

Continuum

Strategies and Solutions for Providers of
Long-term Care, Hospice, and Home Healthcare

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In This Issue

The 2008 Form 990 Is Here

The Role of Information
Technology Controls in
Not-for-profit Healthcare
Organizations

Reimbursement Update:
Rating the Quality of
Nursing Homes



In This Issue

The 2008 Form 990 Is Here..... 1

By GERALYN R. HURD, CPA, and NICOLE M. BENCIK, CPA

The Role of Information Technology
Controls in Not-for-profit
Healthcare Organizations 3

By JEFFREY A. PALGON, CPA, CISA, CISSP

Reimbursement Update: Rating
the Quality of Nursing Homes..... 5

By SCOTT E. MARTIN, CPA

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The 2008 Form 990 Is Here

By GERALYN R. HURD, CPA, and NICOLE M. BENCIK, CPA

The Internal Revenue Service (IRS) has released the “final” instructions for the new Form 990, and many entities, including not-for-profit healthcare organizations, must file the expanded form for 2008. Authors GERALYN HURD and NICOLE BENCIK discuss some of the significant changes in the instructions and the greater level of disclosure – and effort – Form 990 requires.



The extensive Form 990 has ignited much debate and discussion the past year. The previous Form 990 failed to allow a not-for-profit organization to tell its best “story” and the impact of its activities. The new Form 990 runs 80 pages and requires much more information beyond the audited financial statements.

The revised form seeks to provide enough information for an organization to annually prove its privilege of tax-exempt status. In many ways, the form becomes an organization’s most revealing public relations document, vital to both retaining its exempt status and raising funds. In particular, information related to the areas discussed here could prove critical to various stakeholders.

Governance

Part VI and its corresponding schedules require information about the organization’s governing body and

management, policies, and disclosure practices. This section captures information related to many of the Panel on the Nonprofit Sector’s “Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations.”

For example, Part VI, Line 1b, of the core form, “Return of Organization Exempt From Income Tax,” asks how many voting board members are independent. According to the instructions (which are being called final but could be changed yet), a board member is independent if:

1. The member was not compensated as an officer or employee of the organization or a related organization;
2. The member did not receive annual total compensation or other payments exceeding \$10,000 from the organization or a related organization as an independent contractor; and

3. Neither the member nor any family member was involved in a transaction with the organization or a related organization that must be reported on Schedule L, “Transactions with Interested Persons.

The four-part Schedule L requires disclosure of family or business relationships with other officers, directors, key employees, the organization’s highest-paid employees, or top independent contractors. An organization must report:

1. Excess benefit transactions (only for 501(c)(3) or 501(c)(4) organizations);
2. Loans, including salary advances and other advances and receivables, outstanding at year-end to and from interested persons;
3. Grants or assistance (including provision of goods, services, or use of facilities) benefiting interested persons, including a substantial contributor or a related person; and
4. Business transactions involving interested persons if: a) all payments during the year between the organization and the interested person exceeded \$100,000; b) all payments during the year from a single transaction between such parties exceeded the greater of \$10,000 or 1 percent of the organization’s total revenues; or c) compensation payments by the organization paid to a family member of certain persons exceeded \$10,000.



Form 990 also expands the information required about an organization's conflict of interest policy. It is no longer sufficient simply to report whether the organization has a written policy. Core Form, Part VI, Lines 12b and 12c ask if officers, directors, or trustees, and key employees are required annually to disclose interests that could give rise to conflicts and if (and how) the organization regularly and consistently monitors and enforces compliance. Schedule O requires additional disclosure of the process.

Compensation

In Part VII, organizations must report their compensation of officers, directors, trustees, key employees, independent contractors, and the five most highly compensated employees who are paid more than \$100,000. The "final" instructions clarified a revised definition for key employees. A key employee must satisfy three tests:

1. The \$150,000 Test: The employee receives reportable compensation exceeding \$150,000 for the year.

2. The Responsibility Test: The employee a) has responsibilities, powers, or influence over the organization as a whole similar to those of officers, directors, or trustees; b) manages a discrete segment or activity of the organization that represents 10 percent or more of its activities, assets, income, or expenses; or c) has or shares authority to control or determine 10 percent or more of the organization's capital expenditures, operating budget, or compensation for employees.
3. The Top 20 Test: The employee is one of the 20 employees who satisfy the other two tests with the highest reportable compensation from the organization and related organizations for the calendar year.

In the past, key employees typically included chief executive officers, chief financial officers, executive directors, and administrators. The new definition could ensnare a program director, for example, who accounts for 30 percent of an organization's revenues if the director makes more than \$150,000. Such an employee would then have his or her compensation publicly disclosed and be subject to the conflict of interest rules.

Schedule J, "Compensation Information," will now require an organization to break down a covered individual's W-2 or Form 1099 into base compensation, bonus or incentive payments, and other compensation, plus any deferred compensation and nontaxable benefits like housing and insurance.

Fundraising and Gaming

According to the IRS, increasing concerns about noncompliance with federal and state regulations for gaming and other fundraising activities, as well as "the lack of transparency concerning fundraising activities, particularly regarding how much of each dollar given by a donor in good faith is actually provided to a charity for charitable work," led to the creation of Schedule G. The schedule, "Supplemental Information Regarding Fundraising or Gaming Activities," requires extensive recordkeeping as well as separate reporting for fundraising and gaming.

In Part I, an organization must disclose how it solicits donations (via e-mail, telephone, grant applications, or fundraising events). Professional fundraisers must now be disclosed if the individual receives more than \$5,000 in compensation. Not-for-profits must list all states in which they are registered or licensed to solicit funds or have been notified they are exempt from registration or licensing. It is imperative to review each respective state's registration requirements.

Parts II and III segregate the fundraising from the gaming. In Part II, an organization must provide details on its two highest-grossing events. Part III breaks out gaming into bingo, pull tabs/instant bingo/progressive bingo, and other gaming, and requires additional information as well.

Stepping Up to the Plate

Not-for-profit organizations need to take several steps to deal with the heightened requirements of the new Form 990. They must develop an action plan for determining which schedules to file each year and designate individuals to compile the requisite information. An organization's plan should include training those individuals, including the payroll department and legal counsel, who will be responsible for gathering information.

Finally, the board must understand its increased accountability for Form 990, which specifically inquires whether the board has reviewed the form before its filing. An organization will suffer no direct IRS consequence if the query is answered in the negative, but the response might concern stakeholders. Form 990 is a publicly disclosed document, and stakeholders undoubtedly will be watching.

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The Role of Information Technology Controls in Not-for-profit Healthcare Organizations

By Jeffrey A. Palgon, CPA, CISA, CISSP

As information technology (IT) systems have proliferated among not-for-profit organizations, including healthcare groups, the internal controls that protect those systems and the data they use have become increasingly important. Author Jeffrey Palgon describes some of the challenges that not-for-profit executives face in managing these controls and preparing for newly required reviews of IT controls.

The failure of Enron, WorldCom, and other large corporations at the beginning of this decade put a 500-watt spotlight on internal controls.

Nonprofits Assistance Fund, a 501(c)(3) organization that makes loans to not-for-profit organizations, defines internal controls as “the system of practices, procedures and policies intended to safeguard the assets of the organization from fraud or error and ensure accurate recordkeeping.” Internal controls can range from something as simple as requiring employees to lock file rooms containing patient medical records to something as complex as mandating a comprehensive review of fundraising protocols.

The lack of an effective system of internal controls contributed to the downfall of many corporate giants. To help prevent similar economic disasters from happening in the future, lawmakers and regulators have enacted a series of requirements designed to strengthen organizational internal control structures.

In 2006, The American Institute of Certified Public Accountants (AICPA) issued a set of eight Statements on Auditing Standards (SAS) that focus on risk assessment. These standards, known as SAS 104-111, are designed to help nonpublicly traded organizations – including not-for-profits – improve their internal checks and balances.²

As not-for-profit organizations begin to comply with the AICPA’s new standards, they are paying closer attention to

the internal controls protecting their information technology assets. Because of the increased reliance that not-for-profits are placing on technology and external auditors are placing on internal controls, it is important for not-for-profit leaders to understand the role of IT controls in their organizations.

General and Application Controls

IT controls fall into two categories:

1. General controls protect an organization’s entire IT infrastructure. They ensure the integrity of the environment for business applications – such as payroll, accounts payable, and human resources – as well as the data within those applications.
2. Application controls are automated checks and balances within the IT system that help ensure that transactions are processed properly and as intended.

General controls permeate the entire organization. They include higher-level activities, such as IT planning, systems acquisition, and systems monitoring. They address questions such as: How does management evaluate what applications it requires? How does it test and implement those applications? How does management monitor what happens on its IT systems?

Application controls are specific to individual business functions. Access to applications is a critical issue: Can anyone in the organization view certain records, or does each person need

a user name and password to view records? Are there restrictions within an application so that someone in the payroll department doesn’t have access to the purchasing department’s files? Application controls also focus on changes to software code – who is authorized to make those changes, and who must approve them before they can go live?

Organizations and external auditors are placing increased emphasis on the efficacy of IT controls. For example, instead of just examining general ledger transactions, external auditors now focus more on the controls that safeguard those transactions. In many cases, those controls are part of the IT systems that organizations use to run their businesses.

Segregating duties in the accounts payable process is a common example. In most organizations, one person approves an invoice, a second person prepares the check, and a third person signs the check. The same holds true for IT systems. If one person initiates a wire transfer, a second person should approve it, and a third person would process the transaction.

Challenges to the IT Control Environment

Program development and program changes are two of the more complex areas of the IT control environment where not-for-profit organizations tend to be deficient. Many organizations have small IT departments, where employees develop, test, and implement changes

Risk Factors to Assess Periodically		
Risk Factors	Higher-risk Considerations	Lower-risk Considerations
Nature of technology	Complex, unique, customized, developed in-house	Simple, commonly used, off-the-shelf
Nature of people	Inexperienced, lack of training, limited number, high turnover	Experienced, trained and specialized, sufficient resources, low turnover
Nature of process	Decentralized, multilocation, ad hoc	Centralized, formalized, consistent
Experience	History of problems, including processing errors, system outages, and data corruption	No history of problems
Significance to the financial reports	Direct – used for initiating and recording amounts into the financial reports	Indirect – used for analytical purposes, but does not initiate or record amounts into the financial reports

to applications. It's not uncommon for employees wearing two or three hats in a leanly staffed IT department to fail to maintain adequate records of the application changes. This lack of documentation makes it difficult for auditors as well as future employees to determine what changes were made.

Ensuring that such changes are made with proper review and approval requires establishing appropriate controls, such as having someone in the accounts payable department approve any changes to the accounts payable system after the changes have been tested.

Batch processing is another IT area where not-for-profit organizations encounter challenges. Many batch processes run automatically, often every night. If one of those batch processes fails and no one notices the error, then subsequent batch processes could be incorrect as well. Appropriate IT monitoring controls can help prevent such errors.

From the perspective of the IT user, access to programs and data can present challenges to the IT control environment. Organizations should have formal procedures for granting employees access to the information they need to do their jobs while restricting access to information they do not require. Individual employees should not be granted access to certain data without a supervisor first approving the request in writing, so that an audit trail can be established. In addition, when employees leave the organization, IT controls should trigger a swift, automatic protocol for terminating their access to the IT system.

Not-for-profit organizations frequently outsource core accounting and other functions to external service providers. These vendors host the applications,

make all system changes, and process all transactions for their clients. If a vendor's IT controls fail, their clients could suffer, too.

To help mitigate the risk of outsourced IT control failures, vendors obtain audits of their IT controls under SAS 70, "Reports on the Processing of Transactions by Service Organizations." A SAS 70 audit demonstrates to clients that the vendor's IT controls have been tested according to the standard. Not-for-profit organizations should look at their outsourcing service providers as an extension of their own control environment and understand the scope, results, and any issues identified in their vendors' SAS 70 audit reports.

Preparing for an IT Controls Review

Under the AICPA's new risk assessment standards, not-for-profit organizations are required to have their external auditors perform an annual review of their IT controls. To prepare for such a review, organizations should examine their IT policies and procedures, update any that are not current, identify any policies that are not yet in place, and develop a written plan for implementing those policies.

It is also appropriate for organizations to provide their auditors with an application and technology inventory worksheet, which helps auditors understand what systems each organization has and which systems require proper IT controls. The worksheet might include:

- The application name;
- Related business process (financials, payroll, subsidiary accounting);
- Application details (package or in-house, customized, owner);

- The database the application uses;
- The operating system on which it runs;
- The hardware platform it uses; and
- The application's physical location.

In preparing for their IT review, organizations also need to assess risks that they and their IT environments face. For example, software applications that are complex, unique, customized, or developed in-house carry higher risk, while applications that are simple, commonly used, and off-the-shelf afford lower risk. Other risks include people, processes, past experience, and the significance of risks to the financial reports (see table, "Risk Factors to Assess Periodically").

Internal controls play an essential role in protecting the information systems and data that not-for-profits require to carry out their missions. Understanding the various types of IT controls that organizations rely on and assessing their effectiveness according to the type of risks they present are critical responsibilities for not-for-profit executives.

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¹ www.nonprofitsassistancefund.org/pages/glossary#1.

² For a discussion of the AICPA's risk assessment standards, see Eric J. Marion, "An Individual Approach for Auditing: New Risk Assessment Standards," *Continuum* Winter 2008. http://folio.crowehorwath.com/files/PDF/PUB7196_IndApproach.pdf.

Reimbursement Update

By Scott E. Martin, CPA

In December 2008, the Centers for Medicare & Medicaid Services (CMS) launched its new Five-Star Quality Rating system for evaluating for-profit and not-for-profit nursing homes that participate in the federal Medicare program. This rating system is a result of continued efforts by CMS to focus on and emphasize quality in the nursing home component of the healthcare continuum.

This effort is spurred by the *Omnibus Budget Reconciliation Act of 1987* (OBRA '87), part of which is a federal nursing home reform law, and more recent improvement initiatives, such as *Advancing Excellence in America's Nursing Homes*, a coalition of consumers, healthcare providers, and nursing home professionals.

The rating system was created to help consumers, their families, and caregivers compare nursing homes more easily and to help those stakeholders identify questions they might want to ask in connection with nursing home care.

The nursing home ratings are derived from three sources of data:

1. Health inspections
2. Staffing
3. Quality measures

CMS calculates a star rating for each of these sources and then combines the three ratings to calculate an overall rating. The rating ranges from one to five stars, with five stars being the most favorable. More information about the system, including quality ratings for thousands of nursing homes, can be found at www.medicare.gov/NHCompare.

The Five-Star Quality Rating system has not been without controversy, as nursing home trade associations have strongly expressed concern that the

ratings are based on subjective, out-of-date, overly simplified, or otherwise flawed data.

Nevertheless, given that the ratings are public and used to assess the overall quality of nursing homes, it is very important for nursing home providers to perform an in-depth evaluation of their specific ratings to determine the accuracy of the calculations and consider what improvements would raise their ratings. In addition, there has been speculation in the industry that in the future such quality ratings could be tied to Medicare reimbursement.

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