



Audited Financial Statements Best Demonstrate a Hospital's Actual Financial Status

Audited financial statements are uniformly recognized as the best illustration of a hospital's financial performance. These statements are used by financial institutions as the "gold standard" of reporting on which lending, bond ratings, and other market decisions are based. Other documents sometimes cited by those unfamiliar with health care are meant for different purposes and can lead to false conclusions. For example, the Internal Revenue Service (IRS) Form 990 has the sole purpose of reporting to the federal government selected information to support a hospital's tax-exempt status. Also, Medicare Cost Reports are used for determining government payment rates and funding programs, not assessing a hospital's finances.

- There are fundamental differences in the reporting frameworks for these different documents:
 - The IRS Form 990 use a blend of U.S. Generally Accepted Accounting Principles (GAAP) and tax-basis accounting.
 - Audited Financial Statements use U.S. GAAP standards.
 - Medicare Cost Reports use a blend of U.S. GAAP and Medicare-specific cost determination rules.

Revenue and expenses per audited financial statements will typically differ from the total revenue and expenses per the IRS Form 990 and Medicare Cost Reports. There are several reasons why this may occur:

- Under GAAP, donated services are considered a contribution *and* an expense and are meant to be included in the calculation of net income; however, the IRS excludes donated services from its revenue and expense total.
- Unrealized gains and losses on investments flow through audited financial statements. However, the IRS excludes these from the income statement on the Form 990. Asset values revised in accordance with GAAP on audited financial statements may vastly differ from information on the Form 990. For example, a Form 990 may reflect the full value of a hospital (the actual value of the physical asset) if it becomes part of a health system. This may look like a large "profit" to a layperson, even though that hospital could be incurring operating losses. An organization's Form 990 will not show debts or information concerning its subsidiary organizations and related operations.
- Example: Finances for a physician group that is a critical part of a hospital organization will not appear on an IRS Form 990, whereas the audited financial statements will include such an impact on the organization's overall financial performance. These affiliated physician groups in Indiana often incur substantial losses and are subsidized by hospitals, but this will not be reflected on the IRS 990.
- Similar to the Form 990, financial information for physician groups or other subsidiaries will not appear on the Medicare Cost Report. In addition, investment income is often reflected in the audited financial statements through the inclusion of income and expenses of the organization's core entity and is not reflected on a Cost Report. This may significantly overstate operating income on the Cost Report because investment income is eliminated from total net income when determining operating income. If the investment income is not separately identified, it cannot be properly excluded for determination of operating income.

It is important to note that the use of audited financial statements is recognized in Indiana state law as the primary indicator of hospital's financial picture for the public. Pursuant to IC 16-21-6-3, the Indiana State Department of Health (ISDH) requires that hospitals must submit a fiscal report, and such report "*must be provided from reports or audits certified by an independent certified public accountant or by the state board of accounts*".

Key Takeaway:

The Form 990 serves a legitimate purpose of proving NFP compliance with the IRS; it does not, and was never intended to, provide an accurate and comprehensive description of an organization's financial performance. The same is true for Medicare Cost Reports, which were created for use in government payment policy. Even small hospitals are often complex organizations with many variables. Indiana state law recognizes the importance of audited financial statements through requirements established under IC 16-21-6-3, and a hospital's financial story is best told through audited financial statements.

NOTE: Indiana's investor-owned hospitals file a Form 10-K with the US Securities and Exchange Commission. The annual report on Form 10-K provides a comprehensive overview of the company's business and financial condition and includes audited financial statements.