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CASE 3: Charitable Contributions and Debt: A Comparison of St. Jude Children's Research Hospital/ALSAC and Universal Health Services

CASE TOPICS OUTLINE

- 1. St. Jude Children's Research Hospital/ALSAC
  - A. Primary Objective
  - B. Sources of Capital
  - C. Reporting Practices
- 2. Universal Health Services
  - A. Investor-Owned Hospital
  - B. Debt Including Leases
- 3. Comparison

Hospitals are an industry in which both not-for-profits and investor-owned facilities operate. The sources of capital available to the not-for-profits include charitable contributions and debt offerings—unless they are governmental, in which case, higher taxes are also an alternative. Debt availability is always, in part, a function of performance, and just as failures have arisen in both sectors, about one-third of the investor-owned hospitals have been described as losing money. Of interest is how can one effectively evaluate such an industry, with this type of diversity in organizational forms and capital availability? A necessary prerequisite to such an evaluation is to have a firm understanding of how charitable contributions are presented.

St. Jude Children's Research Hospital/ALSAC has the mission of finding cures for children with catastrophic diseases through research and treatment. For the fiscal year 1999, this entity reported total assets of $221,664,232 and income of $177,071,890. A Web site at http://www.stjude.org, as well as Guidestar's listing, references a Form 990 (Return of Organization Exempt from Income Tax) filing, availability of audited financial statements upon request, and information that the hospital has 2,100 employees and 350 volunteers. Founded in 1962, the organization seeks funds from contributions and grants for unrestricted operating expenses, specific projects, buildings, and endowments. More than 4,000 patients are seen annually, with a hospital maintaining 56 beds. The Form 990, Part III states that the hospital provided 15,231 inpatient days of care during the fiscal year and patients made 40,982 clinic visits. ALSAC is the American Lebanese Syrian Associated Charities, Inc., the fund-raising arm of St. Jude Children's Research Hospital. It reported 1999 total assets of $1,007,699,320 and income of $274,123,399. This organization reports the number of employees as 565 and the number of volunteers as 800,000. With its sole focus on the hospital, ALSAC's self-description explains that no child has ever been turned away due to an inability to pay for treatment and explains key accomplishments in the research area achieved by St. Jude's research and treatment of children with catastrophic diseases. What is borne out by the example of St. Jude is the fact that a review of the Form 990 filed for the fiscal year ending 6/30/99 indicates in Part VI the names of related organizations: ALSAC and St. Jude Hospital Foundation, both of which are tax exempt. To gain a sense of capital availability to a not-for-profit entity, affiliated entities must be considered. In addition, the role of volunteers is a source of human capital not effectively captured within the framework of financial statements for not-for-profits, as reflected in the Form 990 for the fiscal year ending 6/30/99 for ALSAC, which states in Part VI:

Unpaid volunteers have made significant contributions of their time, principally in fund-raising activities. The value of these services is not recognized in the financial statements since it is not susceptible to an objective measurement or valuation and because the activities of these volunteers are not subject to the operating supervision and control present in an employer/employee relationship.

Hence, as one evaluates capital sources and uses by not-for-profits, care is needed to consider affiliated organizations' role, total contributions, and the effect of volunteerism on the comparability between not-for-profit and investor-owned operations.

Universal Health Services, Inc. filed its 10-K on March 28, 2001, for the calendar year 2000, which includes comparative information for 1999. Analysts have described the company as the most aggressive company in the industry over the 1999–2001 time frame in making acquisitions, particularly of not-for-profit operations and investor-owned operations experiencing losses. The company is praised for it high operating leverage, the relatively small number of shareholders relative to the magnitude of total revenue, and stock price as a multiple of earnings. The company operates 59 hospitals and, as of 1999, had an average number of licensed beds of 4,806 at acute care hospitals and 1,976 at behavioral health centers, with patient days of 963,842 and 444,632, respectively. Of interest is a commentary on the competition found in the company's filing:

Competition

In all geographical areas in which the Company operates, there are other hospitals which provide services comparable to those offered by the Company's hospitals, some of which are owned by governmental agencies and supported by tax revenues, and others of which are owned by nonprofit corporations and may be supported to a large extent by endowments and charitable contributions. Such support is not available to the Company's hospitals. Certain of the Company's competitors have greater financial resources, are better equipped and offer a broader range of services than the Company. Outpatient treatment and diagnostic facilities, outpatient surgical centers and freestanding ambulatory surgical centers also impact the healthcare marketplace. In recent years, competition among healthcare providers for patients has intensified as hospital occupancy rates in the United States have declined due to, among other things, regulatory and technological changes, increasing use of managed care payment systems, cost containment pressures, a shift toward outpatient treatment and an increasing supply of physicians. The Company's strategies are designed, and management believes that its facilities are positioned, to be competitive under these changing circumstances. *(Source: 10-K filed 3/28/2001)*

Financial information is provided in Tables 5.3-1 and 5.3-2 for both the not-for-profit and the investor-owned hospitals.

Table 5.3-1: Financial Comparisons of the Not-for-Profit Entities

Fiscal Year Ended 1999	*St. Jude Children's Research Hospital Form 990**	*American Lebanese Syrian Associated Charities, Inc. (ALSAC) Form 990**
Contributions, gifts, grants and similar amounts received: Direct public support	$91,978,426	$231,793,748
Indirect public support		2,906,934
Government contributions (grants)	31,469,447	
Program service revenue, including government fees and contracts (i.e., health insurance revenue)	46,034,710	
Accounts receivable	24,217,029	4,230,764
Pledges receivable		23,604,748
Allowance for doubtful accounts	9,363,328	
Program service expenses		99,282,906
Program service expenses: Research	87,225,830	
Program service expenses: Education and training	5,471,186	
Program service expenses: Medical Services	93,735,602	
Reconciliation of revenue, gains, and other support to audited numbers: net unrealized gains on investments	−4,023,815	65,891,269
Deferred grant revenue	1,857,628 (Statement 5)	

Fiscal Year Ended 1999	*St. Jude Children's Research Hospital Form 990*[*]	*American Lebanese Syrian Associated Charities, Inc. (ALSAC) Form 990*[*]
Support from American Lebanese Syrian Associated Charities, Inc.	91,978,426 (Statement 7)	91,978,426 (paid per Statements 4, 6)
Excluded contributions		2,746,295 (Statement 1)
Excess or (deficit) for the year	−10,933,191	120,521,982
Net assets or fund balances at end of year	199,707,440	994,501,910
Temporarily restricted		15,715,890
Permanently restricted	14,000,000	247,147,826
Total liabilities	21,956,792	7,017,192
Schedule of deferred debits & credits by contract (FAS 116 adjustment noted to result in this deferred revenue)	157,628	

*

The GuideStar.org Web site (http://www.guidestar.org) provides access to Forms 990 in .PDF format.

Table 5.3-2: Universal Health Services, Inc.'s Financial Excerpts[*]

Income Statements (in thousands)	*Reported 1999 Calendar Year*
Net revenues	$2,042,380
Operating charges	1,913,346
Components:	
Salaries, wages, and benefits	793,529

Income Statements (in thousands)	*Reported 1999 Calendar Year*
Provision for doubtful accounts	166,139
Lease and rental expense	49,029
Interest expense, net	26,872
Net income	77,775
Total assets	1,497,973
Total liabilities	856,362
Total retained earnings	482,960
Capital stock	306
Paid-in capital in excess of par	158,345

*

The 10-K filing as of 3/28/2001 at EDGAR (http://www.sec.gov/edgar.shtml) provides financial statement information for 2000 and 1999.

Requirement A: Recording Revenue

- 1. What is meant by the reference in Table 5.3-1 to an FAS 116 adjustment?
- 2. How are contributions recorded? Is there a distinction between pledges receivable and accounts receivable?
- 3. Are there circumstances when financial statements can quantify volunteers' services?
- 4. Can financial statement users of not-for-profit hospitals' financial statements expect to be fully informed regarding affiliated parties, such as the linkages between St. Jude Children's Research Hospital, ALSAC, and the foundation cited? Explain.

Requirement B: Revenue Mix (Strategy-Related Considerations)

The 10-K filing of Universal Health Services, Inc. describes the mix of revenue sources, as depicted in Table 5.3-3.

Table 5.3-3: Patient Revenue Mix

PERCENTAGE OF NET PATIENT REVENUES

	2000	***1999***	***1998***	***1997***	***1996***
Third Party Payors					
Medicare	32.3%	33.5%	34.3%	35.6%	35.6%
Medicaid	11.5%	12.6%	11.3%	14.5%	15.3%
Managed Care (HMOs and PPOs)	34.5%	31.5%	27.2%	19.1%	N/A
Other Sources	21.7%	22.4%	27.2%	30.8%	49.1%
Total	100%	100%	100%	100%	100%

N/A-Not available *(Source: 10-K filed 3/28/2001)*

- 1. How does this revenue mix compare with the revenue blend of the not-for-profit entity, St. Jude Children's Research Hospital (ALSAC)? Access the latest SEC filing and compare the reported revenue mix; has it changed?
- 2. What does that imply as to the strategies of investor-owned hospitals in managing risk and ensuring adequate capital relative to not-for-profit entities? An opportunity exists to explore the greater social and political questions that are frequently debated about the compatibility of profit-oriented entities and quality of health care, relative to not-for-profit entities. As background, identify what the latest SEC filings report concerning charity care.

Directed Self-Study

Access the 10-Q (from sec.gov) for the quarterly period ended June 30, 2006 and explain how Hurricane Katrina affected Universal Health Services. The same 10-Q reports on a funding commitment the company has made to the alma mater of the Chairman of the Board of Directors and Chief Executive Officer. Describe the disclosure and explain why the event is an "Other Related Party Transaction." [Download the 10-Q in text format and apply the Find capability in your word processor. Also access FARS and identify the guidance relevant to each event.]

Health Insurance, Public Policy, and Backdating

A key factor in the health care industry is health insurance. Public policy has debated universal health care, changes to governmental programs such as Medicare, adjustment of tax policy regarding employers' and employees' deduction for premiums, and alternative approaches to this sector of the economy. State and local governments, under a new accounting rule, have recently estimated their total retiree health bill to be about $1.1 trillion. Over the past decade, some governmental units used pension funds to help pay for double-digit growth in health care for retired public workers. Explain how accounting interacts with public policy. Use FARS as a resource, according particular attention to FAS 158.

Health insurer UnitedHealth has been the focus of media coverage involving what is known as the "options backdating scandal". UnitedHealth's internal probe estimates its past decade exposure at half a billion dollars ("UnitedHealth Faces Formal Probe," *Wall Street Journal*, December 27, 2006, p. B8). Is there a relationship between the magnitude of the restatement and the nature of the health care sector of the economy? Explain. The SEC's Division of Corporation Finance shared a "Sample Letter Sent in Response to Inquiries Related to Filing Restated Financial Statements for Errors in Accounting for Stock Option Grants" dated January 2007 (http://www.sec.gov/divisions/corpfin/guidance/oilgasltr012007.htm.) How helpful do you find such guidance?

Key Terms and Glossary

fund balance

> "refers … to a common group of assets and related liabilities within a not-for-profit organization and to the net amount of those assets and liabilities… . While some not-for-profit organizations may choose to classify assets and liabilities into fund groups, information about those groupings is not a necessary part of general purpose external financial reporting" (CON6, Footnote 45); fund balances may refer to such fund groups as operating, plant, endowment, and other funds (FAS 117, Par. 98).

permanent restriction

> "A donor-imposed restriction that stipulates that resources be maintained permanently but permits the organization to use up or expend part or all of the income (or other economic benefits) derived from the donated assets" (FAS 117, Par. 168). Information about permanent restrictions is useful in determining the extent to which an organization's net assets are not a source of cash for payments to present or prospective lenders, suppliers, or employees and thus are not expected to be directly available for providing services or paying creditors (FAS 117, Par. 98).

pledges

> receipts of promises to give

temporary restriction

> "A donor-imposed restriction that permits the donee organization to use up or expend the donated assets as specified and is satisfied either by the passage of time or by actions of the organization" (FAS 117, Par. 168). Separate line items may be reported within temporarily restricted net assets or in notes to financial statements to distinguish between temporary restrictions for (a) support of particular operating activities, (b) investment for a specified term, (c) use in a specified future period, or (d) acquisition of long-lived assets. Donors' temporary restrictions may require that resources be used in a later period or after a specified date (time restrictions), or that resources be used for a specified purpose (purpose restrictions), or both. For example, gifts of cash and other assets with stipulations that they be invested to provide a source of income for a specified term and that the income be used for a specified purpose are both time and purpose restricted. Those gifts often are called *term endowments* (FAS 117, Par. 15).