Re: Comment of UPMC Health System to Financial Accounting Standards Board Regarding Exposure Draft No. 194-B

Dear Sir:

Attached is a comment submitted on behalf of UPMC Health System to the Financial Accounting Standards Board regarding Exposure Draft No. 194-B (Consolidated Financial Statements: Purpose and Policy).

The comment, which is written from the perspective of one of the largest nonprofit integrated healthcare systems in the United States, focuses on the fundamental inappropriateness of the concept of "control" as that concept is applied to the nonprofit healthcare industry and to the charitable assets held by nonprofit healthcare entities. Briefly, the issues raised in the comment include:

- A true assessment of control in the nonprofit healthcare industry may be better achieved by analyzing the nature of the reserved powers held by the corporate member of related healthcare entities, as well as statutory membership rights which that parent organization may hold as a matter of law. If a facts and circumstances test is ultimately needed in order to assess control between two nonprofit healthcare entities, the test should be set forth in a FASB statement that is, at a minimum, drafted solely to the nonprofit community (but perhaps more specifically drafted solely to the nonprofit healthcare industry) and that considers the unique aspects of nonprofit corporate operations and governance.

In the comment, any reference to the term "nonprofit" means the type of organization which is organized under the relevant state nonprofit corporation law, which is exempt from state and federal income taxes, and which is generally referred to as a "charitable" organization.
• The application of charitable trust principles to the assets held by nonprofit healthcare organizations may effectively preclude a parent healthcare organization from having the ability to use its power to increase the benefits and limit the losses from the activities of a subsidiary.

• The Exposure Draft's definition of "control" may not be attainable by certain nonprofit healthcare entities due to the power of state attorneys general over charitable assets which, in certain jurisdictions, extends beyond mere "protective rights" and effectively places the interests of the community ahead of the parent's interest in increasing its financial benefits and limiting its losses.

• When the affiliation of healthcare entities includes a religiously affiliated subsidiary, the existence of a governance structure which allows for proper canonical sponsorship of the subsidiary may inappropriately preclude the secular, nonprofit parent from having sufficient "control" over the subsidiary to permit consolidated financial reporting under the Exposure Draft.

• Certain risks to nonprofit organizations and others may surface if the Exposure Draft is applied to nonprofit organizations. Those risks include the preparation of less meaningful financial statements due to oversimplification of "control" analysis, the pursuit of inappropriate financial reporting goals, the creation of confusion for creditors, bondholders, board members, and the community by necessitating a significant financial reporting change when no structural change has been effected, and confusion regarding whether financial integration for antitrust purposes exists.

• The FASB may wish to consider: incorporating a grandfather provision; creating a strong distinction between nonprofit and for-profit financial reporting requirements (for example, relying on a control assessment that focuses primarily on reserved powers and statutory membership rights rather than voting rights); adopting new accounting principles only after careful analysis of significant issues specifically affecting the healthcare industry (and possibly including a statement by the FASB that purports to disavow any effect of new consolidation principles beyond financial accounting); and considering financial disclosure in lieu of unconsolidated financial reporting.
We appreciate the opportunity to submit this comment on behalf of UPMC Health System for consideration by the FASB. Further information or clarification on the issues presented will gladly be provided by Thomas E. Boyle, Esq. (412-562-8823) or Janice M. Smith, CPA, Esq. (412-562-8940) of Buchanan Ingersoll Professional Corporation, or George A. Huber, Esq., General Counsel of UPMC Health System (412-647-8470).

Very truly yours,

Thomas E. Boyle

Enclosure

cc: George A. Huber, Esq.
    Janice M. Smith, CPA, Esq.
Comment of UPMC Health System
to
Financial Accounting Standards Board
Regarding Exposure Draft No. 194-B

CONSOLIDATED FINANCIAL STATEMENTS:
PURPOSE AND POLICY

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I. INTRODUCTION

This comment is being submitted by UPMC Health System ("UPMC") to the Financial Accounting Standards Board (the "FASB") to address certain issues raised by the Exposure Draft, entitled Consolidated Financial Statements: Purpose and Policy, released by the FASB on February 23, 1999 (the "Exposure Draft"). This comment focuses on the fundamental inappropriateness of the concept of "control" -- defined in the Exposure Draft as the ability of an entity to direct the policies and management that guide the ongoing activities of another entity so as to increase the controlling entity's benefits and limit its losses from that other entity's activities and involving decision-making ability that is not shared with others -- as that concept is applied to the nonprofit healthcare industry and to the charitable assets held by nonprofit healthcare entities. This comment is written from the perspective of one of the largest nonprofit integrated healthcare systems in the United States. UPMC is a healthcare system that was carefully structured to achieve full financial integration of component entities while maintaining some level of local governance at many hospital facilities in order to give the local community some

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1 In this comment, any reference to the term "nonprofit" means the type of organization which is organized under the relevant state nonprofit corporation law, which is exempt from state and federal income taxes, and which is generally referred to as a "charitable" organization.
voice in local healthcare operations to the extent consistent with the charitable mission of each entity.

Part II of this comment explores the structural complexities of nonprofit healthcare transactions and presents examples of the structural balance that a "parent" organization must achieve between attaining full financial integration of "subsidiary" entities and allowing the subsidiary entities (as each entity is most familiar with its own charitable mission) to assist in the fulfillment of their charitable missions. It explores the perceived shortcomings of the FASB's definition of "control" and concludes that a true assessment of control may be better achieved by analyzing the nature of the reserved powers held by the corporate member of related healthcare entities, as well as statutory membership rights which that parent organization may hold as a matter of law.

Part III of this comment explores the legal complexities of the nonprofit healthcare industry to demonstrate the general inapplicability of certain for-profit concepts to nonprofit transactions. A nonprofit healthcare organization can share "control" of a subsidiary entity and achieve financial integration to the fullest extent possible but potentially still fall short of the proposed definition of "control" as it is understood in the for-profit context. This is because nonprofit entities must contend with charitable trust issues, the far-reaching power of state attorneys general over charitable assets, and structural issues raised when, for example, canonical oversight of a subsidiary is present. For these reasons, attempting to force consolidated nonprofit organizations into for-profit models creates undue confusion and potentially places the nonprofit organization at odds with its charitable goals. Many of these nonprofit systems have been consolidated for financial reporting purposes for many years, notwithstanding the charitable trust
and attorney general oversight. The Exposure Draft would at least call into question the consolidated reporting for these long-standing nonprofit systems because of a failure to address clearly and adequately the realities of American nonprofit law and the unrealistic goal of mimicking the for-profit model.

Part IV of this comment sets forth the risks to nonprofit organizations and others that may surface if the Exposure Draft is applied to nonprofit healthcare organizations. Those risks include the preparation of less meaningful financial statements due to oversimplification of "control" analysis, the pursuit of inappropriate financial reporting goals, the creation of confusion for creditors, bondholders, board members, and the community by necessitating a significant financial reporting change when no structural change has been effected, and confusion regarding whether financial integration for antitrust purposes exists.

Part V of this comment sets forth certain recommendations and suggests some alternatives for consideration of the FASB, including the incorporation of a grandfather provision, the creation of a strong distinction between nonprofit and for-profit financial reporting requirements, adoption of new accounting principles only after careful analysis of significant issues specifically affecting the nonprofit healthcare industry, and consideration of financial disclosure in lieu of unconsolidated financial reporting.

II. STRUCTURAL COMPLEXITIES OF NONPROFIT HEALTHCARE TRANSACTIONS -- ATTAINING FULL FINANCIAL INTEGRATION WHILE FACILITATING ATTAINMENT OF CHARITABLE MISSION AND VALUES

A. UPMC -- A FULLY INTEGRATED HEALTHCARE SYSTEM

UPMC is one of the largest nonprofit integrated healthcare systems in the United States, and the leading integrated healthcare delivery system in western Pennsylvania. UPMC
has affiliated with numerous tertiary care, community, and specialty hospitals. It has carefully structured each transaction with the intention of creating a fully integrated healthcare system, and has achieved such full financial integration. Creditors, bondholders, board members, and the community at large have come to know UPMC as a fully integrated healthcare system -- from both an operational and a financial perspective.

The mission of UPMC is to provide premier programs in patient care, biomedical and health services research, and teaching that will contribute to the prevention, diagnosis, and treatment of human disease and disability. There are numerous stated values that guide UPMC in achieving its mission, including "to be responsive to the needs of individuals of all backgrounds and serve as a vital resource to the local community," while advancing its educational and research objectives.

B. METHODOLOGY ENGAGED IN ATTAINING A STRUCTURAL BALANCE

In effectuating the various mergers and affiliations which created the UPMC system, UPMC had to attain a structure with ultimate control over subsidiary entities in UPMC, while recognizing that each subsidiary entity (or "subcorporation") could play some role in governance that would ultimately facilitate attainment by the subcorporation of its unique charitable mission. In other words, each subcorporation within the UPMC system effectively must serve its community within the governance structure and boundaries established by the law and UPMC. This subcorporate independence within the broad bounds of the system is a key concept that has allowed UPMC to serve numerous diverse communities with wide community acceptance and is a relatively common approach in the nonprofit healthcare arena.
UPMC's policy with respect to hospital system mergers is based on three important principles. First, in order for the UPMC system to operate as an overall integrated unit, it must have a centralized authority which has power to initiate whenever necessary those key actions needed to assure consistency, efficiency and effectiveness of purpose among its various corporate entities. It placed this authority in the parent of the system, UPMC. Second, UPMC recognizes that it must exercise its initiation powers on a very limited and careful basis, and only when it is necessary to do so in the best interests of the system. UPMC appreciates the fact that the hospitals it acquires bring to the system a proud tradition of their own, and a highly capable board of directors, medical staff and administration which should not be micro-managed by UPMC. UPMC understands that subcorporate independence within the broad bounds of the system is an important motivational factor for attaining positive outcomes, and UPMC depends on the local hospital board to determine how the needs of the hospital's service community are best addressed. Some subcorporations have veto rights or joint decision-making authority on select issues such as medical staff composition. Third, a balanced relationship is maintained between the parent's authority and the subcorporation's independence, with articulated quality and financial outcome expectations.

When UPMC acquires a certain hospital facility, in order to effectuate a smooth transition, UPMC usually establishes some sort of "integration period" (perhaps three to five years after closing) in which both UPMC and the local hospital board are required to mutually agree before any changes can be made to the hospital's governing documents, corporate structure, mission statement, programs, services, medical staff, board composition and membership, hospital subsidiaries, and hiring of senior management. After the integration period, the UPMC
board has the authority to initiate or approve unilaterally such changes, but typically only after close consultation, collaboration and coordination with the hospital board of directors. The local hospital board is expected to significantly influence the UPMC board and to represent the community interest with respect to any action contemplated by UPMC.

C. HOW ATTAINMENT OF THE FULLEST POSSIBLE FINANCIAL INTEGRATION MAY STILL POTENTIALLY FALL SHORT OF THE EXPOSURE DRAFT’S DEFINITION OF CONTROL

Paragraph 10 of the Exposure Draft defines "control":

Control, as defined by this Statement, involves the presence of two essential characteristics: (a) a parent’s nonshared decision-making ability that enables it to guide the ongoing activities of its subsidiary and (b) a parent’s ability to use that power to increase the benefits it derives and limit the losses that it suffers from the activities of that subsidiary.

The Exposure Draft attempts to describe generalized situations that involve relationships between nonprofit entities and discuss whether they generally do or do not involve control of one entity by another entity. Paragraphs 54 to 58 of the Exposure Draft apply specifically to nonprofit corporations but appear to provide inadequate guidance to financial statement preparers, especially when considering such complex integrated healthcare structures as described above. Paragraph 56 provides in part:

If a nonprofit corporation is governed by an elected board of directors, whether it is a controlled entity usually depends on whether a single member or other entity has the right or ability to vote a majority or significant minority of the corporation’s voting rights.

Reliance solely on voting rights to determine control among nonprofit healthcare entities is inadequate. Rather, a true assessment of control may be better achieved by analyzing the nature of the reserved powers held by the corporate member of related healthcare entities, as
well as statutory membership rights which that parent organization may hold as a matter of law.\(^2\) With respect to UPMC, it is the careful structuring of high-level reserved powers that only UPMC can exercise that provides the basis for its control over subsidiaries and that allows the subcorporate independence within the broad bounds of the system. The FASB, however, should provide sufficient guidance to the nonprofit healthcare industry to allow preparers of financial statements sufficient discretion in analyzing control and to continue to conclude that adequate parent control exists to consolidate the relevant financial statements.

One example of recognition by an authoritative body of the absence of a traditional parent-subsidiary relationship in the nonprofit healthcare setting is the issuance by the Internal Revenue Service ("IRS") of certain guidance for the nonprofit healthcare industry that looks to "other explicit manifestations of control" such that the entities "are the equivalent of a parent and its subsidiary" in order to assess relatedness for purposes of federal tax exemption. See R. Darling and M. Friedlander, IRS Exempt Organizations CPE Technical Instruction Program for FY 1997, "Chapter J: Virtual Mergers--Hospital Joint Operating Agreement Affiliations," pp. 131-137 (the "CPE Text"). The CPE Text lists nine factors that, if present in a relationship between a "parent" corporation and its "subsidiary," would demonstrate significant control by the parent. Id. The list includes the authority to establish budgets, the authority to direct services, the authority to set or approve fees and prices, and the authority to buy assets for

\(^2\) If the structural relationship between two nonprofit entities is based on a membership model, generally the "parent" corporation would be the sole corporate member of the first tier "subsidiary" corporation. As a member, the parent is generally entitled to certain rights under the respective state's nonprofit corporation law. For example, under the Pennsylvania Nonprofit Corporation Law members have various rights and powers, including the right to adopt amendments to articles of incorporation (Section 5914(a)), the right to adopt a plan of merger or consolidation, (Section 5924(a)), the right to inspect certain books and records of the corporation (Section 5508(b)), and the power to adopt, amend and repeal the bylaws (Section 5504). Statutory membership rights vary in scope and are dictated by state law.
and sell assets of participating entities. *Id.* The list is not intended by the IRS (or for the purposes of this comment) to be exhaustive.

The FASB may consider devising its own list of factors indicative of control that would typically appear in the governing documents of the relevant entities as reserved powers, but may also appear in affiliation agreements or other contractual arrangements between entities, or may be vested in an entity by statute (statutory membership rights). The list could include those powers typically present in a control relationship between two nonprofit healthcare entities and would be considered by an auditor when assessing whether one nonprofit healthcare entity controls another for the purposes of consolidated financial reporting. Such powers may include approval of fundamental changes, approval of strategic plans, approval of borrowing and major expenditures, approval of senior management, approval of new services, and the like, even if they are shared to some degree between the parent and subsidiary.

UPMC stresses that the FASB should *not* implement the principles set forth in the current Exposure Draft, which are skewed to for-profit corporations, by merely permitting a "facts and circumstances" analysis of control by the accounting professional to adapt the principles to the nonprofit healthcare industry. As to nonprofit healthcare corporations, implementation of the Exposure Draft principles under a facts and circumstances test would be fundamentally inappropriate. A nonprofit entity is philosophically so different from a for-profit entity, that any attempt to adapt principles that were drafted specifically for for-profit corporations will most surely fall short of recognizing all of the relevant factors that are necessary in order to equitably treat nonprofit corporations for purposes of financial reporting. Therefore, if a facts and circumstances test is ultimately needed in order to assess control
between two nonprofit healthcare entities, the test should be set forth in a FASB statement that is, at a minimum, drafted solely to the nonprofit community (but perhaps more specifically drafted solely to the nonprofit healthcare industry) and that considers the unique aspects of nonprofit corporate operations and governance. Ideally, the test should be structured (1) to take into account the unique characteristics of today's nonprofit healthcare affiliations and (2) to include the primary indicators of control in nonprofit healthcare entity affiliations that have historically been demonstrative of powerful ties between nonprofit entities.

D. FULL FINANCIAL INTEGRATION, NOTWITHSTANDING SOME LEVEL OF SHARED CONTROL, SHOULD NOT PRECLUDE FINANCIAL CONSOLIDATION UNDER THE CIRCUMSTANCES

When nonprofit healthcare organizations utilize the concept of subcorporate independence within the broad bounds of the system it is simply unclear as to whether an interpreter of the Exposure Draft would find that the parent has control or not in light of the guidance given by the Exposure Draft. Adoption of the Exposure Draft, in light of this uncertainty, is strongly discouraged. There clearly can be some level of shared control between two nonprofit healthcare entities with full financial integration of the entities. UPMC and many other nonprofit healthcare systems have demonstrated this. UPMC strongly desires to preclude the adoption of any accounting principles for the nonprofit healthcare industry that do not adequately analyze control and the unique structures within which it can be maintained.

It is noted that complete, nonshared control may not even be attainable when healthcare affiliations of a large magnitude take place because it simply would not be prudent to overlook the significant role that each subsidiary corporation can play in facilitating attainment of the subsidiary's charitable mission, especially when the parent organization is not located
within the specific community served by the hospital facility. Allowing a local governing board some say in certain matters in order to retain the proper community focus does not weaken full financial integration as long as any local board power must be exercised within established parameters.

Thus, UPMC asserts that requiring nonshared control by a parent corporation over a subsidiary in order to report on a consolidated basis is a gross oversimplification and may simply not even be attainable. Rather, analyzing the extent of the control that one nonprofit healthcare entity has over another would achieve financial reporting that is consistent with the nonprofit healthcare industry and that is consistent the nature of the relationship as it was structured.

III. LEGAL COMPLEXITIES OF THE NONPROFIT HEALTHCARE OPERATIONS -- INAPPROPRIATENESS OF DEFINING FULL FINANCIAL INTEGRATION OF NONPROFIT ENTITIES BY FOR-PROFIT CONCEPT OF "CONTROL"

A. GENERAL

The indicia or evidence of control (nonshared decision-making ability), as well as the results of such control (ability to use that power to increase benefits and limit losses), as described in the Exposure Draft, may not be achievable for certain nonprofit organizations due to the legal environment within which nonprofit healthcare entities must operate. Some aspects of that legal environment of nonprofit healthcare organizations, which may preclude achievement of full financial integration (as defined in the for-profit world), are described below.
B. CHARITABLE TRUST ISSUES

The application of charitable trust principles to the assets held by nonprofit healthcare organizations may effectively preclude a parent healthcare organization from having the ability to use its power to increase the benefits and limit the losses from the activities of a subsidiary.

Paragraph 57 of the Exposure Draft appears to contain certain indicia of control that may be inconsistent with charitable trust law. Paragraph 57 provides in part:

To control a nonprofit corporation, the holder of a "controlling" voting right must also have either the means to increase its benefits and limit its losses through the decision-making powers that stem from that voting right or a right to share in the corporation's net assets upon dissolution, which might stem from provisions in the controlled corporation's articles of incorporation. A controlling nonprofit corporation (parent) usually can benefit from its decision-making powers over a controlled nonprofit corporation (subsidiary) by directing its subsidiary to contribute assets to the parent or by directing the use of its subsidiary's assets in other ways that increase the parent's capacity to carry out its mission and provide needed goods and services to its beneficiaries. Other means of increasing benefits include opportunities to initiate actions that result in revenue enhancements or cost savings through synergies between the subsidiary and the parent or its affiliates (citation omitted). Moreover, if a nonprofit corporation controls another nonprofit corporation, it usually can direct the controlled nonprofit corporation to contribute or otherwise transfer assets to the controlling corporation (parent) or its nonprofit affiliates because that transfer of assets is directed at providing a public benefit.

Two specific issues within that description that may raise charitable trust issues are discussed below: (1) a nonprofit parent corporation may not be able to direct a nonprofit subsidiary to contribute certain assets to the parent, and (2) a nonprofit parent may not be able to initiate certain actions solely to produce revenue enhancements to the parent.
1. A NONPROFIT PARENT MAY NOT BE ABLE TO DIRECT A NONPROFIT SUBSIDIARY TO CONTRIBUTE ASSETS TO THE PARENT

In Pennsylvania, as in many other states, the charitable nature of the assets of a nonprofit corporation has been recognized in statute and case law. "[A]ll property held by a nonprofit corporation is held in trust to carry out its charitable purposes." In re Roxborough Memorial Hospital, O.C. No. 555 of 1997; 17 Fiduc. Rep. 2d 412, 423 (Pa. Phil. 1997). "All property held by a charitable nonprofit including the operating revenues, grants, donations, bequests, etc. generated therefrom, constitute property committed to charitable purposes." Id.

The Pennsylvania Nonprofit Corporation Law also recognizes the authority of a nonprofit corporation to take and hold trust property:

(a) General rule.--Every nonprofit corporation incorporated for a charitable purpose or purposes may take, receive and hold such real and personal property as may be given, devised to, or otherwise vested in such corporation, in trust, for the purpose or purposes set forth in its articles.

15 Pa.C.S.A. § 5547(a). Other states also recognize that charitable trust concepts apply to dealings involving nonprofit corporations. See, e.g., Holt v. College of Osteopathic Physicians & Surgeons, 40 Cal.Rptr. 244, 249 (Cal. 1964) (citations omitted) ("Rules governing charitable trusts ordinarily apply to charitable corporations.").

Generally, it is the state’s attorney general, by virtue of the parens patriae powers of his or her office, who is authorized to inquire into the status, activities and functioning of public charities. In Pennsylvania, the parens patriae powers were recognized at common law and have been affirmed by the courts of the Commonwealth. Commonwealth v. Barnes Foundation, 159 A.2d 500, 505 (Pa. 1960) (citations omitted).
Because of the charitable trust nature of nonprofit assets, and the oversight authority that rests with the attorney general, it is simply not clear as to whether a subsidiary nonprofit corporation would be able to contribute assets to a parent nonprofit corporation without, at a minimum, obtaining approval from the attorney general especially where an issue exists as to whether the subcorporation's assets are being diverted from their intended charitable purpose. Recently, the case of Allegheny Health, Education and Research Foundation ("AHERF") illustrates this point.

On July 21, 1998, AHERF, together with four of its other affiliates, i.e., Allegheny University of the Health Sciences, Allegheny University Medical Practices, Allegheny University Hospitals-East and Allegheny Hospitals, Centennial filed separate Chapter 11 bankruptcy petitions to reorganize their respective debts and business affairs. Certain AHERF affiliates not in Chapter 11 bankruptcy, however, became a target of creditors of the AHERF entities in bankruptcy. In October 1998, the Attorney General for the Commonwealth of Pennsylvania, acting in his capacity as parens patriae, moved for injunctive relief against the nonbankrupt entities to protect and preserve the charitable assets and missions of the nonbankrupt entities from the reach of AHERF's creditors. The Attorney General's office contended that AHERF's nonbankrupt hospitals were separate, nonprofit organizations and could not be utilized to benefit AHERF or its creditors. See Motion for Special Ex Parte Relief Pursuant to 42 Pa.R.C.P. No. 1531(a), In re Allegheny General Hospital, et al., No. _____ of 1998 (Pa. Ct. Common Pleas, Allegheny Co., Orphans' Ct. Div., 1998). Perhaps the fact that the issue has not yet been resolved indicates the uncertainty of the law and complexity of the issue regarding the contributing of assets by a nonprofit subsidiary to a nonprofit parent.
Another complicating factor in this issue of the contributing of assets by a nonprofit subsidiary to a nonprofit parent arises when charitable assets may be transferred out of the community or out of the state in which they were arguably intended for use. Some attorneys general may argue that charitable assets are held in a constructive trust for the benefit of the citizens of the community where the healthcare entity is located, especially if the community to be served is named in the governing instrument. See *Complaint for Declaratory Judgment, Butterworth v. Boca Raton Community Hospital, Inc.*, Case No. CL 96-10191AF (Fla. 15th Cir. Ct., Palm Beach County, 1996). In Paragraph 22 of that pleading, the attorney general asserted:

The original subscribers to Boca Raton Community Hospital, Inc. and the many benefactors of the Hospital intended through their gifts to establish a trust to operate a community based charitable hospital. Gifts or bequests to an organization engaged solely in charitable work, such as the Hospital, will usually be construed to be held in trust for that purpose. Accordingly, Boca Raton Community Hospital, Inc. holds its assets in a constructive trust for the benefit of the citizens of the community where the Hospital is located.

Therefore, if a parent nonprofit corporation is located in a different community, or perhaps is organized for different charitable purposes, than the subsidiary nonprofit corporation, challenges could be raised under charitable trust theories to any attempt by the subsidiary to transfer assets to the parent.

Another example of the difficulty that a parent corporation may have in directing a subsidiary to contribute assets to the parent arose when the Pittsburgh-based Sisters of Mercy desired to merge the East Coast hospital network of which they were a member and which included Holy Cross Hospital (of Fort Lauderdale, Florida) with other Catholic health systems. Subsequent to the announcement of the proposed merger, former trustees "asked state Attorney
General Bob Butterworth to block the nuns' plans as a violation of the community's best interests." See Bob LaMendola, *Sisters, Trustees Reach Agreement--Hospital's Assets Were at Issue*, SUN-SENTINEL, June 18, 1997, at 1B. As part of the argument, the former trustees asserted that the Sisters intended to transfer charitable assets out of the community. The Florida Attorney General never took action to block the merger or restructuring; however, the Sisters of Mercy (who had *never* intended to take assets out of the local community) wrote to Butterworth and stated their intention to maintain the charitable assets in Broward County. Perhaps in light of the fact that, in this particular circumstance, the former trustees made arguments about transfers of charitable assets to enlist hostile community reactions, which were then used to urge the attorney general to protect the "community's" interests in the charitable assets, one may conclude that no nonprofit healthcare parent corporation can possess the requisite level of control over the assets of its subsidiaries to enable it to report on a consolidated basis, as long as the attorney general located in the state of the subsidiary may have the capacity to preclude such transfer. UPMC would hope that the FASB did not intend to disrupt hundreds or thousands of financial statements of nonprofits across the country, but that could be an outcome if the Exposure Draft is not modified or clarified.

The legal doctrine of *cy pres* appears to be the underlying source of limitations on a parent as to the use of the assets of its subsidiary. The exercise of the *cy pres* power can be described as follows:

> Where property is given in trust for a particular charitable purpose, the trust will not ordinarily fail even though it is impossible to carry out the particular purpose. In such a case the court will ordinarily direct that the property be applied to a similar charitable purpose.
The doctrine has clearly been used to keep charitable assets available to a local community in a merger situation. In Massachusetts, if a Massachusetts charity wishes to merge into a non-Massachusetts entity, it first must go through dissolution and submit its assets to the court's application of the *cy pres* doctrine. Richard C. Allen, *Regulation of Public Charities and Fund-Raising*, at 105, (PLI New York Practice Skills Course Handbook Series No. 34, 1998).

Among other things, Charities Division (within the department of the Massachusetts Attorney General) considerations include:

- Will the merger result in a significant change of use of general, non-donated assets? Usually, the answer is "No" when two Massachusetts charities merge. However, for example, if the merger will result in a significant geographic change of use of assets, court approval may be prudent, if not mandatory. For example, many charities have been strongly supported financially by their local communities. If two such charities from different geographic areas were to merge, and if the result would be that assets accumulated over time with the support of one community would be transferred to a use in another community, court approval may be called for. See *Attorney General v. Hahnemann Hospital*, 397 Mass. 820, 836 (1986) (charity does not have unfettered discretion to apply funds to amended charitable purpose).

*Id.* In light of this application of the doctrine of *cy pres* in a merger setting, it appears that the doctrine can also be successfully asserted to preclude the free transfer of community assets of a subsidiary corporation to a parent corporation in a different geographic region.

It is noted that some tax-exempt bond financing documents now alert investors to the charitable trust issues that may arise when a parent organization must call upon subsidiary organizations to contribute toward payments under the terms of applicable loan agreements. A disclosure in the bond offering is sometimes made to the effect that:
The obligation described herein of SYSTEM to make payments of
debt service on the Bonds, and the obligation of SYSTEM to cause
SUBSIDIARIES to transfer funds to SYSTEM for the purpose of
making debt service payments on the Bonds, the proceeds of which
were not loaned or otherwise made available to or used for the
benefit of such SUBSIDIARIES, may not be enforceable to the
extent that (i) such payments will be made on an obligation issued
for a purpose that is not consistent with the charitable purposes of
the organization from which such payment or transfer is requested;
(ii) the transfer of funds from a SUBSIDIARY to provide for such
payment may contradict charitable trust principles, which vary
from jurisdiction to jurisdiction, applicable to such SUBSIDIARY;
(iii) such payments will be made from any property that is donor
restricted or that is subject to a direct or express trust that does not
permit the use of such property for such payments or transfers; (iv)
such payments would result in the cessation or discontinuation of
any material portion of the health care or related services
previously provided by the organization from which such payment
or transfer is requested; or (v) such payments would be construed
to be impermissible dividends. Due to the absence of clear legal
precedent in this area, the extent to which the property of any
SUBSIDIARY may be transferred as described above cannot be
determined and could be substantial.

Therefore, assessing the ability of a parent nonprofit corporation to direct
its nonprofit subsidiary to contribute assets to it or to direct the use of the subsidiary's assets in
other ways that increase the parent's capacity to carry out its mission may simply be an
unrealistic benchmark in an analysis of control of nonprofit healthcare entities.

2. A NONPROFIT PARENT MAY NOT BE ABLE TO INITIATE
CERTAIN ACTIONS SOLELY TO PRODUCE REVENUE
ENHANCEMENTS

a) REVENUE ENHANCEMENTS TO PARENT MAY BE
ANTITHETICAL TO CHARITABLE TRUST PRINCIPLES

The implication of nonprofit corporation assets being held in trust
is that it may restrict the holder of the assets to administer the assets in accordance with the
charitable trust without being dedicated to increasing benefits and limiting losses to a parent
entity. It is assumed that the terms "benefits" and "losses" as used in the Exposure Draft are based solely on some financial measurement. Charitable trust principles may not be so much concerned with financial success as with assuring that charitable assets are used for the stated charitable purposes. "The trustees of a charitable trust, like those of a private trust, are under a duty of loyalty; they must administer the trust solely with a view to the accomplishment of the purposes of the trust and not with a view to promoting their own interests." IVA AUSTIN WAKEMAN SCOTT AND WILLIAM FRANKLIN FRATCHER, SCOTT ON TRUSTS § 379 (4th ed. 1989).

Therefore, assessing the ability of a parent nonprofit corporation to initiate actions that result in revenue enhancements through synergies between the nonprofit subsidiary and the nonprofit parent may again be an unrealistic benchmark in an analysis of control of nonprofit healthcare entities.

b) REVENUE ENHANCEMENTS TO PARENT MAY BE ANTITHETICAL TO NATURE OF A NONPROFIT CHARITABLE ENTITY WHERE THE BENEFIT ALSO FLOWS FROM THE PARENT THROUGH THE SUBSIDIARY AND ULTIMATELY TO THE COMMUNITY

The language in the Exposure Draft dealing with initiation by a parent corporation of certain actions to produce revenue enhancements for the parent corporation may be antithetical to the nature of a nonprofit charitable entity. The focus of a nonprofit charitable corporation that functions as a parent typically is not solely on using a subsidiary to produce revenue enhancements. Rather, the opposite may apply. The parent nonprofit charitable corporation may bestow benefits (such as financial support and administrative support) "downward" to enable its subsidiary to benefit the charitable class it was established to serve. Thus, focusing so keenly on revenue production or avoidance of financial loss for the benefit of
the parent corporation does not make sense in the nonprofit healthcare setting because charitable
goals may be best served when benefits flow "downward" to a nonprofit subsidiary from a
nonprofit parent. In a typical, consolidated nonprofit healthcare system, the financial benefits
flow in both directions.

c) REVENUE ENHANCEMENTS TO PARENT MAY BE
ANTITHETICAL TO THE INTENDED STRUCTURE OF
NONPROFIT HEALTHCARE AFFILIATIONS

Nonprofit healthcare affiliations may be intentionally structured to
create a subsidiary that is a community asset. In other words, the primary goal of an affiliation
may be that the subsidiary benefit the community. Revenue enhancements to the parent are
clearly not the goal of every nonprofit healthcare affiliation, as evidenced by numerous nonprofit
healthcare acquisitions of failing community hospitals. Also, it is not uncommon in such
affiliations that there be some provision to the effect that, if the parent corporation converts to
for-profit status, or if the parent corporation decides to eliminate the asset because it can no
longer afford it, the subsidiary corporation may (upon certain conditions) revert back to local
community control. Thus, focusing intensely on revenue production for the benefit of the parent
corporation does not make sense in the nonprofit healthcare setting because benefiting the
community may be the intended goal of an affiliation rather than benefiting the parent
corporation.

C. POWER OF STATE ATTORNEYS GENERAL

The Exposure Draft's definition of "control" -- involving a parent's nonshared
decision-making ability and ability to use that power to increase benefits and limit losses from
the activities of a subsidiary -- may not be attainable by certain nonprofit healthcare entities due
to the power of state attorneys general over charitable assets which, in certain jurisdictions,
extends beyond mere "protective rights" and effectively places the interests of the community
ahead of the parent's interest in increasing its financial benefits and limiting its losses.

Paragraph 12 of the Exposure Draft helps describe circumstances wherein
decision-making ability is not shared:

A parent's decision-making ability often is constrained by laws,
regulations, corporate charters, shareholder and partnership
agreements, debt covenants, and other agreements that impose
limits to protect the interests of noncontrolling investors, creditors,
and others. However, protective rights, by themselves, generally
do not result in shared control or otherwise deny a parent's control
of its subsidiary.

Additional guidance provided in Paragraph 46 of the Exposure Draft attempts to
describe shared versus nonshared decision-making. Paragraph 46 provides in part:

A parent's nonshared decision-making power over its subsidiary is
similar to a parent's exclusionary power to regulate or deny others'
access to its assets. It is a particular entity's power that is not
shared with others but is limited to some degree by law,
regulations, fiduciary responsibilities, and the nature of its specific
assets. It enables a parent to regulate others' access to assets by
directing its subsidiary to (a) sell, lease, loan or otherwise make
specified assets available to others at prices determined by that
parent or (b) hold and invest specified assets.

Paragraph 47 of the Exposure Draft provides an example to be used as guidance in
determining whether control is shared or merely limited such that the definition of control is not
contravened:

For example, management of a majority-owned corporation in
bankruptcy or reorganization may have continuing responsibilities
for conducting its business activities, but that corporation is not
controlled by its majority owner when the decision-making powers
for the ongoing activities of that corporation are under the
supervision of and require the approval of a court-appointed
trustee. In those cases, the trustee's duties generally place the
interests of the corporation's creditors ahead of the majority owner's interest in increasing its benefits and limiting its losses.

Because of the broad power that the attorney general has over charitable assets, and the apparent trend across the country for attorneys general to exercise that power, it is unclear whether an interpreter of the Exposure Draft would find that the decision-making ability of a nonprofit parent corporation is "nonshared." A nonprofit parent may indeed be precluded from selling certain assets or otherwise making specified assets available to others at prices determined by the parent.

In Pennsylvania, the Office of the Attorney General has issued a "Review Protocol for Fundamental Change Transactions Affecting Health Care Nonprofits" (the "Protocol"). The underlying principle of the Protocol is stated as follows:

Whenever a nonprofit, charitable health care entity enters into a transaction effecting a fundamental corporate change which involves a transfer of ownership or control of charitable assets, regardless of the form of the transaction contemplated (i.e., sale, merger, consolidation, lease, option, conveyance, exchange, transfer, joint venture, affiliation, management agreement or collaboration arrangement, or other method of disposition); unless the transaction is in the usual and regular course of the nonprofit's activities; and regardless of whether the other party or parties to the transaction are a nonprofit, mutual benefit or for-profit organization; the Office of the Attorney General, as parens patriae, must review each transaction to ensure that the public interest in the charitable assets of the nonprofit organization is fully protected. Consequently, to review each transaction, the OAG must be provided relevant financial, corporate, and transactional information, in order to reach a decision on whether or not to object to or withhold objection to the proposed transaction. This decision will determine the Attorney General's position relative to Orphans' Court proceedings required in fundamental change transactions under the Nonprofit Corporations Law.

Numerous other states appear to be using similar criteria to govern fundamental changes in nonprofit organizations. One example is the state of Rhode Island, which may have
one of the toughest state laws dealing with the transfer of hospital charitable assets. One purpose of the Rhode Island Hospital Conversions Act is to clarify the jurisdiction and authority of the attorney general "to preserve and protect public and charitable assets in reviewing both hospital conversions which involve for profit corporations and hospital conversions which include only not for profit corporations." R.I. Gen. Laws § 23-17.14-3(5). The statute allows the attorney general to review any hospital transaction wherein 20 percent or greater of the charitable assets are transferred. R.I. Gen. Laws § 23-17.14-4(6). Modern Healthcare magazine reported on a hospital affiliation that was blocked by application of the Rhode Island statute:

Rhode Island's attorney general last week rejected an affiliation between Care New England of Providence, R.I., and Boston-based CareGroup, saying the deal surrenders the keys to the Rhode Island Provider Network's charitable vault.

But in blocking Care New England's border crossing into Massachusetts, Attorney General Jeffrey Pine said the three-hospital system was risking its assets by ceding governance control to a larger organization that is suffering sizable losses.

Pine said he didn't oppose the concept of a hospital system in the state mixing assets with an out-of-state partner, asserting he would rather leave the direction to local trustees. But he added, "I do believe that local entities . . . have to retain sufficient control to assure our state that the organizational purposes of the hospital are going to be furthered into the future."

John Morrissey, Modern Healthcare, Sept. 14, 1998, at 20. Conversion statutes, which have been enacted in many states, sometimes only govern conversion of nonprofit hospitals to for-profit status. Application of the Rhode Island statute, however, illustrates that the statutes can be quite intrusive upon certain decisions of nonprofit healthcare entities.
In light of the guidance given in the Exposure Draft, it is difficult to determine whether the attorney general power described above would be construed as merely "protective" or would be construed as akin to the power of a trustee in bankruptcy (as described in Paragraph 47 of the Exposure Draft). The oversight power of attorneys general over nonprofit healthcare transactions has become so pervasive in the healthcare industry that the issue should be addressed specifically in any accounting principles ultimately adopted.

D. STRUCTURAL ISSUES RAISED IN CIRCUMSTANCES OF RELIGIOUS CORPORATIONS

When the affiliation of healthcare entities includes a religiously-affiliated subsidiary, the existence of a governance structure which allows for proper canonical sponsorship of the subsidiary may inappropriately preclude the secular, nonprofit parent from having sufficient "control" over the subsidiary to permit consolidated financial reporting under the Exposure Draft.

As previously stated, Paragraph 10 of the Exposure Draft defines one characteristic of "control" as "a parent's nonshared decision-making ability that enables it to guide the ongoing activities of its subsidiary." Paragraph 45 of the Exposure Draft provides in part:

In the United States, noncontrolling shareholders, limited partners, creditors, and others typically have protective rights that enable them to block specific actions that might affect their interest in a parent's subsidiary. Those protective veto rights, however, generally do not enable them to initiate policies or share in a parent's decision making for the ongoing activities of its subsidiary.
This section raises an issue regarding control that may be shared by a nonprofit parent organization and the authority providing canonical sponsorship of a religiously-affiliated subsidiary. In other words, when a parent organization allegedly has control over a religiously-affiliated subsidiary, but that control must be exercised within certain canonical boundaries which the canonical steward oversees, does the alleged parent organization "control" the religiously-affiliated subsidiary such that it can report the financial information of the subsidiary on a consolidated basis consistent with the guidance in the Exposure Draft?

Here, it may be necessary to explore the purpose of consolidated financial statements, as set forth in Paragraph 1 of the Exposure Draft:

There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

A key focus in this statement of purpose may be who has the "controlling financial interest."

When the affiliation of healthcare entities includes a religiously-affiliated subsidiary, the governance structure established must allow for proper canonical sponsorship of the subsidiary. Usually this is accomplished by the retention of certain "reserved powers" by canonical stewards of a public juridic person. For example, if the apostolic work of a particular

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3 The term "canonical sponsorship" is defined as follows:

The reservation of civil law control over certain limited canonical areas by the public juridic person that founded and/or sustains an incorporated apostolate that remains canonically a part of the public juridic person. This retention of control need not be such as to create civil law liability on the part of the sponsor for corporate wrongs but should be sufficient, on the other hand, for the canonical stewards of the sponsoring religious institute or diocese to meet their canonical obligations of faith and administration in the activities of the incorporated apostolate.


4 The term "canonical steward" is defined as follows:
religious institute is a Catholic hospital, the governing documents of the civilly incorporated nonprofit hospital generally will vest certain reserved powers in the superior general and council of the religious institute.

The Exposure Draft does not analyze the issue of control in hypothetical situations wherein either a religiously-affiliated nonprofit parent or a secular nonprofit parent alleges "control" over a religiously-affiliated subsidiary. Paragraph 45 of the Exposure Draft provides in part:

In the United States, noncontrolling shareholders, limited partners, creditors, and others typically have protective rights that enable them to block specific actions that might affect their interest in a parent's subsidiary. Those protective veto rights, however, generally do not enable them to initiate policies or share in a parent's decision making for the ongoing activities of its subsidiary.

It is not clear, however, whether any control that a canonical steward may have over another entity could be deemed to be "protective veto rights" or something else. Because religious

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Person(s) charged by the canon law with managing the affairs of a public juridic person. Examples of canonical stewards and juridic persons are a bishop in a diocese, superior general and council in a religious institute, and provincial superior and council in a provincialate. In their oversight of the incorporated apostolates of juridic persons, it has been recommended that canonical stewards serve as corporate members with reserved corporate powers that parallel their canonical faith and administrative responsibilities; this position is referred to as a canonical administrator in the actual language of the code of canon law.


The term "public juridic person" is defined as follows:

An aggregate of persons or aggregate of things, constituted by operation of law or by an act of competent ecclesiastical authority as its own legal person, existing independently of other persons, endowed with its own rights and duties, which are fitting to its own nature; previously referred to as a moral person. Some examples of public juridic persons are religious institutes and the provinces of religious institutes, dioceses, and parishes; the public juridic person also encompasses incorporated apostolates sponsored by such ecclesiastical entities.

affiliations are common among nonprofit hospital entities, perhaps this issue should be specifically addressed in any guidance regarding accounting principles that deal with the issue of control in the nonprofit healthcare industry.

IV. POTENTIAL RISKS OF APPLICATION OF EXPOSURE DRAFT

A. LESS MEANINGFUL FINANCIAL STATEMENTS DUE TO OVERSIMPLIFICATION OF "CONTROL" ANALYSIS

As stated in Paragraph 8 of the Exposure Draft, consolidated financial statements are more meaningful to financial statement users "if one of the entities in the group of affiliates directly or indirectly controls the economic resources and activities of the other entities." Since "control" is the key to determining whether financial information should be consolidated, that term must be carefully defined. Assigning a definition to the term is not easy, especially when the definition attempts to suit both the nonprofit and the for-profit world.

While it may be true that assigning a narrow definition to "control" assists auditors in making judgments about the control structure of related entities, that term is not easily defined in the nonprofit healthcare industry. Reserved powers over subordinate entities may be held by entities at various levels of a corporate structure, and a true definition of control may lie in interpretation and analysis of those reserved powers, along with other indicia of control specific to the nonprofit healthcare industry.

B. PURSUIT OF INAPPROPRIATE FINANCIAL REPORTING GOALS

An additional concern raised by the language in the Exposure Draft is the focus on "international harmonization." Paragraph 192 of the Exposure Draft provides in part:

The Board concluded that this Statement not only improves the quality of consolidated financial statements but also is a positive step toward international harmonization. In many important respects, its definition of control, its requirement to include
controlled entities in consolidated financial statements, and its
description of the purpose of consolidated financial statements are
consistent with recent trends in other countries.

If the nonprofit healthcare industry does not have the involvement of foreign
affiliate entities that is experienced in the for-profit world, perhaps "international harmonization"
should not be a goal of consolidated financial reporting at this time for the nonprofit healthcare
industry in the United States.

C. CREATION OF UNDUE CONFUSION FOR CREDITORS, BONDHOLDERS,
BOARD MEMBERS, AND THE COMMUNITY AT LARGE

If nonprofit healthcare entities previously properly reported on a consolidated
basis, application of the Exposure Draft could create undue confusion for creditors, bondholders,
board members, and the community at large by necessitating a significant financial reporting
change when no structural change has been effectuated.

There could be confusion caused by implementation of the Exposure Draft if
certain nonprofit healthcare entities that currently report on a consolidated basis will no longer be
able to do so upon the effective date of the principles introduced in the Exposure Draft,
especially due to the fact that no structural change has taken place. The potential confusion will
most likely rest with the primary users of the financial statements -- creditors, bondholders, board
members, and the community at large. Several potential difficulties are noted below:

• Debt covenants could be violated and may be difficult to renegotiate, as a
  practical matter, because of the difficulty in getting majority consent of the bondholders.

• If there is a change from consolidated to combined financial statements due to
  changes in generally accepted accounting principles ("GAAP"), entities subject to the annual
  continuing disclosure requirements of Securities Exchange Act of 1934 Rule 15c2-12 (dealing
with municipal securities disclosure) may issue financial statements which are of limited use to investors. Also, in an interpretation of Rule 15c2-12 issued by the Securities and Exchange Commission, the Securities and Exchange Commission indicated that when changes in GAAP occur, if such changes are material, obligated persons should include a narrative explanation in the annual financial information describing the impact of the change. 6

- Those who invest in a parent organization typically invest in the whole enterprise. In the nonprofit healthcare industry, typically it is the subsidiary organizations that are providers of healthcare services and the ultimate sources of income to the parent. Thus, unconsolidated financial statements may not give investors the necessary information they need regarding the operation of the business enterprise as a whole.

Therefore, the FASB should consider the above factors that affect healthcare nonprofit organizations and the effect of those factors on financial statement users in developing any final implementation plans for the policies set forth in the Exposure Draft.

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6 In a letter from the Securities and Exchange Commission to the National Association of Bond Lawyers dated June 23, 1995, regarding Rule 15c2-12, the following question and response were set forth:

**Question 11:**

Over the term of a municipal security, the accounting principles pursuant to which an issuer or obligated person prepares its financial statements may change as a result of future promulgations by FASB and GASB, as well as changes in state law. May a written undertaking provide that such changes will be deemed to be included by reference in the undertaking when they are adopted and disclosed in the issuer's annual filings under the undertaking?

**Response:**

[The undertaking may specify the accounting principles being followed by reference to GAAP or mandated state statutory principles, as in effect from time to time. This provision anticipates changes in GAAP or state law requirements. If such changes occur and are material, obligated persons should consider including a narrative explanation in the annual financial information describing the impact of the changes.]
D. CONFUSION REGARDING WHETHER FINANCIAL INTEGRATION FOR ANTITRUST PURPOSES EXISTS

Application of the proposed Exposure Draft may create an improper inference that not-for-profit healthcare entities that do not meet the FASB test for consolidation of financial statements are not economically integrated for purposes of antitrust intracorporate immunity, as enunciated initially by the United States Supreme Court in Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984). In Copperweld, the Supreme Court addressed the issue of intracorporate immunity and held that a parent corporation and its wholly owned subsidiary are legally incapable of conspiring for purposes of the antitrust laws. The rationale behind the ruling is that the parent and subsidiary are a single economic unit, with a unity of economic interest. The activities of what in substance is a single economic unit, although in form comprised of legally distinct entities, are simply not the kind of combinations prohibited by Section 1 of the Sherman Act.

The kinds of factors looked at for purposes of determining whether intracorporate or Copperweld immunity applies include, among other things, whether there is a joint interest in overall economic performance between/among the entities, such as the consolidation of the healthcare entities' financials. Certainly, many other factors are considered, including control over strategic, financial, and operational planning; consolidated governance and/or management; control over the appointment and removal of directors; control over the healthcare entities' capital and operating budgets; the ability to consolidate and/or re-allocate clinical programs and/or service offerings; control over the sale, transfer, or encumbrance of the healthcare entities' assets; and the like.
There are no cases, statutes, regulations, or official guidelines that are
determinative as to the specific powers that can be retained or delegated and how each of the
factors is to be weighted. What ultimately matters for purposes of 
*Copperweld* is whether the
two entities share a unity of economic interest, which is a determination made on a case-by-case, 
fact-specific basis. From a practical perspective, therefore, such objective facts such as the
consolidation of financial statements could be important.

V. RECOMMENDATIONS / ALTERNATIVES TO APPLICATION OF
CONSOLIDATION POLICIES AS SET FORTH IN EXPOSURE DRAFT TO
NONPROFIT ENTITIES

A. INCORPORATION OF A "GRANDFATHER" PROVISION

One suggested alternative to the application of the Exposure Draft is for the FASB
to incorporate a grandfather provision for organizations which have historically been
consolidated for financial reporting purposes. This will avoid undoing and restating financial
statements and may help avoid some potential problems under current debt financings.

B. CREATION OF A STRONG DISTINCTION BETWEEN NONPROFIT AND
FOR-PROFIT FINANCIAL REPORTING REQUIREMENTS

A common theme running through the issues discussed above seems to be the vast
differences between nonprofit healthcare entities and for-profit entities -- differences in terms of
government oversight, corporate structure, corporate goals, and the like. When an attempt is
made to define a concept as fundamental as "control," the differences between the types of
entities are heightened. For example, in II.C of this comment, the inadequacy of relying solely
on voting rights to determine control among nonprofit healthcare entities was discussed, and it
was shown that relying on a control assessment that focused primarily on reserved powers and
statutory membership rights produced a result that made sense in the nonprofit healthcare industry.

Therefore, the FASB should consider whether to promulgate accounting principles that strongly distinguish between nonprofit healthcare entities and for-profit entities. If separate standards cannot be promulgated, then additional guidance in the application of the principles should, at a minimum, address some of the issues wherein significant differences lie, as set forth throughout this comment.

C. ADOPTION OF NEW ACCOUNTING PRINCIPLES ONLY AFTER CAREFUL ANALYSIS OF SIGNIFICANT ISSUES SPECIFICALLY AFFECTING THE NONPROFIT HEALTHCARE INDUSTRY

UPMC stresses to the FASB the far-reaching effects of financial consolidation, beyond mere financial reporting purposes, for the nonprofit healthcare industry. For example, courts may consider whether entities report on a consolidated basis in order to assess antitrust issues (as discussed above), and financial institutions may consider whether entities report on a consolidated basis to determine the extent of borrowing to be permitted. Because the effect of implementation of the accounting principles contained in the Exposure Draft may preclude nonprofit healthcare entities that previously presented their financial statements on a consolidated basis from continuing to do so or vice versa, perhaps the FASB should adopt new accounting principles that affect the nonprofit healthcare industry only after careful analysis of significant issues specifically affecting the nonprofit healthcare industry. Further, should the FASB ultimately adopt new financial accounting consolidation principles for nonprofit healthcare entities, UPMC requests that the FASB pronouncement include a statement to disavow any effect of the consolidation principles beyond financial accounting. For example, the
FASB could indicate that the principles are not intended to reflect in any way upon charitable trust, bond, or antitrust interpretations.

D. CONSIDERATION OF FINANCIAL DISCLOSURE IN LIEU OF UNCONSOLIDATED FINANCIAL REPORTING

Using control as a key indicator to determine the extent of the relationship between two for-profit entities appears to make sense. However, due to the magnitude of the philosophical differences between nonprofit and for-profit corporations (charitable goals versus profit-making goals, and functioning in the best interest of community versus functioning in the best interest of shareholders, to name a few), the FASB should consider whether an attempt to measure the relationship of two nonprofit entities by looking at control as a benchmark should be completely abandoned. While control can exist in some form between nonprofit entities, control can be present in ways that differ from for-profit relationships, control is commonly shared in some form in the nonprofit world, and control in the nonprofit world must be exercised within the boundaries of charitable trust principles and other applicable laws. Therefore, control, in and of itself, may simply be an inappropriate benchmark upon which to assess the appropriateness of consolidated financial reporting for nonprofit healthcare entities.

One suggested alternative to the application of the accounting principles introduced in the Exposure Draft to nonprofit entities is to allow consolidated financial reporting on essentially the same principles that currently apply, only with some requirement that the nonprofit healthcare entity make some disclosure on the financial statements regarding the extent of the reporting entity's relationship with its subsidiary corporations based on a joint assessment of management and the accounting professional. This would allow the nonprofit healthcare industry to continue its current methodology of financial consolidation, while fully apprising
financial statement users of the nature of the relationship between the entities which have presented consolidated financial information.

VI. CONCLUSION

UPMC appreciates the opportunity to submit its comment on the contents of the Exposure Draft for consideration by the FASB. Further information or clarification on the issues presented in this comment will gladly be provided by Thomas E. Boyle, Esq. (412-562-8823) or Janice M. Smith, CPA, Esq. (412-562-8940) of Buchanan Ingersoll Professional Corporation, or George A. Huber, Esq., General Counsel of UPMC Health System (412-617-8470).