Identifying Charity Care In Financial Statements

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Most healthcare institutions have now presented at least one year's audited financial information using the format and definitions required by the new audit and accounting guide, *Audits of Providers of Health Care Services* (American Institute of Certified Public Accountants [AICPA], New York City, 1990). The guide requires facilities to report charity care and allows them to report community services. Many Catholic healthcare providers have also had some experience with the charity care reporting guidelines suggested in the Catholic Health Association's (CHA's) Social Accountability Budget. CHA's broad definition includes community service, which is wisely included in the institution's audit report.

Despite their familiarity with these two documents, how well have institutional managers communicated to constituents the institution's provision of charity care and related services?

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Cost of Doing Business

Under the earlier AICPA accounting rules, most healthcare providers reported gross patient revenue and reduced it by the amount of revenue not collected and thus written off. This latter category was identified as deductions from revenue and included Medicare and Medicaid allowances, charity care services, bad debts, and managed care and other contractual reductions. Some healthcare providers followed a different practice and reported both bad debts and charity care services as expenses. This followed the convention of most businesses and was understood by most users of financial statements. In this context, charity care and bad debts were seen as a cost of doing business.

No matter which reporting method healthcare facilities used, they usually reported the costs of providing charity care as expenses in appropriate categories (e.g., personnel, supplies). In most instances they made no disclosure to help readers of financial statements understand what percentage of the expenses reported did not generate net revenue but were used to provide charity care and community services.

Reporting through Footnotes

Under the AICPA accounting rules in the new guide, all patient revenue is to be reported net of all deductions. Bad debts are not considered a deduction from revenue and are therefore reported as an expense. The costs of providing charity care and community services are still included as expenses and reported in the appropriate expense category. Under the new accounting rules, healthcare organizations have some leeway in determining the method and computation for reporting charity care services. (For more discussion of *Audits of Providers of Health Care Services*, see Martha Garner and Woodrin Grossman, "Reporting Charity Care," *Health Progress*, January-February 1992, pp. 58-63.)

The most common method of complying with the requirement to disclose charity care services is to use the footnotes to report how much patient revenue was written off as charity care. However, few users of financial statements actually read footnotes. Usually footnotes are narrative rather than tabular. The information listing the work done to affirm the institution's mission is thus, in effect, missed by many users.

Issues to Address To make financial statements more reflective of the provider's mission while complying with the AICPA's demands, managers must address two issues:

- Defining and measuring charity care services
- Finding the most effective way to present the institution's role in providing charity care services in the financial statements

Definition and Measurement The Principles and Practices Board of the Healthcare Financial Management Association, Westchester, IL, first defined the method for computing charity in its Statement No. 2, "Defining Charity Service as Contrasted to Bad Debts" (1978). The recently released Statement No. 14, "Patient Service and

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tem at the core of healthcare reform. Bentley argued that "the current emphasis on global budgeting and cost control will undermine the possibility of delivery reform. If the debate disintegrates into a political debate about cost control, it will divide groups against each other."

At the same IOM meeting, however, Reinhardt argued that healthcare providers should seek to "exploit the inevitable." He urged providers to "prepare themselves to demonstrate convincingly the benefit-cost ratios implied by their various offerings, . . . to anticipate the errors that naturally occur in any budget-driven system, and to cooperate with the private- and public-sector budgeteers in attempts to avoid such errors."

Whether hospitals will spend their time and effort fighting global budgets and pointing to its flaws or preparing to cooperate with budgeteers and helping to structure spending limits to their advantage, it is essential that the provider community learn all it can about such budgeting. Political necessity demands it. □

NOTES

1. Paul Starr and Walter A. Zelman, "A Bridge to Compromise: Competition under a Budget," *Health Affairs*, Suppl., March 1993, pp. 7-23.
2. *Starr and Zelman.*
3. Uwe Reinhardt, "Health Care in an Age of Constrained (Though Not Shrinking) Budgets," paper presented at Institute of Medicine, Washington, DC, January 11, 1993.
4. Henry J. Aaron and William B. Schwartz, "Managed Competition: Little Cost Containment without Budget Limits," *Health Affairs*, Suppl., March 1993, pp. 204-215.
5. Reinhardt.
6. Suzanne W. Letsch, "National Health Spending Trends, 1991," *Health Affairs*, Spring 1993.
7. Stuart H. Altman and Alan B. Cohen, "The Need for a National Global Budget," *Health Affairs*, Suppl., March 1993, pp. 194-203.
8. Reinhardt.
9. Aaron and Schwartz.

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A place for managers to emphasize the organization's contribution to the community is in a discussion and analysis.

Related Issues" (1992), clarifies issues in light of the new audit guide. These documents are helpful in establishing procedures within an institution to define and measure the charity care rendered.

The measurement of charity care and community services is facilitated by use of the Social Accountability Budget (*Social Accountability Budget: A Process for Planning and Reporting Community Service in a Time of Fiscal Constraint*, CHA, St. Louis, 1989). This tool helps managers and others within the institution determine which services it renders for the good of the community and the fulfillment of the facility's mission in contrast to those rendered for marketing or other reasons.

Once a facility knows what to classify as charity care or community service, it must measure these services. A healthcare organization must follow predetermined procedures and maintain good records. Financial statement information must be reported to all members of the community, all who interact with the institution, lenders and other providers of financial services, and governing boards. The information quantifying the costs of these social goods should be prominent in financial statements. Even though disclosure of the costs of providing community services is not required, reporting this information will greatly expand readers' knowledge of the facility and its mission.

Presentation in Financial Statements Disclosure in financial statements is critical to the institution's explanation of how it fulfilled the charity care and community service portion of its mission. After reviewing the alternative methods of providing the disclosure, healthcare managers might find it prudent to disclose as much information as possible on the face of the income statement. Rather than merely writing, "See footnotes for information," managers could draw attention to the disclosure by writing, "See footnote number X, which details the patient charity care service provided in the amount of $X and community service in the amount of $X." This disclosure can be placed near the total revenue line on the face of the income statement.

A table might present footnote information more clearly than a narrative. Tables are easier to read and will catch the reader's eye. The disclosures can be expanded in the footnote to describe the charity care and community services as a percentage of patient revenue or net income.

A final place for managers to emphasize the organization's contribution to the good of the community is in a discussion and analysis. This may be incorporated into the audit report and included in part in the facility's annual report.

Such a discussion is a common feature of the financial reporting of corporations to stockholders and should be used more often by not-for-profit organizations. By explaining in a clear, narrative fashion the significant events that occurred during the year and their impact on the institution's performance, managers can answer all questions that may arise. Surely the facility's contribution to the community through its provision of charity care can be well explained in this manner.

Act Now

Now is a good time for managers to review the new financial reporting formats. They have an opportunity to make the institution's mission, its contributions to the community, and the true financial implications of these contributions clearer and more easily understood by all users of financial statements. □