ACCOUNTING PRINCIPLES (Cont'd)

Once a nursing home has applied one of these methods, that method must be used consistently thereafter.

LEASES

Often a facility will obtain the use of land, buildings, or equipment by entering into an agreement to lease them from an outside party. In some cases a lease is merely obtaining the use of an asset for a specified period; however, under certain conditions a lease is considered to be in substance a purchase of property. For a determination of the acceptable accounting treatment for leases, reference should be made to:

Accounting for Leases - Statement of Financial Accounting Standards No. 13

TIMING DIFFERENCES

Timing differences result when accounting policies and practices used in an organization's accounting differ from those used for reporting operations to governmental units collecting taxes or to outside agencies making payments based upon the reported operations. These differences must be recorded on the Nursing Home's records when they arise. The references relative to their acceptable accounting treatment are as follows:

- Income tax allocation - Accounting Principles Board Opinions Nos. 11, 23 and 24.

ACCOUNTING PRINCIPLES (Cont'd)

- Third-Party Cost Reimbursement - Timing Differences - Hospital Audit Guide.

The following condensed income statement illustrates a timing difference attributable to different methods of calculating depreciation expense for financial accounting versus tax or third-party reimbursement purposes.

Assumptions:

1. Depreciation for accounting purposes is calculated on the straight-line method and amounts to $10 for the current year.

2. Depreciation for tax and third-party reimbursement purposes is calculated on a declining balance method and amounts to $20 for the current year.

3. The tax rate is 40%.

4. The third-party utilization is 50%.

5. The only deduction from revenue is the contractual allowance.

ACCOUNTING PRINCIPLES (Cont'd)

	Accounting Records	Tax/Third-Party Cost Report
Revenue	$180	$180
Deductions from Revenue	(B) 30	(B) 25
Net Revenue	150	155
Expenses (excluding Depreciation)	110	110
Depreciation	10	20
Total Expenses before taxes	120	130
Income before taxes	30	25
Taxes	(A) 12	(A) 10
Net Income	$ 18	$ 15

(A) The income tax expense is comprised of three components:

(1) $10 currently payable, (2) $4 payable in future periods representing the tax effect of the difference between depreciation expense for accounting and tax purposes (40% X $10 = $4), and (3) $2 to be applied against tax liabilities in future periods, representing the tax effect relative to reimbursement caused by the difference between depreciation for accounting purposes and cost report purposes, computed as follows: 40% (tax effect) X 50% (third-party utilization) X $10 (difference between depreciation for accounting and cost report purposes) = $2 or stated

ACCOUNTING PRINCIPLES (Cont'd)

another way, it is the difference between the deductions from revenue per the accounting records ($30) and the Tax/Cost Report Records ($25) times the tax rate of 40%. The journal entry to record these items is:

			Account
DR. Income Tax Expense-Current	$10		9011.00
DR. Income Tax Expense-Deferred	$ 2		9015.00
CR. Income Taxes Payable		$10	2091.00
CR. Deferred Income Taxes Payable		$ 2	2122.00

(B) The deduction from revenue (contractual adjustments) is calculated as follows:

	Accounting Records	Tax/ Cost Report
Medicare Revenue ($180 X 50%)	$90	$90
Reimbursable Costs:		
$120 X 50%	60	
$130 X 50%	—	65
Contractual Adjustment	$30	$25

Of the $30 contractual adjustment for accounting purposes, $25 is the current portion and $5 is the deferred portion. The journal entry to record this expense is: