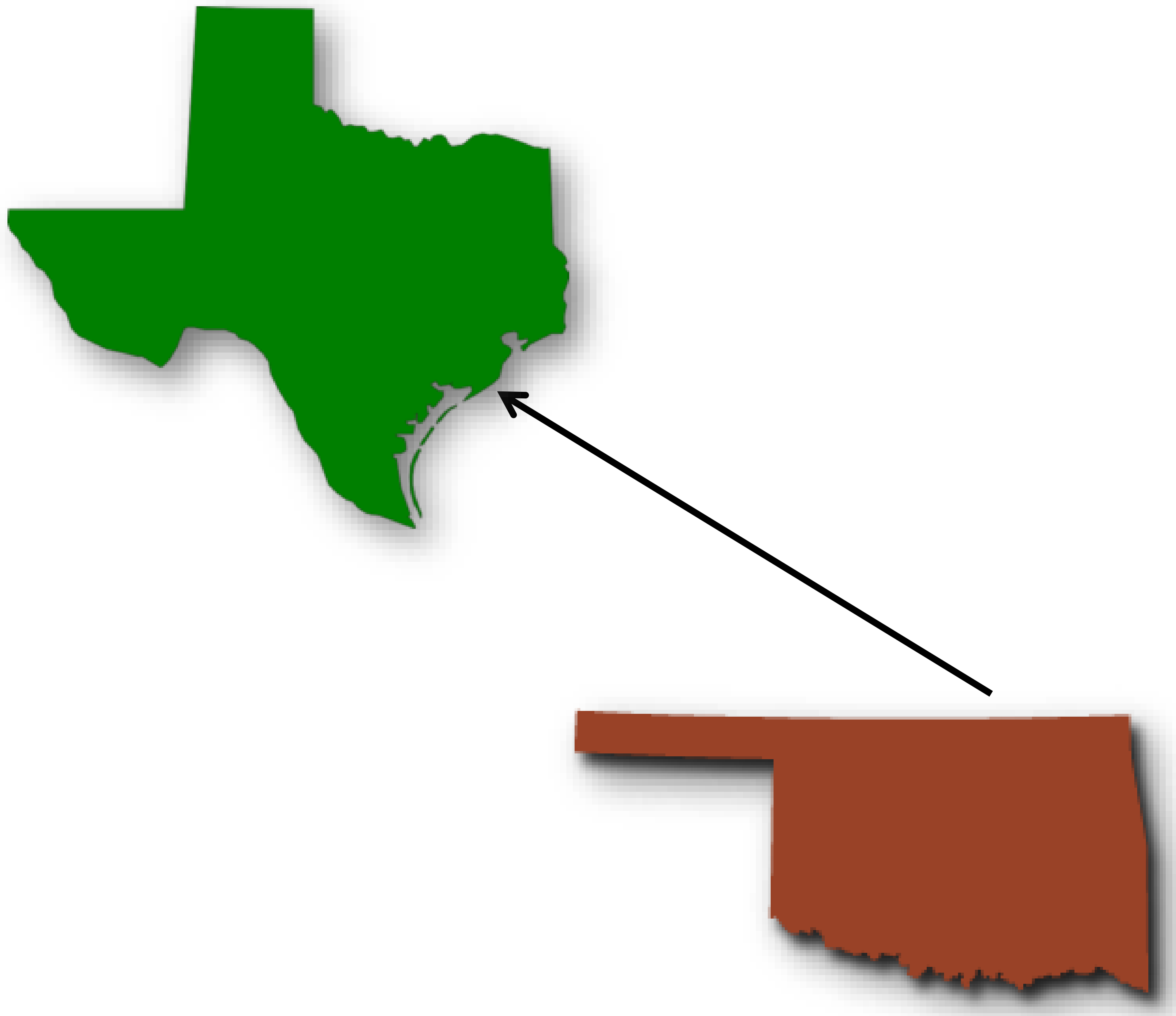
  Uniform Rentals
- Bedding, Floor Mats, Mops

Types of Taxes

- Sales taxes are **transaction taxes** imposed on transfers of tangible personal property and taxable services.

- Use tax is imposed on the **“use”** of property in a state. It is important to understand what constitutes a use.

Use Tax



- Why didn’t the vendor charge me tax?

- Can I just add the tax to the invoice?

Nexus

- The reason they didn’t charge you tax is because the vendor may not have Nexus.
- If you add the tax to the invoice, more than likely they have no way to remit the tax to the proper state.
- Adding tax to invoices will not hold up under audit.

Nexus

- **Nexus** is defined as the minimum contact an entity must have in order for a state to impose a tax.
- **Nexus** requires sufficient contact between the state and the business it wants to tax.
- **Nexus** standards vary depending on the type of tax involved, therefore it is possible to have nexus for one tax and not another.

Where is tax due?

- Sales taxes are based on destination in most states.

- What is the ship to address on the invoice?

Responsibility for Tax

- The Seller has a fiduciary responsibility to collect tax that is legally due for the state.
- This is not the Sellers' Tax, but the Buyers'.
- The legal incidence of the sales tax is usually on the purchaser, not the retailer.
- However, in most states the retailer is charged with collecting the tax.

Imposition of Tax

- Tangible Personal Property
  - Most state sales and use tax statutes are written so that all retail sales of tangible personal property are subject to tax unless specifically exempted or excluded by the statute.

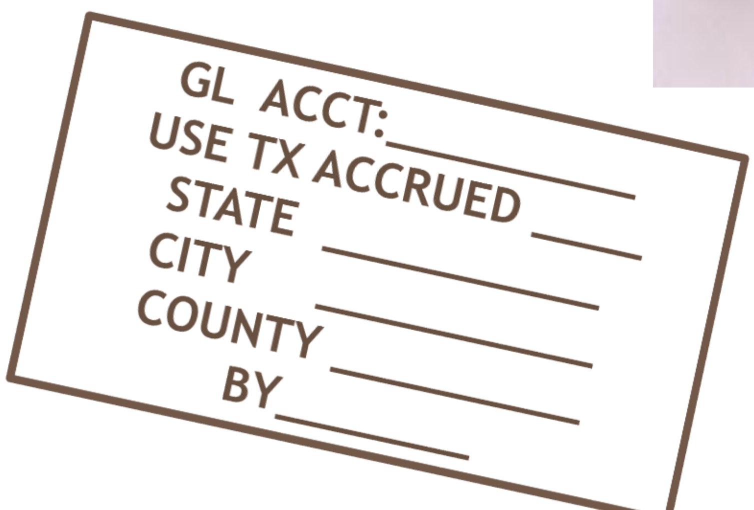
- Services
  - In contrast to the treatment of tangible personal property, services are generally exempt unless specifically designated as taxable.

Basic Compliance

- Manual Accruals
  - If AP can handle the task…
    - Most AP systems have an option to accrue tax within the AP screen
    - Write a "hard line of accrual" into the tax payable account
  - Pull out the questionable invoices for a decision maker to review
    - Use a spreadsheet
    - Use a database
  - Make copies or scans of invoices

Basic Compliance

- Use an Orderly Process
  - Buy a stamp
- Disfigure the invoice



Audits and Assessments

Big Issues in Audits

- Transactions within a corporate group
- Items brought in from out-of-state
- Hardware/software maintenance
- Contractor issues

Contact Information

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Q & A