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health adviser

Contents

- Surviving the PHO minefield
- Double hit on property investors
- Banking on the Bank?
- US Estate Tax
- International Financial Reporting Standards

Surviving the PHO minefield

Many general practices have been part of a Primary Health Organisation (PHO) for more than twelve months now. The impact on cashflow varies from practice to practice depending on whether they are funded under the Access formula or the Interim formula.

The common issues arising for practices that have joined a PHO are:
- How to allocate the funds between practitioners within the practice;
- How to manage the impact of clawbacks on cashflow.

How to share the PHO income - A range of options are being implemented for sharing PHO revenue amongst practitioners within a group practice. Largely the choice of method will be dependent on the manner in which the practice has previously been sharing income or more specifically Government funded income. The manner in which revenue is shared can determine whether goodwill is owned by the individual practitioner or the group practice itself. This can be an important issue if you are contemplating selling your practice.

Some models to consider:

Corporate Model - All capitation funding and patient co-payments belong to the Group Practice (company or partnership) with shareholder/partner GPs being allocated a sessional fee for sessions worked as well as a percentage of fees generated by each respectively. Any surplus after paying practice overheads would be shared equally according to shareholding as a return on investment.

Fee For Service Model - All capitation funds are pooled into a bank account. Those funds are allocated to a practitioner if they see a "GMS type patient". That is a patient who previously would have previously qualified for GMS funding. The payment to the doctor from the capitation account would depend on whether a child or adult had been seen. An in-house payment schedule could be set up based on the old GMS payment schedule with allowances for CPI adjustments. Existing practice management systems already in place have the ability to easily track which patients are GMS type patients. This model allows an easier entry into the capitation funding regime.

Surviving the PHO minefield (cont)...

Cost Centre Model - This is a variation of the Fee for Service Model where all PHO monies are paid directly to the practitioner for whom the funding relates. Those doctors with more children or elderly patients would therefore receive a greater portion of the PHO funding. Each doctor would then need to make a regular contribution into the cost-centre account for their allocated share of practice overheads. The cost-centre, either a company or partnership, would usually employ staff and hold the lease of the building. Adjustments would be necessary if a doctor was to see a PHO-funded patient who had enrolled with another doctor in the practice, as the lower patient co-payment would disadvantage that doctor financially.

Easing the impact of clawbacks

Many practitioners have been surprised by the magnitude of some claw-backs required. Hopefully as patients become more educated regarding the PHO regime, the size of the claw-backs will be reduced.

Practices could also consider the following to try and minimise claw-backs:

- Maintaining accurate and current patient registers;
- Staff incentives;
- Robust accounting systems to forecast cashflow movements.

Some practices have been able to better manage the impact of clawbacks by incentivising their staff to maintain more accurate registers. Staff are given targets for the month in terms of register accuracy and when they are reached, a sum of money which has been allocated to a pool is shared amongst the administration staff. The co-operation of administration staff will be key to smoothing out some of the frustrations of PHO funding.

Secondly, the uncertainty of PHO funding has given further reason for practices to ensure that cashflow is carefully managed and cashflow projections are updated regularly. For example, practices should anticipate that over the winter months, patients are more likely to visit other practices after hours. This should be factored into your cashflow over that period.

The above is a brief summary only of the potential issues to be considered by PHO funded practices. Many practices have now had a sufficient settling in period to identify the impact of PHO funding on their practice, both cashflow-wise and the effect it has on the financial equity between partners/shareholders within the group. It is now time to start considering options to iron out these issues going forward.

Double hit on property investors - **The IRD has delivered a double hit to residential property owners.**

LAQC's and the family home - The first blow is to taxpayers whose family home is owned by a loss attributing qualifying company (LAQC). The IRD has noted its concern regarding the practice of some taxpayers selling their private home to an LAQC and then claiming tax deductions.

A typical scenario involves an individual taxpayer selling their home to an LAQC, of which they are a shareholder, and then paying rent to the LAQC to continue residing in the property. The LAQC will normally borrow the maximum finance to fund the purchase with the result that a tax loss is incurred which is attributed to the individual and offset against their other income.

The IRD considers that such arrangements will often be tax avoidance. Where this is proven, the IRD indicates that the taxpayer must pay the tax avoided as well as interest and a 100% shortfall penalty for taking an abusive tax position.

The IRD's concern is that a tax deduction is being claimed for what are seen as private expenses. In particular, they will be targeting LAQCs that only own the family home and not other investments and will be seeking non-tax reasons for this structure.

Proposed changes to tax depreciation - The second blow is to residential property investors generally. The IRD has suggested changes to the tax depreciation rules which will result in a reduced depreciation deduction for residential rental properties. The proposals are part of a general review of the depreciation rules. In relation to rental housing, the IRD is concerned that there are tax advantages for investment in residential property. In particular, they note that the depreciation rates for buildings may be too high with the increasing practice of splitting-out building components such as electrical wiring, plumbing and internal walls in order to apply higher depreciation rates.

In relation to the depreciation rate for buildings, a reduced rate is proposed of 2% straight-line or 3% diminishing value.

In relation to splitting-out building components, two options have been proposed. Under the first option, a list of separately depreciable assets would be identified, such as domestic appliances, hot water cylinders, carpets and light fittings, with the remainder of the building - including wiring, plumbing and internal walls - being depreciable at the building rate. An ndependent valuation would be required for the listed assets at the time of purchase and sale. The alternative option is to depreciate all assets as part of the building. This would remove any need for separate valuations on purchase and sale and would provide wider scope for repairs and maintenance deductions.

Banking on the Bank?

People often ask why won't the Bank advance me more funds - they have plenty of security from my house/ building/business.

Grant Thornton's Recovery & Reorganisation practitioners often encounter the harsh outcomes that arise when borrowing has been achieved based purely on this asset backing approach. These outcomes generally include business failure due to an excessive debt financing burden and the realisation of appreciating assets at fire sale prices.

Trading banks and ethical financiers realise the potential for these negative outcomes and often incorporate in their lending criteria the simple test of "would we still do this loan if there was no security?"

This sensible and ethical approach of ensuring future cash flows and profitability can meet the debt financing requirements, emphasises the desire of the financier to achieve a repayment of their advances without the requirement of entering the expensive, debilitating process of realising their security.

Looking at this from another perspective, consider being the victim of predatory lending practices. Put simply, these are the loaning of money at high entry fees and above market interest rates, with the intention of obtaining the asset tendered as security when the anticipated default occurs. The lending and credit procedures of trading banks and ethical financiers are designed and monitored by the Reserve Bank, to ensure customers are protected against these practices however, this does not prevent their occurrence as often when a borrower is initially declined, they then apply to parties who will provide the funds at a higher interest rate and overall cost.

The more rational approach we believe is to listen to the concerns of the lenders - these concerns emphasise real risks the borrower will face and that should be adequately addressed.

In most circumstances, the ability of a party to service debt and to obtain financing can be established by a process of forecasting and financial position evaluation that can be undertaken by a business adviser. If this process shows an inability to service debt or a finance application is declined, what is required is a further consideration of the borrower's priorities. For example, a declined business loan where the directors have offered all of their personal assets as security emphasises the impact a business failure may have upon their family. Is it therefore more appropriate to establish a path forwards that requires less debt financing or provides a higher ability to meet repayments?

When considering an application for additional financing, thought should also be given to the ability to make early repayments, the potential for staged draw downs and the term of the loan, which whilst lowering the repayments, can increase the overall cost. For example, a $10,000 loan at 10% over three years requires a total repayment of $11,500 approximately, whereas $10,000 at 7% over 25 years requires a total repayment of approximately $21,000.

US Estate Tax

US citizens, including people with dual citizenship, are required to report their world-wide income to the Internal Revenue Service each year. They are also subject to US estate tax of up to 55% of the value of their world-wide estate at the time of death.

By contrast, non US citizens are usually subject to US estate tax on their US based assets only, although some individuals may have a wider exposure.

US citizens who have lived outside the US for most of their lives may be unaware of their estate tax exposure. Similarly, their executors may be unaware of the US estate tax rules and their own potential exposure as representatives of the estate.

Individuals can choose to relinquish their US citizenship status to avoid US estate tax. However, in practice this is rare and can lead to reduced travel flexibility to the US and the loss of US social security benefits. It should also be noted that forfeiture of citizenship status does not immediately remove an individual's US income tax return filing obligation which continues for a further 10 years after the loss of citizenship status.

Individuals in these circumstances should consider obtaining specific planning advice. Relatively straight forward mechanisms can be used to mitigate and defer the estate tax cost.

International Financial Reporting Standards

New Zealand has joined much of the rest of the world in adopting international financial reporting standards (IFRS) with effect from 1st January 2007. There is an option to adopt the standards early with effect from 1st January 2005. The process of adoption will require restating the opening statement of financial position so that the assets, liabilities and equity meet the requirements of the IFRSs.

In order to present comparative financial information, an entity will be required to prepare their previous year's financial information based on IFRSs. This means that the opening statement of financial position which is required to be restated under IFRS, will be the balance date two years prior to the reporting date. For example, for entities with a March balance date applying IFRSs for the first time from 1st April 2007, the restated statement of financial position applies at 31st March 2006. Consequently for those entities that early adopt, the opening statement of financial position date may have already passed.

As well as a significant number of changes in the requirements of IFRSs, "new" terminology is used:

Current Terminology:	IFRS Terminology:
Statement of Financial Performance	Income Statement
Statement of Financial Position	Balance Sheet
Statement of Movements in Equity	Statement of Change in Equity

Currently, there is no provision for differential reporting exemptions which apply under the existing reporting framework. The Ministry of Economic Development is reviewing the reporting framework in New Zealand with a view to aligning the reporting framework with that of Australia. To this end, they issued a discussion document in March 2004 which recommended a 3 tier system of reporting requirements. Under the Financial Reporting Act 1993, the only entities affected by this Act are companies, and issuers that may not necessarily be companies. Partnerships, trusts and charities are not covered under the Financial Reporting Act. The proposed new reporting framework will cover all entities which will be governed by a revised financial reporting act. This may have significant impact on a number of entities depending on the tier that they fall into under the reporting framework. The Ministry of Economic Development is expected to release an update of the discussion document in the last quarter of 2004. Grant Thornton will be reviewing the discussion document in depth and will keep you informed of the developments in the reporting framework.

If you have any queries in relation to the reporting framework or the adoption of IFRSs, please contact your Partner.

If you require further information on any of these topics or would like details on any other accounting matters, contact your local Grant Thornton office:

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