

Financial Reporting Pitfalls Lurking in Healthcare Reform
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Financial Reporting Pitfalls Lurking in Healthcare Reform

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As human resources departments across the country digest the implications of the landmark healthcare reform laws passed by Congress in March, accounting departments, too, are gearing up to assure that corporate financial statements accurately reflect the massive changes hurtling toward Corporate America.

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The list of compliance requirements (and the penalties for non-compliance) is long, certainly. At their essence, however, the two laws Congress approved in March—the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act—require companies to assure that their employees have access to some minimum amount of health insurance. That leaves HR departments the task of analyzing existing benefits and determining where they may want to make changes to offer compliant yet cost-effective alternatives, says Pat Kitchen, a partner with McGladrey & Pullen.

Then come the accounting departments, which must assure that the cost implications are fully explored and reflected in financial statements, says Peter Bible, a partner with auditing firm Amper Politziner. For accounting purposes, he says, corporate health benefits fall into two distinct buckets: one for active employees, and another for retirees. That liability for retiree benefits will get the most scrutiny as

healthcare reform proceeds, he says.

"That's the big liability you see building on companies' balance sheet," Bible warns. "Those liabilities have gone through the roof, and that's where you see the most accounting issues." "You can't reflect the impact of some change or amendment to a plan that you think you are going to make in the future and build it into your measurements now."

-Ken Stoler, Director HR Services, PricewaterhouseCoopers

Those issues are already cropping up. Immediately after healthcare reform was signed into law, a handful of large public companies dashed off Form 8-K disclosures to announce big charges to their other comprehensive income line item, reflecting a change in the tax benefit related to retiree drug subsidies. That was to comply with Accounting Standards Codification 740, Income Taxes, which says companies must report any significant effect resulting from new legislation or regulation in the same period the legislative or regulatory change occurs.

Healthcare reform was signed into law on March 23. That left companies under tight deadlines to meet first-quarter March 31 closing dates for calendar-year companies, says Stephen Shill, a partner with accounting firm BDO. The law eliminated part of the deductibility of the subsidy companies received for offering drug coverage; as a result, companies had to adjust their deferred tax assets through the income statement to reflect the change, he explains.

Stoler

With that first-quarter headache behind them, corporate accounting departments are now focused on how to reflect changes in retiree benefits, says Ken Stoler, director of the HR services practice at PricewaterhouseCoopers. For now, current employees are the easy part: "From an accounting perspective, you're basically just accounting for whatever the cost is in the current period," he says. With retirees, however, "you're talking about promises made to employees today for benefits that are going to be paid potentially many, many years into the future."

An alert published by Deloitte notes that ASC 715, Compensation-Retirement Benefits, directs companies to remeasure the net periodic cost of any retirement benefit after a significant event has occurred. To determine whether healthcare reform qualifies as "significant" to a given benefit plan, companies are supposed to consider reform's effect on the plan's accumulated obligation, the net periodic cost, other comprehensive income, and other qualitative factors, Deloitte says.

Planning Ahead

The healthcare reform measures contain several provisions with effective dates well into the future, but companies still need to gauge the effects of those changes today, Stoler says. That is, however healthcare reform might change the benefits provided to retirees-you need to incorporate those changes into how you measure your future obligations right now, he explains. "You're looking at all the projected future costs that you've promised to your employees."

HEALTHCARE ACT SPECIFICS

Below is an excerpt of a PwC bulletin describing some of the financial reporting challenges stemming from healthcare reform.

Many employers are determining which aspects of the Act will impact them, what the impact will be, and when the effects should be accounted for. Additionally, as certain pieces of the new legislation could significantly impact future earnings, some employers are reconsidering their benefits strategy and plan design.

Many provisions of the Act do not take effect until years in the future; however, accounting rules require their expected impact to be reflected in current reporting periods. Specifically, postretirement benefits accounting requires that current-period measurements of the benefit obligation reflect an estimate of the effects on future benefit levels of presently enacted law changes.

Many of the specifics associated with the new legislation remain unclear. Further guidance is expected to become available as clarifying regulations are issued to address how the law is to be implemented. Until then, it may be difficult for employers to reasonably estimate the impact certain aspects of the Act will have on their plans and their financial statements.

This DataLine describes a number of potential implications of the new legislation for an employer's accounting for postretirement benefits other than pensions, as summarized below.

Where the legislation impacts retiree health care benefits, measurements of the benefit obligation should include an estimate of the impact, except for those aspects of the legislation that the employer cannot reasonably conclude apply to its plan.

If the impact of the legislation is significant to an employer's postretirement benefit plan, an interim remeasurement is necessary. Otherwise, the effects of the Act should be included in the next measurement of the benefit obligation.

The effects of the legislation can be treated either as a plan amendment (i.e., giving rise to prior service cost) or an actuarial loss (gain).

Some employers may consider amending the terms of their postretirement benefit plans as a way of mitigating the impact of the Act. Such an amendment should not be anticipated or accounted for prior to adoption of the plan amendment.

Aspects of the legislation that impact only active employees (not retirees) will generally be accounted for in the period the related benefit costs are recognized.

Key Provisions: Impact on retiree health care plans

A number of provisions in the Act impact retiree health care plans provided by employers. Currently, it is unclear how certain of those provisions will apply to different types of employers and different types of plans.

The accounting guidance for postretirement benefits requires that measurements of benefit obligations be based on facts and circumstances that exist at the measurement date. Thus, any measurement of the accumulated postretirement benefit obligation (APBO) for accounting purposes after March 23, 2010 should include the expected impact of the Act. If an employer cannot reasonably conclude whether certain provisions in the Act apply to its plan, we believe it would be appropriate to defer accounting for those provisions until it is possible to reasonably conclude that they apply.

We believe this approach is consistent with the guidance provided by the FASB when the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was enacted. In ASC 715-60-35-142 through 35-143, the FASB noted that if an employer and its actuarial consultant were unable to determine the impact of the legislation, it would be appropriate to defer recognition until the impact could be determined.

Companies should consider disclosing the impact of the Act on their benefit obligations, including any significant changes to their measurement assumptions. They also should consider disclosing any significant uncertainties, including provisions in the new legislation for which the accounting has been deferred pending further clarification as to applicability.

Source

PwC Alert on Healthcare Legislation (April 23, 2010)

That's why reporting retiree health benefits is so tricky, Stoler says. It's always been an actuarial calculation that considers the number of retirees and makes some assumptions about their expected life span and demand for health services. Now, that calculation must include a complex web of legislative changes in minimum requirements, limits, costs, and relief measures related to those benefits.

Those changes include items like minimum coverage requirements, penalties for failing to meet them, requirements to eliminate annual and lifetime benefit caps on essential coverage, an excise tax on so-called "Cadillac plans," temporary relief on insurance for early retirees, a rebate on certain prescription drugs for Medicare recipients, and many others.

Mark Drozdowski, a partner with KPMG and an audit sector leader for the firm, says he expects calendar-year companies generally to begin reporting the effects of healthcare reform with their year-end financial statements, at least to the extent they can deduce what that effect is. "There's a lot of uncertainty out there in whether or not companies will even be able to estimate it this year," he admits. "They'll disclose it if it's material, but in many cases it may not be material. There's work that needs to be done to get to that point to know what the impact will be."

CFOs are at least trying to tally some early numbers, even if they are far from ready to be included in financial reports. In a recent survey by Financial Executives International and Baruch College, CFOs said they generally expected an 8 percent increase in costs directly related to healthcare reform; only 15 percent of those answering the poll expected not to change their benefit plans as a result of the legislation.

At a more detailed level, however, Stoler and Drozdowski say companies are still watching for interpretive guidance from regulators-especially the U.S. Department of Health and Human Services-to define what will constitute "essential" or "excessive" coverage thresholds that are established in the legislation.

Uncertainty, however, does not excuse companies from disclosure, Stoler says. "It may be very difficult for companies and actuaries to estimate this impact, but difficulty is not enough reason to not record anything," he says. "Just because it's hard to come up with an estimate, it doesn't mean you shouldn't. You can acknowledge it's an estimate and that it may be easier to come up with over time as you get more information."

And Stoler has one more warning about disclosing the effects of healthcare reform. Companies might consider changing their benefit plans to minimize the cost of complying with the legislation, but they cannot simply combine legislative changes with benefit changes into a single disclosure and then report it to investors as a net non-event. That's a no-no.

"You can't reflect the impact of some change or amendment to a plan that you think you are going to make in the future, and build it into your measurements now," he says. "We've had a number of inquiries from companies that are considering it. It's important for companies to understand that."

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