

PHC-PA-1: Introduction to Audits of Health Care Entities

INTRODUCTION

Health care entities cover a wide range of service providers to health care patients, including the following types of entities:

- Hospitals
- Health care systems
- Accountable care organizations
- Rehabilitation facilities, including drug and alcohol rehabilitation centers
- Long-term acute care hospitals
- Mental health facilities
- Surgery centers
- Imaging centers
- Clinics, physician groups, and individual physicians
- Laboratories
- Nursing homes, including skilled nursing facilities
- Continuing care retirement communities, including assisted and independent living facilities
- Home health agencies
- Hospice care providers
- Prepaid health care plan providers, including managed care organizations
- Durable medical equipment and related medical service providers

Health care entities may be nonprofit, investor-owned, or governmental entities. Nonprofit health care entities can be further segregated between nonprofit *business*-oriented health care entities and nonprofit *nonbusiness*-oriented health care entities. Nonprofit *business*-oriented health care entities are similar to other nonprofit organizations in that they have no ownership interests. The primary distinction, however, is that they are typically self-sustaining from the fees they charge for goods and services. They may receive a small amount of contributions from donors.

WHAT IS THE SCOPE OF PPC'S PRACTICE AIDS FOR AUDITS OF HEALTH CARE ENTITIES?

PPC's Practice Aids for Audits of Health Care Entities includes the following sets of practice aids:

- *PPC's Practice Aids for Audits of Health Care Entities (Nonprofit and Investor-owned Entities)* provides practice aids for auditing nonprofit *business*-oriented health care entities and investor-owned health care entities in accordance with generally accepted auditing standards (GAAS) developed by the American Institute of Certified Public Accountants (AICPA). It also includes procedures and practice aids to perform a financial audit in accordance with the Government Accountability Office's *Government Auditing Standards* (Yellow Book). Nonprofit *nonbusiness*-oriented health care entities are voluntary health and welfare entities, and practice aids for auditing those types of entities can be found in *PPC's Guide to Audits of Nonprofit Organizations*. *PPC's Practice Aids for Audits of Health Care Entities (Nonprofit and Investor-owned Entities)* use the terms *nonprofit health care entities* or *nonprofit entities* to refer to nonprofit business-oriented health care entities.
- *PPC's Practice Aids for Audits of Health Care Entities (Special-purpose Governmental Entities)* provides practice aids for auditing governmental health care entities that report as special-purpose governments engaged primarily in business-type activities (that is, whose financial statements are prepared using enterprise fund accounting and reporting) in accordance with GAAS. It also includes procedures and practice aids to perform a financial audit in accordance with the Yellow Book. Practice aids for auditing

governmental entities that use governmental fund accounting and financial reporting can be found in *PPC's Guide to Audits of Local Governments*.

Some nonprofit business-oriented health care entities may be part of a larger entity, such as a medical school or university, or they may control another nonprofit organization (such as a fund-raising foundation) or a for-profit entity. Similarly, governmental health care entities that use enterprise fund accounting and reporting may be part of a larger entity, such as a general-purpose government. Some governmental health care entities also have legally separate, tax-exempt component units (such as a foundation, whose primary function is to raise and hold funds to support the hospital and its programs). The foundation would be a private nonprofit organization that reports under the provisions of the Financial Accounting Standards Board (FASB). In those situations, the practice aids included in *PPC's Practice Aids for Audits of Health Care Entities* apply to audits of the health care entity's separately issued financial statements and may not address all of the procedures necessary for auditing other related entities.

Auditors who are familiar with the practice aids in *PPC's Guide to Audits of Nonprofit Organizations* (NPO), *PPC's Guide to Audits of Nonpublic Companies* (ASB), or *PPC's Guide to Audits of Local Governments* (ALG) will see similarities with these *Practice Aids*. These *Practice Aids* tailor the guidance in NPO, ASB, and ALG for a typical engagement to audit a nonprofit health care entity, an investor-owned health care entity, or a special-purpose governmental health care entity. These *Practice Aids* were designed to complement rather than repeat the guidance discussed in the chapters in NPO, ASB, and ALG. Accordingly, references to NPO, ASB, and ALG are included throughout these *Practice Aids* to direct auditors to the more extensive guidance included in NPO, ASB, and ALG.

Exclusion of Single Audit Procedures

These *Practice Aids* do not cover the procedures necessary to perform a Single Audit. If a Single Audit is required, auditors should refer to the additional guidance, letters and correspondence, checklists and practice aids, and audit programs provided for federal awards programs in *PPC's Guide to Single Audits*, which covers Single Audits for both nonprofit and governmental entities; NPO, which covers only nonprofit entities; or ALG, which covers only governmental entities.

Other Areas Excluded from These *Practice Aids*

The following additional items are excluded from these *Practice Aids*:

- Initial audit procedures.
- Disclosure considerations and procedures for conduit-debt obligors.

Auditors can refer to the initial audit programs for nonprofit and investor-owned entities in NPO and ASB, respectively, if they need further guidance and can modify those practice aids as necessary. [Section 205 of NPO](#) , [section 907 of ASB](#) , and [section 203 of ALG](#) provide special considerations for an initial audit.

Obligors of conduit debt securities that are traded in a public market (referred to as conduit debt obligors) should make the additional disclosures that are required of public entities by generally accepted accounting principles (GAAP). Those disclosures are not addressed in these *Practice Aids*. When adopting new accounting standards that refer to public entities, conduit debt obligors need to determine if they are included as a public entity and if an earlier effective date for public entities is provided and applies to the conduit debt obligor.

ACCOUNTING STANDARDS FOR HEALTH CARE ENTITIES

In many respects, accounting for health care entities is no different than accounting for entities in other industries. That is, GAAP that applies to entities in general also applies to health care entities. Nevertheless, preparing a health care entity's GAAP basis financial statements can present unique challenges since most authoritative pronouncements were not written specifically with health care entities in mind.

Nonprofit and Investor-owned Entities

Accounting guidance may be authoritative or nonauthoritative. Financial statements must conform to authoritative standards to be in conformity with GAAP; nonauthoritative guidance may be useful but is not GAAP. The FASB Accounting Standards Codification (ASC) contains the only authoritative source of GAAP for nonpublic, nongovernmental entities. Accordingly, nonprofit and investor-owned health care entities should follow the guidance in the relevant topics of the FASB ASC when preparing their financial statements. In addition, the FASB ASC addresses issues specifically related to health care entities in *FASB ASC 954, Health Care Entities* ([link](#)) . Some health care entities that have secured tax-exempt status as an Internal Revenue Code (IRC) Sec. 501(c)(3)

organization may actually follow Governmental Accounting Standards Board (GASB) accounting standards if the entity is controlled by a governmental entity.

The AICPA Audit and Accounting Guide, *Health Care Entities (September 1, 2014)*, which the authors refer to throughout these *Practice Aids* as the “AICPA HCE Guide (2014),” provides additional accounting guidance for health care entities. That guidance is nonauthoritative for nonprofit and investor-owned health care entities. However, following the AICPA HCE Guide (2014) reduces the accounting diversity experienced in practice. It includes expansive discussions on health care industry-specific topics and common health care industry considerations for general accounting and reporting items.

Governmental Health Care Entities

The GAAP hierarchy for state and local governments consists of four categories of accounting principles that are generally accepted in descending order of authority.^a The first category with the highest level of authority is Statements and Interpretations of GASB. Included in the second category are AICPA Audit and Accounting Guides that are specifically made applicable to state and local governmental entities and cleared by the GASB. Auditors should assume that AICPA Audit and Accounting Guides specifically made applicable to state and local governments have been cleared by GASB, unless the pronouncement indicates otherwise. Accordingly, the accounting guidance in the AICPA HCE Guide (2014) represents authoritative guidance for governmental health care entities. *Chapter 15 of the AICPA HCE Guide (2014)* ([link](#)) specifically addresses issues related to governmental health care entities. The accounting guidance in the AICPA Audit and Accounting Guide, *State and Local Governments (March 1, 2014)* (SLG), also represents authoritative guidance for all state and local governmental entities. [Chapter 12 of SLG](#) provides specific guidance for special-purpose governmental health care entities.