Statutory Issue Paper No. 101

Health Care Delivery Assets—Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities

STATUS
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Original SSAP and Current Authoritative Guidance: SSAP No. 73

Type of Issue:
Health Entities

SUMMARY OF ISSUE

1. This issue paper applies only to reporting entities which directly provide health care services to subscribers, members or policyholders. Such providers acquire and retain assets not directly addressed in current statutory guidelines. These assets commonly referred to as "health care delivery assets", are assets used in connection with the direct delivery of health care services in facilities owned or operated by the reporting entity and include furniture, medical equipment and fixtures and leasehold improvements.

2. Furniture, medical equipment and fixtures used in connection with the direct provision of health care services include diagnostic equipment, laboratory equipment, patient monitoring equipment, hospital beds, examining tables, and operating room equipment.

3. The purpose of this issue paper is to establish statutory accounting principles for health care delivery assets - furniture, medical equipment and fixtures and leasehold improvements in health care facilities that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

4. Furniture, medical equipment and fixtures, and leasehold improvements in health care facilities owned or operated by the reporting entity meet the definition of assets established in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4). Furniture, medical equipment and fixtures, and leasehold improvements held by health reporting entities and used for the direct delivery of health care services are admitted assets to the extent that they conform to the requirements of this issue paper. Furniture, fixtures and equipment, and leasehold improvements which are not used in the direct delivery of health care (e.g., for administrative activities including claims processing, billing, and maintenance of medical records) are nonadmitted assets and are addressed in *Issue Paper No. 19—Furniture, Fixtures, and Equipment* and *Issue Paper No. 31—Leasehold Improvements Paid by the Reporting Entity as Lessee*, respectively.

5. These assets shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining life of the original lease excluding renewal or option periods, using methods detailed in *Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements*.

6. In accordance with the reporting entity's capitalization policy, immaterial amounts of furniture, medical equipment and fixtures, and leasehold improvements may be expensed when purchased.

DISCUSSION

7. Furniture, medical equipment and fixtures and leasehold improvements in health care facilities owned or operated by the reporting entity used in the direct delivery of health care are admitted assets as defined in this issue paper because they are used to fulfill benefit requirements.

8. The AICPA Audit and Accounting Guide: Health Care Organizations is rejected in *Issue Paper No. 100—Health Care Delivery Assets – Supplies, Pharmaceuticals and Surgical Supplies, and Durable Medical Equipment*.

9. The statutory accounting principles established in this issue paper are consistent with the recognition concept in the Statement of Concepts which states:

> The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise's ability to maintain itself as a going concern. Accordingly, the income statement is a secondary focus of statutory accounting and should not be diminished in importance to the extent contemplated by a liquidation basis of accounting.
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> The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

Drafting Notes/Comments

- Land and building, including health care facilities, are addressed in *Issue Paper No. 23—Property Occupied by the Company*.
- Electronic Data Processing Equipment and Software are addressed in *Issue Paper No. 16—Electronic Data Processing Equipment and Software*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

10. The Accounting Practices and Procedures Manual for Health Maintenance Organizations (Chapter 5, *Other Admitted Assets*) states:

> INVESTMENTS INVOLVING EQUIPMENT
>
> The statutory method of accounting for equipment arrangements is governed largely by the form of the agreement to which the HMO is a party.

11. The Accounting Practices and Procedures Manual for Health Maintenance Organizations (Chapter 6, *Nonadmitted Assets*) states:

> COMMON EXAMPLES
>
> Some examples of assets which are non-admitted due to either an uncertainty as to their collectibility or an insufficient basis for determining their valuation or for other reasons are:
>
> (6) net book value of equipment and furniture (except certain electronic data processing equipment and medical equipment)

12. The Health Maintenance Organization Model Act, dated July 1995 states the following:

Section 5. Powers of Health Maintenance Organizations

A. The powers of a health maintenance organization include, but are not limited to, the following:

(1) The purchase, lease, construction, renovation, operation or maintenance of hospitals, medical facilities, or both, and their ancillary equipment, and property reasonably required for its principal office or for purposes necessary to the transaction of the business of the organization;

Section 12. Investments

With the exception of investments made in accordance with Section 5A(1), the funds of a health maintenance organization shall be invested only in accordance with [cite section of law or regulation implementing the NAIC Health Maintenance Organization Investment Guidelines.]

Generally Accepted Accounting Principles

13. The AICPA Audit and Accounting Guide: Health Care Organizations states the following:

6.01. Health care organizations use various types of property and equipment. Those assets may be material to the financial position of institutional health organizations, such as hospitals and nursing homes. Typical accounts used to record property and equipment transactions are land, land improvements, buildings and improvements, leasehold improvements, equipment (fixed and movable), leased property and equipment, accumulated depreciation and amortization, and construction in progress.

6.04. Accounting for property and equipment, supplies, and other assets of health care organizations is similar to that used by other business organizations.

6.05. Depreciation and amortization of property and equipment are recorded in conformity with GAAP. Useful lives assigned to depreciable assets should be reasonable, based on the circumstances. The American Hospital Association publishes useful guidelines for classifications and estimated useful lives for property and equipment used by hospitals. Those guidelines also may be useful to other health care organizations. If there is a potential that an asset is impaired, health care organizations should consider the guidance in *FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of.*

Other Sources of Information

14. The NAIC Survey on State Practice Regarding Admissibility of Health Care Delivery Assets dated January 1996 conducted by the Risk Based Capital Task Force surveyed the state insurance departments that regulate HMOs to determine if and to what degree that they allow HMOs to admit health care delivery assets. Responses from 38 state insurance departments indicated that the vast majority admit such assets at book value. A number of state insurance departments noted that they do place varying limits on the amount of certain health care delivery assets that can be admitted. However, none of the respondent states indicated that they did not admit such assets.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- The Accounting Practices and Procedures Manual for Health Maintenance Organizations, Chapter 5, *Other Admitted Assets* and Chapter 6, *Nonadmitted Assets*
- Health Maintenance Organization Model Act, dated July 1995
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*

- *Issue Paper No. 16—Electronic Data Processing Equipment and Software*
- *Issue Paper No. 19—Furniture, Fixtures and Equipment*
- *Issue Paper No. 23—Property Occupied by the Company*
- *Issue Paper No. 31—Leasehold Improvements Paid by the Reporting Entity as Lessee*
- *Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements*

Generally Accepted Accounting Principles

- The AICPA Audit and Accounting Guide: Health Care Organizations

State Regulations

- No additional guidance obtained from state statutes or regulations.

Other Sources of Information

- NAIC Survey on State Practice Regarding Admissibility of Health Care Delivery Assets dated January 1996
- American Academy of Actuaries Report on Simplification of the Health Risk-Based Capital Formula dated June 1996