



**First Capitol Consulting**

# Internal Controls for Loss Contingencies Arising out of the ACA

**Under ASC 450-20 of FAS 5**, a company must set aside reserves to cover a loss contingency if available information indicates that:

- (1) it is probable that a liability will be incurred as of the reporting date, and;
- (2) the amount of the loss can be reasonably estimated.

Such a loss contingency can arise from potential excise tax liability under the *Employer Shared Responsibility* requirements of the Affordable Care Act (ACA), located in Internal Revenue Code (IRC) Section 4980H (Section 4980H). Companies may be required to set aside reserves for such liability, which potentially began starting in January 1, 2015.

**Section 4980H identifies two types of potential excise tax liabilities:** Section 4980H(a) and Section 4980H(b) penalties.

- **Section 4980H(a)** calls for an excise tax on the employer of \$2,080 multiplied by each full time (FT) employee, if at least one such employee receives a premium tax credit from a healthcare exchange as a penalty for failing to make offers of healthcare coverage to 95% of full time employees (with potential transition relief of 70% for 2015 only).
- **Section 4980H(b)** calls for an excise tax of \$3,120 per FT employee if an employer fails to offer affordable and minimum value coverage and such employees receive a premium tax credit on the exchange.

Accordingly, the penalties under Section 4980H may fall under ASC 450's purview of a loss contingency, requiring a tax accrual. The penalties are probable of being incurred starting from potentially January 1, 2015 if the company cannot satisfy the ACA's requirements. Moreover, the amount of such penalties appears to be capable of reasonable estimation.

The absence of or the extent of tax reserves should be supported by the documented implementation of the company's internal controls that mitigate the risk of liability. In order to do so and properly evaluate such internal controls, coordination among the company's finance, tax, human resources, and internal audit operations will be necessary. This is needed for an external audit as well as for a CFO to sign off the company's financial statements.



The following offers some examples of internal controls to consider in view of the ACA.

## FT Determination Controls

- Documentation of **FT employee determination**: applied measurement method(s), consistency of application among hourly versus salaried employees and other approved categories, use to start dates and lengths of measurement, administrative and stability periods, treatment of rehires, special unpaid leaves
- Documentation of **completeness** of employee workforce in FT determination
- Documentation and calculation showing **offers of healthcare coverage** to applicable percentage of FT employees
- For **salaried employees**, documentation and calculation of hours of service based on weekly or daily equivalencies
- For **hourly workforce**, documentation and calculation of hours of service based on lookback methods
- For **employees with a change in position**, documentation of process to track changes in position and FT determination
- For **employees paid by methods other than hours of service** such as commissions, piecework and tips, documentation of process to track all other forms of compensation
- For **rehired employees**, documentation of process to track rehired status
- For **leaves of absence**, documentation of process to track whether paid or unpaid and if unpaid if fall into the categories FMLA, USERRA or jury duty

## Offer of Coverage Controls

- Documentation of **eligibility criteria**
- Documentation of policies that demonstrate no more than the **maximum 90 day waiting period before offering coverage**
  - a. For **employees hired into or changed to FT designated position**, application of offer of coverage no longer than the first day of the fourth calendar month after hire or change to FT designated position, including tracking employees who are trending towards FT to ensure offer of coverage is timely made.

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- b. For **other hourly employees**, application of measurement periods that comply with 90 day maximum waiting period.
- Documentation of **offer of coverage to eligible FT employees** (e.g., enrollment or acknowledgment and/or waiver of coverage)
- Documentation of non eligibility for employees who are not made offers of healthcare coverage:
  - a. **Tracking employees** trending towards 30 hours per week
  - b. **Scheduling controls** to control employee hours
- Documentation of whether **healthcare coverage satisfies minimum value** (e.g., Summary of Benefits and Coverage)
- Documentation of **affordability**, including the applicability of **safe-harbors** (federal poverty level, W-2 or rate of pay)

## Temps and Other "Non-Employee" Workforce Controls

- Documentation of how the **entire workforce was classified** as among W-2, leased employee or independent contractor and the criteria for such classifications
- Documentation of **enforcement of worker classification** policies
- Documentation of status as "**leased**" employee under IRC 414(n):
  - a. Appropriateness of **worker classification as "leased" employee**
  - b. Diligence in confirmation from **temp agencies offering affordable healthcare coverage** to temps, including seeking and obtaining documentation of offer
  - c. Documentation of **fee for temps with coverage** to be at a rate that is higher than for temps without coverage
- Documentation of **status as an independent contractor**
  - a. Appropriateness of **worker classification** as an independent contractor
  - b. Documentation of **policies setting** for the process for retaining independent contractors and how those policies are enforced
  - c. Documentation of showing that **IRS control factors** demonstrate no common law employment
  - d. Documentation of process and systems controls where an **independent contractor is changed to employee**



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First Capitol Consulting, Inc.

First Capitol Consulting, Inc. (FCCI) combines legal and tax expertise gained from decades of experience working in national law firms and “Big 4” accounting firms with innovative science, data analytics, and intelligent technology to provide unparalleled regulatory compliance services, tax strategies and actionable intelligence to help companies make wise business decisions.

FCCI’s technology platform, **Humanefits**, powered by its new proprietary **Workforce Intelligence Solutions Engine<sup>sm</sup> (WISE)**, is creating a revolution through synergies in data collection and reporting processes layered with E-sign technology.

Through its national regulatory compliance practice, FCCI is an industry leader in helping businesses successfully manage requirements of the Affordable Care Act (ACA). Among FCCI’s wide range of partners are 3 of the 10 top global accounting firms, and 15 leading health insurance brokers in the U.S.

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