

*October 2006*

## **Ensuring Accountability in Not-for-Profit Health Care**

Religious and other not-for-profit organizations, including hospitals, must be more accountable for their tax-exempt status, says a recent policy paper adopted by Florida Hospital and its parent company, Adventist Health System (AHS). The paper addresses some policymakers' concerns that these organizations must better "prove" the value of their tax-exemptions.

This *Health Issues Brief* discusses this issue and outlines Florida Hospital's efforts to set the standard in not-for-profit accountability.

### **Background**

Fifty-eight percent of US hospitals are not-for-profit hospitals (NFPs). They were initially granted tax exemptions to care for the poor. In 1969, IRS ruling 69-545 created the non-defined term of "community benefit" that expanded exemption eligibility beyond charity care alone.

Today, after nearly 40 years of changes in health care delivery and continuing discussion around the definition of community benefit, Florida Hospital is recommending more quantification within IRS Ruling 69-545.

### **Accountability**

Over the past two years, hospital tax exemption has been the subject of much debate. Congress has held hearings in both the houses, and commissioned a Government Accountability Office (GAO) report on tax-exempt and other hospitals. The IRS distributed a voluntary 72-question community benefit questionnaire this past spring to 600 tax-exempt hospitals. State Attorneys General in Illinois, Minnesota and Ohio have questioned the practices of some tax-exempt hospitals in their states.

Key issues in all these discussions include the definitions of charity care and community benefit. Other issues include executive compensation and financial margins.

"The current IRS guidelines should be updated to include clear and specific guidance to the not-for-profit sector regarding tax-exempt guidelines," said Rich Morrison, Corporate Vice President for Government Affairs. "Such an update would improve enforcement of tax-exempt policies and guard against potential abuse."

### **Why is not-for-profit health care important to Central Florida?**

Florida Hospital, Orlando Regional Healthcare and Health Central are all not-for-profits (NFPs) that provide hundreds of millions of dollars in community benefit each year.

National studies show that, as a group, NFPs have higher quality and lower charges.

They also:

- Make greater capital investments
- Provide more charity care
- Subsidize low-margin or money losing services like medical education and trauma
- Fund most research and medical professional training
- Treat far more Medicare and Medicaid patients

## Florida Hospital Recommendations

Florida Hospital agrees that charity care is a key indicator. Still, a focus on the greater context of not-for-profit health care and its long-term benefit to the community is also crucial.

"Not-for-profit hospitals provide many benefits that for-profits don't," said Morrison. "They are the safety net for the poor. As a group, we have lower charges and provide services based on need vs. profitability. Our margins are reinvested into the community instead of going to shareholders."

Morrison stressed, however, that tax-exempt hospitals should use standardized and transparent accounting methods to count community benefit. The IRS guidelines should also provide clear guidance on executive compensation and cash on hand, as well as capital investments. Specific recommendations for an update to Ruling 69-545 include:

**Charity care:** Hospitals should offer discounts to patients with household incomes below 400% of poverty. While not-for-profit hospitals have a particular obligation to provide care to the poor, the extent of uninsured in 1969 was no where near the 21% it is today. The un-reimbursed cost of uninsured care should be counted as a community benefit.

**Charity care calculated at cost:** Charity care should be based on costs (not charges) and should be calculated conservatively, using the ratio of operating costs to gross operating revenue.

**Bad debt:** Bad debt should not be counted as community benefit. The exception may be bad debt in the emergency department.

**Medicare and Medicaid:** Federal laws require not-for-profit hospitals to participate in Medicare and Medicaid, and NFPs see much higher percentages of government patients than for-profits do. Revenue shortfalls (below operating costs) from government payors should count as community benefit. For example, over 40% of Florida Hospital's patients have Medicare, which pays just 67% of costs.

**Subsidized services:** Not-for profit hospitals provide the great majority of services that generate low or negative margins, including trauma centers, burn centers and psychiatric care. Losses not booked as pure charity care or Medicaid should be counted.

**Research and Education:** Not-for-profit hospitals also provide nearly all physician and health professional education as well as extensive research, health education and community partnerships. Losses from these programs should be counted as community benefit.

**Capital investments:** As a group, not-for-profit hospitals invest far more in capital than their for-profit counterparts. These expenditures should be measured over five years instead of one, in order to reflect ongoing investment in the community served. This is consistent with IRS Rule 83-157.

### Defining Community Benefit

The type of not-for-profit hospital -- urban, tertiary referral, suburban or rural -- should be considered when calculating community benefit.

Urban hospitals typically absorb very high losses from their high percentages of Medicaid and charity patients. They may or may not need a stringent community benefit plan.

Similarly, rural hospitals in impoverished places like Appalachia may be the only source of care for their communities. In this case, the hospital's sheer existence is a community benefit.

Large tertiary care centers like Florida Hospital may have a more balanced patient mix but also absorb big losses from Medicaid and charity patients. These hospitals should receive credit for these losses and also take active roles in collaborating around community health improvement.

Suburban not-for-profits with minimal charity care may need a disciplined community benefit plan and active health improvement programs.

**Retained Cash:** Not-for-profit hospitals with high bond ratings can find the most affordable financing for capital projects. One factor in bond ratings is cash-on-hand. At this time, there is no limit on this amount. Florida Hospital recommends a target of 250 days cash-on-hand; or invest in additional services. This would ensure that the NFP uses its resources for the community it serves.

"We believe these updates to the IRS ruling will help all hospitals better quantify their community benefit as well as keep the process transparent," said Morrison. "We have had conversation with the IRS and other policy-makers, and believe we are headed in the right direction for the future."