

## Case Study Problem

- 15-12. For the Major Medical Center financial statements on the following pages, complete the following:
- Read the auditor's opinion letter. Are any flags raised?
  - Review the financial statements. Search for unusual items. What things catch your eye on the balance sheet, operating statement, and cash flow statement?
  - Review the notes. Do any of them raise cause for concern?

- Calculate the following ratios: common size, current, quick, days of cash on hand, receivable turnover, average collection period, fixed asset turnover, total asset turnover, debt, debt to equity, times-interest-earned, operating margin, total margin, ROA, and RONA.
- What do you think of Major Medical Center's financial status?

## CASE STUDY

### Major Medical Center<sup>8</sup>

*I.N. SINCER AND OLD, CPAs*  
2650 East 38th Street  
New York, New York 10089

Report of Independent Auditors.

Board of Trustees  
Major Medical Center

We have audited the accompanying statements of financial position of Major Medical Center (the "Medical Center") as of December 31, 2014 and 2013, and the related statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Major Medical Center at December 31, 2014 and 2013, and the results of its operations, changes in net assets, and cash flows for the years then ended, in conformity with generally accepted accounting principles.

April 30, 2015

*I.N. SINCER AND OLD, CPAS*

<sup>8</sup>Major Medical Center and Hospital Support, Inc. are fictional organizations. Any similarity to real organizations is purely coincidental.

**Major Medical Center**  
**Statements of Financial Position**

	December 31	
	2014	2013
	(In Thousands)	
<b>Assets</b>		
<b>Current Assets</b>	\$ 8,065	\$ 9,005
Cash and cash equivalents		
Assets limited as to use—compensating balance for letters of credit	1,000	—
Short-term investments	1,387	1,283
Receivables for patient care, net of allowance for doubtful accounts (2014—\$27,232; 2013—\$31,934)	49,719	47,614
Pledges receivable	1,814	2,205
Inventories, at average cost	1,690	2,326
Due from third-party reimbursement programs	6,539	—
Receivables for government grants	—	467
Other	2,234	3,415
<b>Total Current Assets</b>	<u>\$ 72,448</u>	<u>\$ 66,315</u>
<b>Assets Limited as to Use</b>	14,487	13,410
Sinking fund	923	—
Compensating balance for standby letters of credit	1,132	618
Long-term investments	3,417	3,543
Due from affiliates, net		
Pledges receivable, net of allowance for uncollectible pledges (2014—\$2,218; 2013—\$4,453)	1,889	1,468
Property, plant, and equipment net	98,555	89,777
Deferred financing costs	1,323	—
Other	2,065	1,043
	<u>\$196,239</u>	<u>\$176,174</u>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>	\$ 11,608	\$ 11,488
Current portion of long-term debt	29,489	25,311
Accounts payable and accrued expenses	25,572	20,096
Accrued salaries and related liabilities	—	1,874
Due to third-party reimbursement programs, net	1,587	—
Advances on government grants	\$ 68,256	\$ 58,769
<b>Total Current Liabilities</b>	55,539	47,709
Long-term debt, less current portion	6,023	6,017
Accrued post-retirement benefits	16,445	17,014
Other noncurrent liabilities	\$146,263	\$129,509
<b>Total Liabilities</b>		
Commitments and contingencies		
<b>Net Assets</b>	\$ 40,582	\$ 38,014
Unrestricted	8,262	7,519
Temporarily restricted	1,132	1,132
Permanently restricted	\$ 49,976	\$ 46,665
<b>Total Net Assets</b>	<u>\$196,239</u>	<u>\$176,174</u>
<b>Total Liabilities and Net Assets</b>		

See accompanying notes.

**Major Medical Center  
Statements of Operations**

	Year ended December 31	
	2014	2013
(In Thousands)		
<i>Operating Revenue</i>		
Net patient service revenue	\$402,921	\$369,512
Other revenue	13,356	13,850
Net assets released from restrictions	4,708	2,863
<b>Total Operating Revenue</b>	<b>\$420,985</b>	<b>\$386,225</b>
<i>Operating Expenses</i>		
Salaries and wages	\$207,141	\$196,453
Employee benefits	44,456	44,860
Supplies and expenses	137,505	117,838
Depreciation and amortization	22,541	18,856
Research	2,457	2,214
Interest	4,456	5,253
<b>Total Operating Expenses</b>	<b>\$418,556</b>	<b>\$385,474</b>
<i>Operating Income</i>	\$ 2,429	\$ 751
Net assets released from restrictions used for capital acquisitions	139	146
<b>Increase in unrestricted net assets</b>	<b>\$ 2,568</b>	<b>\$ 897</b>

See accompanying notes.

**Major Medical Center  
Statements of Changes in Net Assets**

	Net Assets		
	Unrestricted	Temporarily Restricted	Permanently Restricted
(In Thousands)			
<i>Net Assets at December 31, 2012</i>	\$37,117	\$3,023	\$1,132
Increase in unrestricted net assets	\$ 897	\$ —	\$ —
Restricted contributions, grants, and other receipts	—	7,253	—
Investment income restricted for specific purposes	—	252	—
Net assets released from restrictions for:			
Operating expenses	—	(2,863)	—
Capital asset acquisitions	—	(146)	—
<b>Change in net assets</b>	<b>\$ 897</b>	<b>\$4,496</b>	<b>\$ 1,132</b>
<i>Net Assets at December 31, 2013</i>	<b>\$38,014</b>	<b>\$7,519</b>	<b>\$1,132</b>
Increase in unrestricted net assets	\$ 2,568	\$ —	\$ —
Restricted contributions, grants, and other receipts	—	5,421	—
Investment income restricted for specific purposes	—	169	—
Net assets released from restrictions for:			
Operating expenses	—	(4,708)	—
Capital asset acquisitions	—	(139)	—
<b>Change in net assets</b>	<b>\$ 2,568</b>	<b>\$ 743</b>	<b>\$ 1,132</b>
<b>Net Assets on December 31, 2014</b>	<b>\$40,582</b>	<b>\$8,262</b>	<b>\$1,132</b>

See accompanying notes.

**Major Medical Center**  
**Statements of Cash Flows**

	Year Ended December 31	
	2014	2013
	(In Thousands)	
<i>Operating Activities</i>		
Operating income	\$ 2,429	\$ 751
Change in temporarily restricted net assets	743	4,496
	<u>\$ 3,172</u>	<u>\$ 5,247</u>
Adjustments to reconcile change in net assets to cash provided by operations:		
Depreciation and amortization	22,541	18,856
Investment income earned on assets limited as to use	(774)	(698)
Changes in operating assets and liabilities:		
(Increase) decrease in receivables for patient care	(2,105)	7,589
(Increase) decrease in due from third-party reimbursement programs	(8,413)	4,500
Increase in accounts payable and accrued expenses and accrued salaries and related liabilities	9,654	1,412
Net effect of increases and decreases in other assets and liabilities	2,286	(8,707)
Cash provided by operations	<u>\$ 26,361</u>	<u>\$ 28,199</u>
<i>Investing Activities</i>		
Acquisitions of property, plant, and equipment, net	\$(10,043)	\$(12,998)
Less amounts provided by restricted funds	139	146
Increase in investments	(618)	(70)
Cash used in investing activities	<u>\$(10,522)</u>	<u>\$(12,922)</u>
<i>Financing Activities</i>		
Net payment from (to) affiliates	\$ 126	\$ (1,773)
Increase in deferred financing costs	(1,323)	
Repayments of long-term debt	(13,326)	(9,510)
Deposits into sinking fund, as required by mortgage loan agreement	(303)	
Increase in compensating balances for standby letters of credit	(1,923)	
(Increase) decrease in pledges receivable	(30)	(3,190)
Cash used in financing activities	<u>\$(16,779)</u>	<u>\$(14,473)</u>
Net (decrease) increase in cash and cash equivalents	\$ (940)	\$ 804
Cash and cash equivalents at beginning of year	9,005	8,201
Cash and cash equivalents at end of year	<u>\$ 8,065</u>	<u>\$ 9,005</u>

See accompanying notes.

## Notes to Financial Statements

### 1. Organization and Summary of Significant Accounting Policies

#### Organization

Major Medical Center (the "Medical Center") is a not-for-profit corporation. The Medical Center provides health care and related services. The accompanying financial statements do not include the accounts of the Research Foundation, a not-for-profit corporation that solicits funds and awards grants to the Medical Center for research purposes, nor for Hospital Support, Inc., which provides certain support services.

#### Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose. Permanently restricted net assets