

# *Stay informed*

## Healthcare provider 2013 SEC comment letter trends

*Current developments in  
SEC reporting*

*December 2013*



## *PwC's Healthcare provider 2013 SEC comment letter trends*



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The content of this publication is based on information available as of September 30, 2013. Accordingly, certain aspects of this publication may be superseded as new guidance or interpretations emerge. Financial statement preparers and other users of this publication are therefore cautioned to stay abreast of and carefully evaluate subsequent authoritative and interpretive guidance that is issued.



December 20, 2013

Clients and friends:

We are pleased to offer you the inaugural edition of *Stay informed—Healthcare provider 2013 SEC comment letter trends*. This document analyzes the key areas where registrants in the healthcare provider industry received the most number of comments from the SEC during the three year period ended September 30, 2013. It also provides a discussion of the related guidance as well as sample comment letters on each area. Included for your information are some best practices on how to effectively respond to comments received and a summary of the SEC's filing review process.

We hope you find the information and insights in this document useful as you prepare for the upcoming year-end reporting cycle. Please feel free to contact your PwC engagement team or me to discuss the information in this publication or to address any questions you may have.

Best regards,

A handwritten signature in black ink that reads "Timothy R. Weld, Jr.".

Timothy R. Weld, Jr.  
US Healthcare Provider Assurance Leader

The first part of the paper discusses the importance of the research and the objectives of the study. It then moves on to a literature review, which provides a background on the topic and identifies the gaps in the existing research. The methodology section describes the research design, data collection, and analysis. The results section presents the findings of the study, and the conclusion summarizes the main points and offers suggestions for future research.

The research was conducted in a systematic and rigorous manner, following the principles of good research practice. The data was collected from a representative sample of the population, and the analysis was carried out using appropriate statistical methods. The results of the study are presented in a clear and concise manner, and the conclusions are based on the evidence gathered.

The study has several strengths, including a well-defined research design, a large and diverse sample, and the use of advanced statistical techniques. However, there are also some limitations, such as the cross-sectional nature of the data and the potential for self-report bias. Despite these limitations, the study provides valuable insights into the topic and contributes to the existing knowledge in the field.

The findings of the study have important implications for practice and policy. They suggest that there is a need for further research in this area, and that the results can be used to inform the development of effective interventions and policies. The study also highlights the importance of considering individual differences and the role of the environment in the development of the phenomenon being studied.

In conclusion, the study provides a comprehensive and detailed examination of the topic, and its findings are of significant importance. The research was conducted in a thorough and professional manner, and the results are presented in a clear and accessible way. The study is a valuable contribution to the field and provides a solid foundation for future research.

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## ***What's new at the SEC***

2013 was a year of significant change at the SEC—most notably in April when Mary Jo White was sworn in as the agency's 31<sup>st</sup> chair.

As a former US Attorney for the Southern District of New York and head of litigation for a major law firm, Mary Jo White came to the SEC with a reputation as a tough and effective prosecutor with a proven record of success with large scale, complex cases.

Chair White sees the SEC's mission through the lens of its law enforcement responsibilities. One of her key priorities is to further strengthen the agency's core enforcement function. Earlier in the year, she appointed two directors—both former federal prosecutors—to lead the SEC's Enforcement Division, a division that has historically only had one director. Under this new co-leadership model, the division has made several important changes.

In June, Chair White indicated she had reviewed the SEC's long standing policies around settling cases without requiring an admission of guilt—policies which have come under increased scrutiny in the last couple of years. She stated that although settling on a “no admit/no deny” basis will remain a major tool in the SEC's arsenal, the SEC may—in appropriate circumstances—require admissions of guilt to provide greater public accountability. Chair White has also signaled that the SEC may more frequently charge individuals—rather than entities—to provide an even greater measure of personal accountability and to avoid SEC sanctions becoming just a cost of doing business.

Another recent enforcement initiative that is generating a lot of interest is the SEC's renewed focus on accounting and financial reporting fraud.

SEC actions in the accounting and financial reporting arena have decreased significantly in recent years as the agency focused heavily on the financial crisis. Chair White has expressed interest in this downward trend and has accordingly committed additional targeted resources with one of the most visible changes coming in July when the Enforcement Division created a Financial Reporting and Audit Task Force.

This Task Force is focused on issues relating to the preparation of financial statements and disclosure matters in areas such as revenue recognition, reserves and error correction.

The Task Force is also heavily focused on broad analytics and it is working closely with other groups within the SEC to enhance the effectiveness, efficiency and timeliness of fraud discovery in a number of ways including a focus on whistleblowers, the use of academic studies, reviews of class action filings and the expanded development and use of technology-based tools such as the SEC's Accounting Quality Model.

This model is a data-driven tool being developed by the SEC for use throughout the agency with the goal of identifying whether a company's financial reporting is an outlier. The underlying details and drivers behind the model are proprietary, but the SEC staff has indicated it will focus on discretionary accounting decisions, including policy elections; the degree to which off-balance sheet structures are used; the extent and focus of risk factor disclosures; and particular wording choices—all based on analysis and comparisons across a company's industry and informed by lessons learned from past experiences.

In relation to the SEC's regulatory agenda, Chair White has

*“...we need to have a presence everywhere and be perceived to be everywhere bringing enforcement actions against violators in every market participant category and in every market strata.”*

*- Chair White on the SEC's enforcement program*



stated that her objective is to have a quick and thoughtful completion of the remaining rulemaking under Dodd-Frank and the JOBS Act. Over the next year, we expect the SEC to finalize the Dodd-Frank driven proposal which would require many companies to disclose the ratio of CEO compensation to the median employee's pay and to focus on additional Dodd-Frank and JOBS Act mandates. Remaining mandates include disclosure of employee and director hedging policies and pay for performance; executive officer compensation clawbacks; crowdfunding; credit risk retention; over-counter-derivatives; enhanced public offerings by private companies; and a study of ways to streamline the non-financial statement disclosures required in many SEC filings.

In addition, there may also be additional developments in topics such as cybersecurity, the use of social media as a means of communicating with investors without running afoul of the SEC's selective disclosure rules, and bringing clarity to the role of IFRS in the US financial reporting system.

Finally, the Division of Corporation Finance, the division tasked with performing selective reviews of filings made under the Securities Act and Exchange Act, also made key leadership changes. In May, the SEC named Keith Higgins as the division's new director. Mr. Higgins was a partner at a large law firm and has over 30 years of experience in securities law, mergers and acquisitions, compliance and corporate governance. In October, Mark Kronforst was named as the division's new chief accountant. He combines a deep knowledge of accounting and experience in the public and private sector with a broad understanding of the disclosure requirements of the federal securities laws.

## Overview

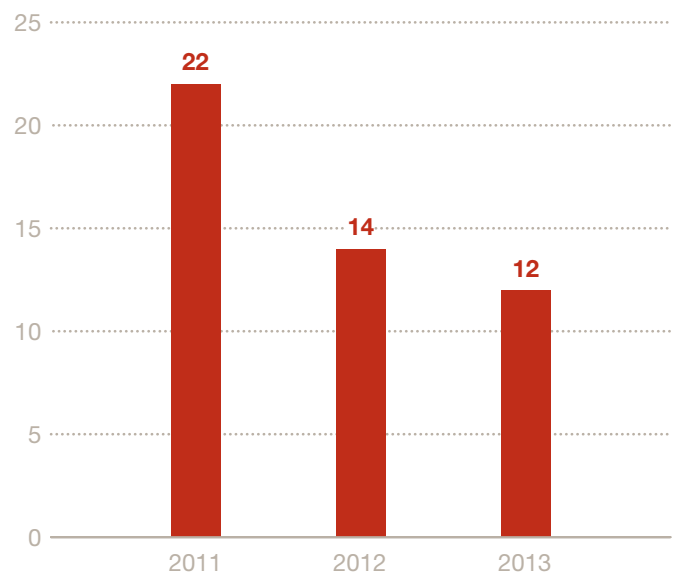
To help registrants gain insight into the SEC's current areas of interest, PwC analyzed comments released by the SEC staff to domestic large accelerated, accelerated and non-accelerated registrants within the healthcare provider industry during the three year period ended September 30, 2013.

From this analysis, we identified the following "hot topic" areas, including industry-specific considerations that we believe you may find useful as you prepare for the upcoming year-end reporting cycle:

Rank	"Hot topic" areas	#	%
1.	Management's discussion and analysis	25	13
2.	Impairments	25	13
3.	Business combinations and consolidation	24	13
4.	10-K and 10-Q compliance	18	10
5.	Segment reporting	15	8
6.	Revenue recognition	11	6
7.	Loss contingencies	11	6
8.	Allowance for contractual adjustments and uncollectibles	10	5
	Other comments	48	26
	Total	187	100

In total, we reviewed 259 comments that were issued to 48 registrants during the period analyzed. After excluding follow-up comments from the SEC staff, we noted 187 unique comments. It is important to note that a company may be reviewed by the SEC staff and not receive a comment letter.

### Number of registrants that received comments by year

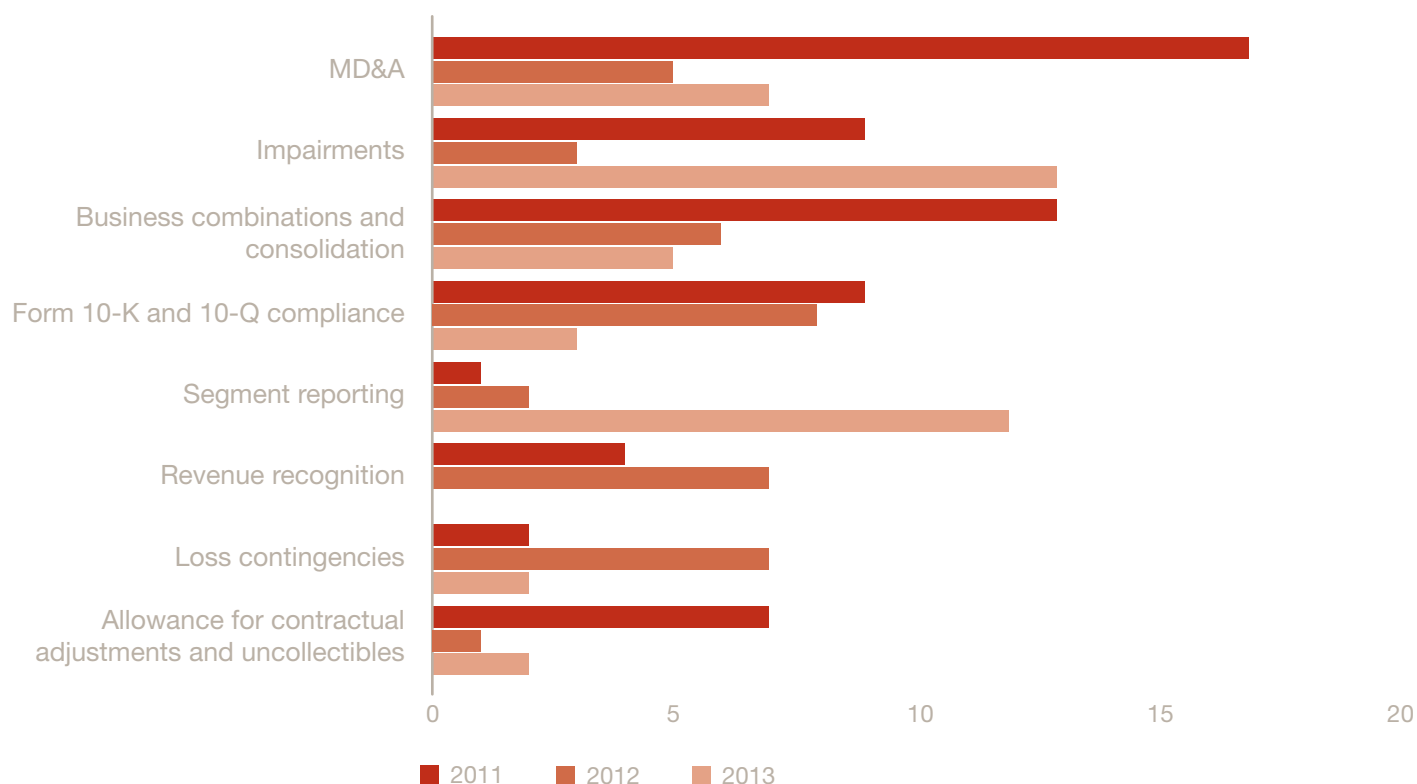




The hot topics identified in the healthcare provider industry are consistent with those in other industries, with comment letters on management's discussion and analysis (MD&A), particularly around results of operations, liquidity and critical accounting estimates, among the most common. With the tough economic environment, the SEC staff also focused on disclosures around impairments. Specific industry

comments related primarily to the allowance for contractual adjustments and uncollectibles. Comments on business combinations and consolidation accounting also featured prominently as registrants took advantage of the favorable financing environment and attempted to increase operating margins through increased economies of scale.

### Number of top comments by year



### Methodology

Our analysis of SEC staff comment letter trends was based on comments on Forms 10-K and 10-Q released during the three year period ended September 30, 2013. We did not include

comments on executive compensation in our analysis. The following SIC codes were used in our analysis:

- Health Services – 8000
- Offices & Clinics of Doctors of Medicine-8011
- Nursing & Personal Care Facilities – 8050
- Skilled Nursing Care Facilities – 8051
- Hospitals – 8060
- General Medical & Surgical Hospitals – 8062
- Medical Laboratories – 8071
- Home Health Care Services – 8082
- Misc Health & Allied Services – 8090
- Specialty Outpatient Facilities – 8093

## Management's discussion and analysis

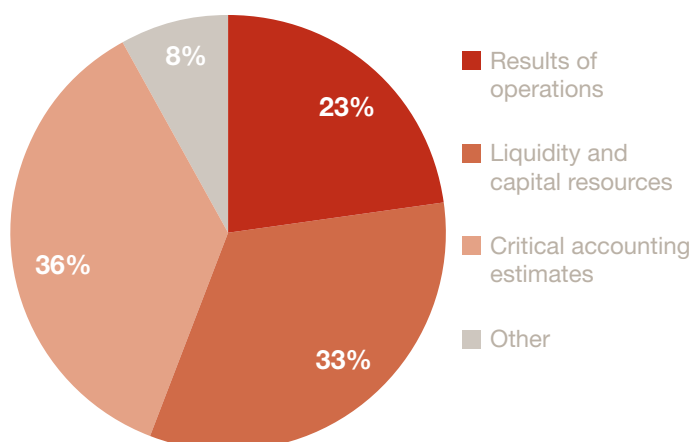
The healthcare provider industry has experienced significant changes in recent years. The slow economic recovery and uncertain regulatory environment, including the implementation of the Patient Protection and Affordable Care Act and continued downward pressure on reimbursement rates, have made it a challenging operating environment.

Given these significant changes, it comes as no surprise that MD&A was one of the more frequent areas of comment. The purpose of MD&A is to provide readers information necessary to an understanding of a registrant's financial condition, changes in financial condition and results of operations. The MD&A requirements are intended to satisfy three principal objectives:

- provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management;
- enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
- provide information about the quality and potential variability of a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.

MD&A should provide a view of the company through the eyes of management, while being mindful of disclosure overload or use of "boilerplate" disclosures. The guidance set forth in Item 303 of Regulation S-K identifies five categories of disclosure in MD&A—liquidity, capital resources, results of operations, off-balance-sheet arrangements, and contractual obligations—along with the requirements for each. Financial Reporting Release 72 also emphasizes the importance of including a discussion and analysis of critical accounting estimates. As shown in the chart, the SEC staff comments on MD&A were primarily focused on results of operations, liquidity and capital resources, and critical accounting estimates.

**% of comments by MD&A subtopic**



In the following sections we have analyzed the SEC staff comments by component of MD&A.

## **Results of operations**

Item 303(a)(3) of Regulation S-K contains the disclosure requirements for results of operations. For purposes of providing an understanding of the results of operations, registrants should discuss each financial statement line item and significant components of revenues and expenses. The discussion of results of operations should not merely consist of numeric dollar and percentage changes, but should analyze the key factors driving material changes period-over-period. A substantive discussion should include a description and quantification of the factors causing fluctuations, such as separate rate and volume components when explaining changes in net sales. Separate discussion by segment is usually necessary to enable a reader to understand the consolidated results. In addition, registrants should discuss known trends and uncertainties, including changes in the regulatory landscape, and the anticipated impact on the results of operations.

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## **Sample comments**

- (1) We note your cost of service revenue has increased as a percentage of net service revenue from xx% in fiscal 20x0, to xx% in fiscal 20x1, and then to xx% in fiscal 20x2. We further note your discussion within the caption Business Strategy at page x, in which you state your intention to achieve margin improvement through the active management of costs because your profitability in a fixed payment system depends on your ability to manage the costs of providing care. In future filings please provide more comprehensive analysis for the underlying increases or decreases in your cost structure. Provide us with an example of the disclosure that you intend to include in future filings.
  - (2) We note that your home health care revenues included \$xx billion and \$xx billion from Medicare for the years ended December 31, 20x1 and 20x0, respectively. We also note that the primary increase in your home health care revenues is due to increased Medicare program base episodic rates. Considering that the health care reform bills mandated reductions in the base rates for 20x1, please provide an analysis of the trends management expects to see in revenues. Please discuss whether these trends and uncertainties are reasonably likely to have a material impact on your results of operations and liquidity. Refer to Item 303 of Regulation S-K and Section III of our Release 33-8350. Please provide us with the text of your proposed disclosure to be included in future filings, including any amendments to this Form 10-K.
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## **Liquidity and capital resources**

Items 303(a)(1) and (2) of Regulation S-K contain the disclosure requirements for liquidity and capital resources. This guidance calls for a discussion of the registrant's material cash requirements, sources and uses of funds, and material trends and uncertainties related to a registrant's ability to satisfy its obligations.

Comments received by registrants in the healthcare provider industry primarily relate to the SEC staff requesting more clear and transparent disclosures on the adequacy and sources of liquidity, the impact of debt covenants and slow economic recovery on liquidity, and the primary drivers of changes in cash flows.

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## **Sample comments**

- (1) We note your cash balance has decreased to approximately \$xx million at June 30, 20x1 from approximately \$xx million at December 30, 20x0. We also note your disclosure on page x that you are highly leveraged and that you believe cash from operations, cash on hand and your revolving credit facility will be sufficient to meet your working capital needs during the next 12 months. Considering your (i) high leverage, (ii) current credit rating and (iii) cash generated from operations, cash expended for property and equipment (\$xx million through June 30, 20x1) along with other investing and financing outflows, please expand your liquidity and capital resources disclosure to more thoroughly discuss and quantify your total expected uses of cash (e.g., capital expenditures) over the next 12 months and the sources of cash that support your conclusion. Please also address how your business will be affected if your liquidity needs are not fully satisfied. Please refer to "Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations" which can be located at our website at <http://www.sec.gov/rules/interp/33-8350.htm>.
  - (2) On page x, you indicated that the recent economic downturn has resulted in a decrease in your ability to collect accounts receivable from some of your customers. Tell us why you did not address this in your MD&A. Additionally, we note that you attributed a decrease in operating cash flows to "timing differences which resulted in year-over-year increase in working capital changes." Please clarify what these timing differences are.
-

## Critical accounting estimates

Over the years, the SEC staff has emphasized that registrants should consider enhanced discussion and analysis of critical accounting estimates and assumptions that supplements, but does not duplicate, the description of significant accounting policies in the notes to the financial statements. In addition, registrants should provide greater insight into the quality and variability of information regarding their financial condition and operating performance.

Also refer to the related discussion under *Allowance for contractual adjustments and uncollectibles* and *Impairments* included elsewhere in this document.

***MD&A is intended to provide in one section of a filing material, historical and prospective information that will enable the reader to assess the financial conditions, results of operations and liquidity of a registrant.***



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## Sample comments

- (1) Based upon your disclosure, we note that you consider the process for determining reserves for self insurance to be a critical accounting policy, and that these reserves have proven to be materially inaccurate in the past. In this regard, please revise your discussion of this critical accounting policy in future filings to disclose the following with respect to your self-insurance reserves:
- The types of assumptions that underlie the most significant and subjective estimates;
  - The sensitivity of those estimates to deviations of actual results from managements assumptions; and
  - The circumstances that have resulted in revised assumptions in the past

Please provide us with the proposed disclosures you intend to include in your next 10-Q filing in response to this comment.

- (2) We note the discussion describing your Critical Accounting Policies duplicates your disclosure regarding the Principles of Consolidation, Revenue Recognition, Accounts Receivable and Allowance for Uncollectible Accounts and Goodwill and Intangible Assets at Note x Summary of Significant Accounting Policies in your consolidated financial statements. In future filings, please revise your discussion of critical accounting policies to supplement, rather than duplicate, your accounting policy discussion in the notes to the consolidated financial statements. For example, a discussion of frequency and magnitude of the retroactive adjustments to Medicare reimbursement described at page xx may allow users to gauge the sensitivity of home-based service revenues. Please see SEC release No. 33-8350 at <http://www.sec.gov/rules/interp33-8350.htm>. Provide us with an example of the disclosure that you intend to include in future filings.
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# Impairments

Given the slow economic recovery and downward pressure on reimbursement rates, as well as the high degree of judgment involved, the SEC staff has focused on the transparency of disclosures around goodwill and long-lived assets that are at risk of being impaired. These disclosures allow an investor to assess the likelihood of a future material impairment charge.

## Goodwill

The SEC staff has indicated that it expects registrants to provide foreshadowing disclosures if there is a reasonable likelihood of a material impairment in future periods. The evaluation about whether a reporting unit is at risk of failing step one of the goodwill impairment test is a matter of professional judgment. The SEC staff has stated that a reporting unit may be at risk if the reporting unit's fair value is not "substantially in excess of its carrying value." When evaluating whether a reporting unit's fair value substantially exceeds its carrying value, registrants may need to consider the level of uncertainty associated with the methods and assumptions used in the fair value estimation process. In cases where a reporting unit's fair value is not substantially in excess of its carrying value, the SEC staff expects management to make the following disclosures:

- the percentage by which the fair value of the reporting unit exceeded its carrying value as of the date of the most recent step one analysis;
- the amount of goodwill assigned to the reporting unit;
- the key assumptions that drive fair value;
- the sensitivity of fair valuation to changes in assumptions and inputs used; and
- a description of potential events and circumstances that could have a negative effect on the reporting unit's fair value.

When an impairment charge is recognized, registrants should consider disclosing the events that gave rise to the impairment, such as changes in the underlying business or environment, the amount of the impairment loss, and the method of determining fair value of the reporting unit. Such disclosures should provide sufficient linkage to answer the question of why the charge belongs in the current period and should not have been taken sooner.

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## Sample comments

- (1) We note you recognized goodwill impairment charges of \$xx million relating to your ancillary business in the second quarter of 20x0. In addition, during your 20x0 fourth quarter earnings call you stated that 150 centers are currently losing money. Considering the above, with regard to your impairment testing, please provide us with, and confirm that in future Exchange Act filings you will disclose, the following: clarify what you consider a reporting unit and your basis; of the total number of reporting units to which goodwill is allocated, how many were impaired at the date of the most recent test; clarify how many reporting units, if any, were considered at risk of impairment (i.e. in step one of the impairment test, the reporting unit has a fair value that is not substantially in excess of its carrying value); For any at risk reporting unit, provide us with (i) the percentage by which fair value exceeded carrying value as of the date of the most recent test, (ii) the amount of goodwill allocated to the reporting unit, (iii) a description of the methods and key assumptions used and how the key assumptions were determined, (iv) a discussion of the degree of uncertainty associated with the key assumptions (i.e. the discussion regarding uncertainty should provide specifics to the extent possible (e.g., the valuation model assumes recovery from a business downturn within a defined period of time)), and (v) a description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.
  - (2) We note that the price of your stock significantly declined following the announcement of the CMS's Medicare rate reductions which led you to terminate exploration of strategic alternatives, including a potential sale of the Company's real estate assets or the whole. Addressing any change in the fair value of your stock as viewed by market participants and factors that could impact the valuation of your reporting units under the income approach, such as the CMS's 11.1% Medicare rate reduction, any estimates from the Centers of Medicare and Medicaid Services and the Congressional Budget Office on health expenditure as a result of the 2010 Patient Protection and Affordable Care Act, the recent debt ceiling legislation that could trigger a 2% Medicare cut to health providers in the event of an impasse, and budget constraints of cash-strapped states, tell us whether you performed an interim goodwill impairment test and what the results were.
-

## Long-lived assets

Long-lived assets are assessed for impairment under two models: (1) assets to be held and used and (2) assets to be disposed of by sale.

Held and used assets should be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount of the asset or asset group may not be recoverable. Whereas an asset group that satisfies all of the held for sale criteria under *ASC 360, Property, Plant and Equipment* should be measured at the lower of its carrying amount or fair value less cost to sell.

Similar to goodwill, the SEC staff has issued comment letters relating to impairments of long-lived assets and whether there are assets at risk of being impaired. Comments from the staff are focused on the following areas:

- the basis for the determination of asset groupings;
- the disclosure of methods, assumptions and inputs used, including the sensitivity of the valuation to changes in the assumptions and inputs;
- the consideration of economic challenges, operating losses at a specific segment or the impairment of similar assets as a potential triggering event;
- the adequacy of foreshadowing disclosures for assets at risk of impairment including the percentage by which undiscounted cash flows exceed carrying value; and
- the timing of impairment charges.

In some instances, the SEC staff has requested to see the impairment analysis and other supporting information used by the registrant in its assessment.

*The SEC staff is focused on foreshadowing disclosures around goodwill and long-lived assets that are at risk of being impaired.*



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### Sample comment

- (1) You sold your University Medical Center hospital on August 31, 20x2 for \$xx million. As a result, you recognized a \$xx million impairment for the write-down of long-lived assets to their estimated fair values in the quarter ended June 30, 20x2. Explain to us why the sale resulted in such a large loss and why impairment was not required prior to the quarter ended June 30, 20x2. Tell us when the hospital was acquired, the gross book value, what estimated useful life was being used for depreciation, the amount of depreciation expense recognized for 20x0, 20x1, 20x2 and accumulated through August 31, 20x2, and why you believe the amount of depreciation expense recognized complied with GAAP.
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# Business combinations and consolidation

The healthcare provider industry has experienced an increase in mergers and acquisitions activity in recent years. Such an increase in activity can be attributed to favorable pricing, lower debt financing costs and the need to consolidate in order to take advantage of economies of scale to improve operating margins.

## Business combinations

ASC 805, *Business Combinations*, provides extensive disclosure requirements to enable users to evaluate the nature and financial effects of the business combination. Registrants should carefully consider all of the disclosure guidance in preparing financial statements, both in the period of the acquisition and in subsequent periods.

For registrants in the healthcare provider industry, the SEC staff comments focused on purchase price allocation and the application of the acquisition method.

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## Sample comments

- (1) We note your affiliation transactions and acquisitions of business are accounted for as business combinations, while your affiliations with [XYZ] practices as a result of the parties entering into a service agreement are not business combinations. Please explain to us the reasons why certain transactions are accounted for as business combinations, such as the acquisition of [Company], and why certain transactions are not accounted for as business combinations. In your response, compare and contrast the difference between the transactions you enter into and support for us the differences in accounting treatment with applicable accounting guidance. Also, provide to us the disclosure that you will include in future filings that further describes the differences between these types of transactions that result in the different accounting treatments.
  - (2) In your Business section, you disclose your strategy to continue to grow through selective acquisitions. In this note you disclose various acquisitions that you account for as a “purchase business combination.” Please confirm to us that you applied the acquisition method as stipulated in ASC 805-10-05-4 to account for your business combination transactions since January 1, 20x0 and provide us proposed revised disclosure to be included in future periodic reports that:
    - Discloses in a policy note your policy for applying the acquisition method including, but not limited to:
      - How you measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree;
      - That goodwill is determined as the excess of the fair value of the consideration conveyed in the acquisition over the fair value of the net assets acquired, not the excess of cost over the fair value of the net assets acquired as stated in your goodwill policy note on page xx;
      - How you account for changes in estimates of the fair value of any individual asset acquired or liability assumed; and
      - How you account for transaction costs
    - Clearly indicates that you applied the acquisition method to each of your acquisitions since January 1, 20x0.
  - (3) Please provide us your proposed disclosure to be included in future filings to clarify that these were business acquisitions and not asset acquisitions. Please include a qualitative description of the factors that make up the goodwill recognized as required by ASC 805-30-50. Also include pro forma information in accordance with ASC 805-10-50-2h.
-



## Consolidation

It is not uncommon in the healthcare provider industry for entities to enter into contractual arrangements with affiliated medical professionals and practices, particularly in states where the practice of medicine by corporate entities is not allowed. In certain instances, these arrangements may qualify as variable interest entities (“VIE”).

Under ASC 810, *Consolidation*, a reporting entity must consolidate an entity in which it has a controlling financial interest. Under the VIE model, the party that has the power to direct the entity’s most significant economic activities and the ability to participate in the entity’s economics, also known as the primary beneficiary, consolidates the entity. This party could be an equity investor, some other capital provider, or a party with contractual arrangements.

The application of ASC 810 requires significant judgment and therefore SEC staff has requested more robust disclosures in this area. Comments have focused on the proper application of the VIE model and the completeness of disclosures as required under ASC 810.

*In recent years, the healthcare provider industry has experienced a rise in consolidation activity. The accounting for these transactions requires significant judgment and therefore the SEC staff has requested more robust disclosures.*



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## Sample comments

- (1) In future filings, please provide the disclosures for a public entity that holds a significant variable interest but is not the primary beneficiary as required by ASC 810-10-50-7 through 50-19, as applicable. Please provide us with the text of your proposed future disclosure.
  - (2) You state that if cumulative losses of a hospital exceed its initial capitalization and committed capital obligations of the partners or members, the Company will recognize a disproportionate share of the hospital’s losses that otherwise would be allocated to all of its owners on a pro rata basis. Please revise your disclosure to clarify for GAAP purposes that the noncontrolling interest continues to be attributed its share of losses even if that attribution results in a negative noncontrolling interest balance. Refer to ASC 810-10-45-21. Also, please tell us why you do not believe that the disproportionate share of hospitals losses that will be attributed to you would cause you to be the primary beneficiary and require consolidation.
  - (3) Please advise us of the following: a. explain to us the changes to the nature of your analysis and/or your conclusions reached, if any, as a result of ASU 2009-17; b. provide us with your qualitative analysis under the guidance to arrive at your conclusion that you are not required to consolidate the financial statements of the affiliated practices; and c. include your consideration of whether each affiliated practice is a variable interest entity and whether the Company is considered the primary beneficiary, along with the basis of your conclusions in your response.
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## 10-K and 10-Q compliance

Compliance with the instructions to Form 10-K and Form 10-Q, particularly as it relates to signatures, certifications and exhibits, continues to garner comments from the SEC staff. Guidance on these areas can be found in Item 601 of Regulation S-K, which provides a list of required exhibits to be included in a Form 10-K and Form 10-Q.

Comments received in this category primarily relate to:

- omission of signatures from all appropriate officers;
- improper dating of certifications;
- use of inappropriate language in certifications of the principal executive officer and principal financial officer; and
- omission of required exhibits and appendices within the filing (primarily focused on material contracts).

While these comments do not typically require significant effort to address, the resolution of these comments may require a registrant to file an amendment.

*Comments in this area are typically not complex and can be avoided through proper review prior to filing.*



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### Sample comments

- (1) We note that your Section 302 certifications do not comply with Item 601(31) of Regulation S-K in the following respects: You have included the title of the certifying individual at the beginning of the certifications. You use the term “annual report” rather than “report” throughout exhibits 31(a) and 31(b). You use the word “Company” rather than “Registrant” throughout exhibits 31(a) and 31(b). Please revise your certifications to address these deficiencies.
  - (2) We note that you have not included all of the exhibits or schedules to Exhibit x and Exhibit x. Please confirm that you will file a complete copy of each exhibit with your next Exchange Act periodic report.
-

## Segment reporting

Segment reporting has been a hot topic for comment letters across all industries, and the same holds true for the healthcare provider industry. The most common comments issued by the SEC staff have been on the proper identification of operating segments and the aggregation of operating segments into reportable segments.

It is not unusual for the SEC staff to request documentation supporting the registrant's identification of operating segments. Comments frequently request information about the registrant's organizational structure and the discrete financial information regularly reviewed by the chief operating decision maker (CODM). When discrete financial information is provided to the CODM, it is often difficult for a registrant to assert the CODM does not use the information. It is important to remember that the SEC staff reviews publicly available information for consistency between segment disclosures and the types of other information provided to the public. For example, the SEC staff may listen to a registrant's earnings calls, read press releases and investor presentations and review information on a company's website to identify these inconsistencies.

The SEC staff has also challenged registrants to explain how the operating segments meet the "economic similarities" criterion for purposes of aggregation. Comment letters may request information from registrants to demonstrate that the operating segments exhibit similar long-term financial performance; sometimes requesting an analysis of the historical gross margins for each operating segment. Registrants should continually reassess their segment conclusions, especially when there is a change in the registrant's business and management reporting structure.

*The most common comments issued by SEC staff on segment reporting have been on the proper identification of operating segments and the aggregation of operating segments into reportable segments.*



We also see frequent comments related to the entity-wide disclosures, including revenues by product or service, net sales and certain types of long-lived assets by geographic location, and information about major customers. The SEC staff may issue comments when these disclosures are missing or when there are inconsistencies between the financial statement footnote disclosures and information provided outside of the financial statements.

Finally, comments on segment reporting may also impact other areas such as the registrant's identification of reporting units for the goodwill impairment test and disclosures in MD&A regarding each segment's results of operations.

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### Sample comments

- (1) Your response to comment x indicates that you maintain a “decentralized approach” to management of your centers, that each center is managed by a center manager who is responsible and accountable for the operating and financial performance of the center and that the CODM regularly assesses the performance of each of the 1,100 operating centers to make decisions about capital allocation and strategic direction. It is still unclear based on your disclosure and response, why your individual operating centers are not considered operating segments as they appear to meet each characteristic in ASC 280-10-50-1. Please provide to us courtesy copies of your CODM reports for the year ended December 31, 20x0 and nine months ending September 30, 20x1 and an analysis of how you considered each of the criteria in ASC 280-10-50-1 in determining that each center is not considered an operating segment.
  - (2) Refer to your specialty hospitals segment. Please provide us with a separate analysis of your long term acute care hospitals and your inpatient rehabilitation facilities demonstrating whether or not each one represents an operating segment under ASC 280-10-50-1. If both or either represent an operating segment, provide us with your analysis demonstrating why they are included as one reportable segment under ASC 280-10. Please also provide us with an analysis demonstrating that there are no operating segments or components of an operating segment within the specialty hospitals segment that would represent a reporting unit under ASC 350-20-35 for your goodwill impairment testing.
  - (3) Please provide us proposed disclosure to be included in future periodic reports to provide your revenues by each group of similar services as required by ASC 280-10-50-40. In this regard it appears that your service groupings as disclosed on pages three through six of your filing would appear to be reasonable groupings for this disclosure. Otherwise, please explain to us how your current disclosure complies with this guidance.
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## Revenue recognition

Revenue recognition continues to be a hot topic in comment letters issued by the SEC staff across all industries. The enactment of various federal and state laws, including those relating to reimbursement rates, have impacted the healthcare provider industry. One of the more recent developments in the industry is the recognition of incentive income associated with electronic health records.

The American Recovery and Reinvestment Act of 2009 established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that “meaningfully use” certified electronic health record (EHR) technology. The SEC staff has issued comments on how companies are describing their accounting policies and classification of income recognized for Medicaid and Medicare EHR incentives.

In addition, the SEC staff has issued comments on whether a registrant has met the revenue recognition criteria and on the timing of revenue recognition relating to supplemental reimbursement programs.

*The SEC staff has inquired and requested additional disclosures on the impact of new federal and state laws on a registrant’s accounting for revenue.*



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### Sample comments

- (1) We note you have continued to recognize revenue for services provided to [Government Payer] even though you agreed to temporarily suspend billings to it until March 1, 20x1. Please tell us how you considered SAB Topic 13:A in determining the services rendered represent revenue when you do not bill for services rendered.
  - (2) You recognized \$xx million of Medicaid hospital and physician incentive payments as a result of The American Recovery and Reinvestment Act of 2009. Please provide us proposed disclosure to be included in future periodic reports of your income recognition accounting policy for these payments, and provide us your analysis demonstrating how your policy was met in the quarter in which income was recognized. Additionally, please provide us your analysis that supports classifying these amounts in the line item “net operating revenues” within your consolidated statements of operations.
  - (3) You disclose that several states utilize supplemental reimbursement programs to offset a portion of the cost of providing care to Medicaid and indigent patients and that these programs are designed with input from CMS as they are funded with a combination of state and federal resources. You also disclose that after these programs are signed into law you recognize revenue and related expenses under these programs in the period in which amounts are estimable and collection is reasonably assured. It is our understanding that during the first quarter of 20x1 CMS approved the Medical Assistance Payment Modernization Act that was signed into law in July 20x0. During your first quarter 20x1 earnings conference call, you attribute part of your revenue increase in that quarter to the new program implemented in [State] during the quarter. Please address the following comments: Please tell us the amount of revenue recognized under this program and the quarters in which you recognized that revenue. Please explain to us how you applied your revenue recognition policy stated above and how its application complies with GAAP. In this regard, if you recorded revenue in the third quarter of 20x0, please explain to us how you were able to reasonably estimate the amount and how collection was reasonably assured without approval from the CMS. If you deferred recognition until the first quarter of 20x1, please explain why and tell us the amount of the revenue recorded in 2011 that relates to services provided in 2010 and how you treated the expenses related to these services.
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## Loss contingencies

Healthcare providers are subject to various legal actions including medical malpractice and class action lawsuits. The costs associated with the resolution of these lawsuits are often material to the financial statements and significant judgment is involved in estimating such costs. Accordingly, loss contingencies have been a point of focus by the SEC staff. The main areas of comment are around the timing of loss accrual and the disclosure of reasonably possible losses.

The guidance in ASC 450-20-50 requires disclosure of certain loss contingencies that do not meet the criteria for an accrual, including material loss contingencies that are considered probable but not reasonably estimable and those that are at least reasonably possible (but not probable).

For contingencies that meet the criteria for disclosure, entities should disclose the nature of the contingency and an estimate of the possible loss or range of loss (or a statement that such an estimate cannot be made). In response to concerns about disclosing too much detail about individual cases, the SEC staff has indicated that they will not take exception to disclosure of a range of loss in the aggregate for all reasonably possible contingencies.

Consistent with comment letter themes in MD&A and goodwill, the SEC staff has also focused on “foreshadowing” disclosures as it relates to loss contingencies and has emphasized that the nature and the amount of a loss should generally not be disclosed for the first time in the period in which it is recorded; instead early-warning disclosures should be provided as soon as they are appropriate. More robust disclosures is expected as matters progress over time.

*The main areas of comment on loss contingencies are around the timing of loss accrual and the disclosure of reasonably possible losses.*



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### Sample comments

- (1) We note in the fourth paragraph on page xx your disclosure: “...While the Company believes that at least a reasonable possibility exists that losses may have been incurred, based on the nature and status of the investigations, the losses are either currently not probable or cannot be reasonably estimated.” This disclosure implies that some of the matters have reasonably possible losses that can be estimated. ASC 450 requires a company to disclose the amount or range of reasonably possible loss, as that term is defined. Please disclose this information, which may be aggregated, in your next Form 10-Q and provide us with your proposed disclosure.
  - (2) We note in the sixth paragraph on page xx, your disclosure: “If a settlement is not finalized, the eventual losses related to these matters could be materially different than the amount recorded and could be material to the Company’s results of operations, cash flows and financial condition in the period that such matters are determined or paid.” Please tell us and disclose in future filings the estimated reasonably possible losses, range of loss, or a statement that such estimate cannot be made.
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## ***Allowance for contractual adjustments and uncollectibles***

The allowance for contractual adjustments and uncollectibles represents a significant and complex estimate for health care provider entities. The current economic environment, which has increased the number of high deductible plans and self-pay patients, and the changes in reimbursement rates have further increased the complexity in estimating these allowances.

Given its significance, the SEC staff has asked registrants to provide clearer and more comprehensive disclosures in both the notes to the financial statements and the MD&A. The comments have primarily focused on gaining a better understanding of management's estimation process as well as the reasons for significant changes in the allowances during the year.

***SEC staff comments have focused on gaining a better understanding of management's estimation process and the reasons for significant changes in the allowances during the year.***



For calendar year end filers, 2012 was the first year of adoption of Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (ASU 2011-07). ASU 2011-07's objective is to provide financial statement users with greater transparency about net patient service revenue and the related allowance for doubtful accounts. This ASU requires healthcare entities that recognize significant amounts of patient service revenue at the time services are rendered, even though they do not assess the patient's ability to pay, to present the provision for doubtful accounts as a deduction from patient service revenue. Additional disclosures are also required relating to changes in the allowance for doubtful accounts related to patient accounts receivable.

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### **Sample comments**

- (1) Please disclose the amount of each reserve related to net revenues, accounts receivable and estimated refunds at the most recent balance sheet date presented, and describe the key assumptions used. Further disclose the change in estimate recorded for each reserve for each period presented.
- (2) Expand these sections to provide greater insight into how management estimates its revenues and the allowance for contractual adjustments and discounts. Define the term "contractual credits" as it is used in the discussion; explain why it is required and how management determines the amounts of the credits. Disclose the amounts of actual adjustments that were recognized in subsequent periods and how these adjustments affected management's estimates of prospective adjustments and discounts.
- (3) Please provide us with proposed disclosure to be included in future filings that separately discloses the allowance for uncollectibles and related activity separate from the allowance for contractual adjustments.
- (4) Please explain to us why you did not disclose the impact of adopting ASU 2011-07. Provide us proposed disclosures to be included in future filings that present the provision for bad debts separately as a deduction from patient service revenue (net of contractual allowances and discounts) to arrive at net patient service revenues less the provision for bad debts on the face of the consolidated statements of income as required by ASC 954-605-45-4 and that provide the disclosures required by ASC 954-605-50-4.

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## ***Responding to comment letters***

**In a recent webcast hosted by PwC, we shared the following best practices that companies should consider when they receive a comment letter.**

### ***Own the process. Use your accountants and lawyers but do not relinquish ownership.***

Registrants should view responding to a comment letter as a project. There should be a project manager coordinating the process including obtaining input from attorneys and accountants in developing the response.

### ***Evaluate how long you believe it will take to respond. Do not rush.***

The letter from the SEC will indicate that the company should respond within ten business days. Evaluate the comments and assess the information necessary to respond. If more time is needed, it is acceptable to request more time. In most instances, the company's legal counsel will make the call to the SEC staff. A good and thoughtful response is much better than a quick response.

### ***Consider the implications and timing on future filings.***

Companies may receive a comment letter shortly before a registration statement or take down off the shelf. Companies should evaluate the comments with their auditors and legal counsel and evaluate if there are implications on the offering and its timing. The Company may want to discuss the timing of an anticipated offering with the SEC staff to determine if the relevant matters can be reviewed on an expedited basis.

### ***Call the staff if you do not understand the comment.***

Do not hesitate to call the SEC staff if the company does not completely understand the comment. The objective of the call should be to gain clarification when a comment or aspects of a comment are unclear.

### ***Comment letters are public and the public may have an interest.***

There is an increasing interest from the public in the comment letter process. Companies should recognize that comment letters become part of public domain once submitted and resolved. The appropriate diligence should be applied to the comment letter process similar to the preparation of the Form 10-K and other public reports.

### ***Precedent of other filings may be helpful but do NOT cut and paste.***

The use of previous comments and responses of other companies as a basis for developing a response may be helpful but there are limitations. While the SEC staff may have accepted a response to a similar comment, it is important to understand that each comment letter is related to a specific fact pattern. Different levels of materiality may also be involved. View the comment letter as a unique communication and respond based on your particular facts and circumstances.

### ***Respond completely to the comment.***

Consider the intent of the comment from the SEC staff. The goal is to avoid a response that will lead to further comments. Therefore, provide a response that is thoughtful and complete the first time.

### ***If the proposed response contemplates a change in the future, provide the proposed disclosure.***

Many comments will request additional disclosure in future filings. In order to ensure that there is a meeting of the minds as to what will be disclosed and presented, including a draft of the applicable disclosure is strongly encouraged.

### ***Consider getting the views of others on the SEC staff.***

Occasionally, there may be a difference of views between the company and the SEC reviewer. It is acceptable to request the input of others on the SEC staff including the Senior Assistant Chief Accountant, the Associate Chief Accountant, the Deputy Chief Accountant and the Chief Accountant of the Division of Corporation Finance. Additionally, with respect to matters pertaining to the proper application of generally accepted accounting principles, companies may seek the views of the Office of the Chief Accountant of the SEC. If a company decides to seek the views of other members of the SEC staff, it is strongly recommended that this fact be discussed with the SEC reviewer before reaching out to other staff.



## Appendix—SEC filing review process

The SEC's Division of Corporation Finance (the "Division") selectively reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 to monitor and enhance compliance with the appropriate accounting and disclosure requirements. The disclosures included in a filing are the responsibility of management. The Division's review process does not guarantee that the filing is accurate or complete.

The Division is organized to provide specialized industry, accounting and disclosure expertise, and currently has twelve Assistant Director Offices. A company's assignment to one of the Assistant Director Offices is largely based on a registrant's primary Standard Industrial Classification (SIC) Code. Organization of the Assistant Director Offices on an industry basis is designed to help the Division ascertain the particular disclosure needs of different industries and to identify industry trends. Each company's Assistant Director Office assignment is listed in the SEC EDGAR system following the basic company information that precedes the company's filing history. Each Assistant Director Office and the industries that it supports are listed below:

Office	Primary Industries
1.	Healthcare and Insurance
2.	Consumer Products
3.	Information Technologies and Services
4.	Natural Resources
5.	Transportation and Leisure
6.	Manufacturing and Construction
7.	Financial Services I
8.	Real Estate and Commodities
9.	Beverages, Apparel, and Mining
10.	Electronics and Machinery
11.	Telecommunications
12.	Financial Services II

### Required and selective review

As required by the Sarbanes-Oxley Act of 2002, the Division performs some level of review of each reporting company at least once every three years and a significant number of companies more frequently. The Division also selectively reviews transactional filings; documents filed when entities engage in public offerings; business combinations; and proxy solicitations. In an effort to preserve the integrity of the selection process, the Division does not make public the criteria used to identify the entities and filings to be reviewed.

### Scope of review

The scope of review may include:

- a full cover-to-cover review in which the Division staff will examine the entire filing for compliance with federal securities laws and regulations;
- a financial statement review in which the Division staff will examine the financial statements and related disclosure for compliance with accounting standards and SEC laws and regulations; or
- a targeted issue review in which the Division staff will examine the filing for one or more specific items of disclosure for compliance with accounting standards and/or SEC disclosure requirements.

The Division will evaluate disclosures from the perspective of a potential investor and ask questions that an investor might ask when reading the filings. When the Division staff identifies instances where it believes an entity can improve its disclosure or enhance its compliance with applicable requirements, it provides the entity with comments. The range of possible comments is broad and depends on the particular facts and circumstances of a filing. The SEC staff also completes many filing reviews without issuing a comment letter.



In addition to the first level examination performed, in nearly all cases a second person reviews a filing and proposed comments. This is performed to help achieve consistency in comments across filing reviews.

### **Staff comments**

The Division views the comment letter process as a dialogue with a company about its disclosure. The SEC staff's comments are based on a company's disclosure and other public information (such as the company's website, social media sites, conference call transcripts and press releases, among others) and reflect its understanding of the company's facts and circumstances. In its comments, the SEC staff may request that a company provide:

- additional supplemental information to better understand the disclosure;
- revised disclosure and/or accounting in a filing;
- additional disclosure in a filing; or
- additional or different disclosure in a future filing.

### **Response to comments**

A company generally responds to each comment in a letter to the SEC staff and, if appropriate, by amending its filings. A registrant's explanation or analysis of an issue will often resolve a comment. The SEC staff may issue additional comments following its review of the registrant's response to its prior comments. The comment and response process continues until the SEC staff and the company resolve the comments.

Depending on the nature of a pending issue, the Division's Office of Chief Accountant may decide to involve the Commission's Office of the Chief Accountant during the comment and response process on matters relating to accounting and financial disclosures.

### **Closing a filing review**

When all of the comments are resolved, the Division provides the company with a letter to confirm that its review of the filing is complete. Additionally, if the comments relate to a registration statement, the company may request that the SEC declare the registration statement effective so that it can proceed with the transaction.

To increase the transparency of the review process, the Division staff's comments and company responses to those comments are made public on the SEC's EDGAR system no earlier than 20 business days after the completion of the review.

### **Reconsideration process**

A company should not hesitate to request that the SEC staff reconsider a comment it has issued or reconsider a staff member's view of the company's response to a comment at any point in the filing review process. Because of the diversity of issues that may be raised in the filing review and comment process, the Division does not require companies to follow a formal protocol in consulting with its staff or in seeking reconsideration of a staff comment. To make it easier for a company to identify the appropriate people to contact about a filing review, the Division includes the names and phone numbers of the SEC staff members involved in that review in each of its comment letters.

If a company wishes to seek more senior level reconsideration of a matter during the filing review process, it is acceptable to do so. Additionally, with respect to matters pertaining to the proper application of generally accepted accounting principles, companies may seek the views of the Office of the Chief Accountant of the SEC.

*A more detailed discussion of the filing review process used by the Division of Corporation Finance can be found on the SEC's website at <http://www.sec.gov/divisions/corpfin/cffilingreview.htm>*



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## About PwC's Health Industries Group

PwC's Health Industries Group ([www.pwc.com/us/healthindustries](http://www.pwc.com/us/healthindustries)) is a leading advisor to public and private organizations across the health industries, including healthcare providers, pharmaceuticals, health and life sciences, payers, employers, academic institutions and non-health organizations with significant presence in the health market. Follow PwC Health Industries at @PwCHealth.

A leading professional services firm, PwC US helps organizations and individuals create the value they're looking for. We're a member of the PwC network of firms in 158 countries with more than 180,000 people. We're committed to delivering quality in assurance, tax and advisory services.

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