

1301 Connecticut Avenue NW Suite 300 Washington, DC 20036-1837 Telephone 202.296.2920 Letter of Comment No: 26 File Reference: 1082-194R Date Received: 5/25/99

May 20, 1999

Edmund L. Jenkins Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Subject: File 194-B, Exposure Draft, Consolidated Financial Statements: Purpose and

Policy

Dear Mr. Jenkins:

The Healthcare Financial Management Association (HFMA) appreciates this opportunity to comment on the exposure draft of the proposed statement of the Financial Accounting Standards Board (FASB), Consolidated Financial Statements: Purpose and Policy.

HFMA is a professional organization of more than 35,000 individuals involved in various aspects of healthcare financial management. In 1975, HFMA recognized the need to establish a special group of expert members within HFMA to serve as the primary advisory group in the areas of accounting principles and financial reporting practices. This group, HFMA's Principles and Practices Board, was instrumental in the development of this comment letter.

HFMA has continually strived for consistency in accounting and financial reporting. The healthcare industry is composed of for-profit, not-for-profit, and governmental entities. These entities compete, not only for market share, but also for investment capital. The investor, with limited capital, has the option of purchasing stock in a for-profit company; corporate taxable bonds of a for-profit company; or tax-exempt bonds of a not-for-profit or governmental entity. The investor must continually weigh the returns against the risks in determining the type of investment to make. The vendor must also make the same consideration when issuing credit in return for goods and services.

In the for-profit industry, the issuance of stock provides a numeric value as an indication of ownership. To a large extent, the stock provides a basic guideline for considerations of consolidations. The not-for-profit industry does not have stock ownership. Therefore, the issues of control are more difficult to identify. The comments provided can be encountered in the not-for-profit healthcare industry. HFMA requests that FASB consider these issues in drafting a final statement which meets the needs of both the for-profit and not-for-profit industry. In addition, to the extent this information can be shared

معصر إليانا

and considered for governmental reporting, it would be appreciated.

Control of Subsidiary

As explained by FASB in paragraph 10, the definition of control involves two essential characteristics:

- 1. the parent has the ability to make the decisions that guide the ongoing activities of another entity; and
- 2. the parent has the ability to increase the benefits that it derives and limit the losses that it suffers from the ongoing activities of a subsidiary.

In the not-for-profit industry, the first characteristic is usually present when the parent is the sole corporate member of another corporation and/or has the power to appoint the majority of the board members of another corporation. This raises several questions as to whether the first characteristic is met if the parent does not appoint the majority of the board of the subsidary. HFMA has outlined several scenarios:

- (a) If one organization (parent) is the sole corporate member of another corporation (subsidiary), the parent usually is entitled to elect the board of the subsidiary. However, it is possible that sole corprate membership does not carry the right to appoint the board of the subsidiary. In such a situation, is the first element of control being met? Absent other indications of control, HFMA would conclude that the first characteristic is not met.
- (b) Is the first characteristic of control met in a situation where a parent nominates the board of another entity, but the other entity's board has to approve the nomination and elect the directors? HFMA would conclude that this constitutes effective control.
- (c) A hospital foundation's bylaws and articles state that the foundation's purpose is to support the hospital, but the hospital is neither the sole corporate member of the foundation nor appoints its directors. HFMA believes the first characteristic of control is not met.
- (d) In reference to Example 6 (page 45) in the exposure draft (ED), if the new foundation's board is initially elected by the university, and subsequently by the foundation's board, and the foundation's board does not and is not required to include board or management members of the university, and the university does not have control over the foundation's bylaws and articles, is control present? HFMA does not believe so, because the university cannot control the foundation's activities or use of assets.

The second characteristic of control may be met if the parent can transfer funds from a subsidiary to itself and/or is the beneficiary of the subsidiary's residual net assets. Some issues that may arise are the following:

- (a) In some states there are restrictions on the amount of funds that one not-forprofit entity can transfer to another. If under state law the subsidiary is not able to transfer funds to its parent, but the parent is entitled to receive residual net assets upon dissolution of the subsidiary (although dissolution is not planned and may not happen in the forseeable future), is the second characteristic of control met? HFMA believes it is.
- (b) If the parent can not transfer funds from the subsidiary to itself and is not the beneficiary of the residual net assets of the subsidiary, HFMA believes that the parent would not control the subsidiary because the second control characteristic is not met.
- (c) A not-for-profit organization may appoint the board members and/or be the sole corporate member of a HUD-financed project (HUD-financed projects usually are separately incorporated legal entities). The first characteristic of control is met because the parent appoints the board of the subsidiary. However, under the HUD rules and regulations, HUD typically has to approve all payments made by the HUD entity to the parent, even if they are payments of management fees provided by the parent for administrative services. HUD also typically has approval over rental fees and other management issues. Is the second characteristic of control met with respect to a HUD entity? Can an argument be made that the HUD entity carries on a function consistent with the mission of the parent, and therefore the second control characteristic is met? In what circumstances would FASB conclude that the parent has control (e.g., the parent has the right to the HUD entity's residual assets)? HFMA requests that the final statement clarify these types of issues.
- (d) If a parent cannot transfer funds from the subsidiary and has no residual interest, but the subsidiary carries out an operation or function that fulfills the parent's mission (e.g., the subsidiary operates a community benefit clinic and occasionally receives subsidies from the parent), is the second characteristic met? HFMA believes it is, based on paragraph 7 of the ED.

<u>Difference between exposure drafts</u>

HFMA is requesting that FASB clarify the apparent differences between the consolidation ED and the ED on *Transfers of Assets Involving a Not-For-Profit Organization That Raises or Holds Contributions for Others*. For example, the "Transfers" ED specifies that under certain circumstances (a hospital that is the beneficiary of funds held by a controlled foundation), the parent (hospital) would record its interest in the foundation using the equity method of accounting. Under the consolidation ED, the foundation would be consolidated if the control characteristics are met. HFMA would conclude that the foundation should be consolidated if the control characteristics are met, and if those characteristics are not met, the "Transfers" statement would apply. HFMA believes that this is not clear from the EDs.

Thank you for the opportunity to comment. We welcome the opportunity to meet with you, or members of your Board, to discuss this matter. Should you have any questions, please call Richard Gundling, FHFMA, CMA, Technical Director, at 202/296-2920.

Sincerely,

Richard L. Clarke, FHFMA

President and CEO

Cc: Timothy Lucas, Director of Research and Technical Activities