Implementing Revenue Recognition for Health Care Organizations

RUSH

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CPAs & Advisors

JANUARY 2019

AGENDA

1. Introductions & Objectives
2. Background, Key Principles, & Transition
3. Common Industry Implementation Challenges
4. Disclosure & Other Considerations
5. Grants & Contributions

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INTRODUCTIONS

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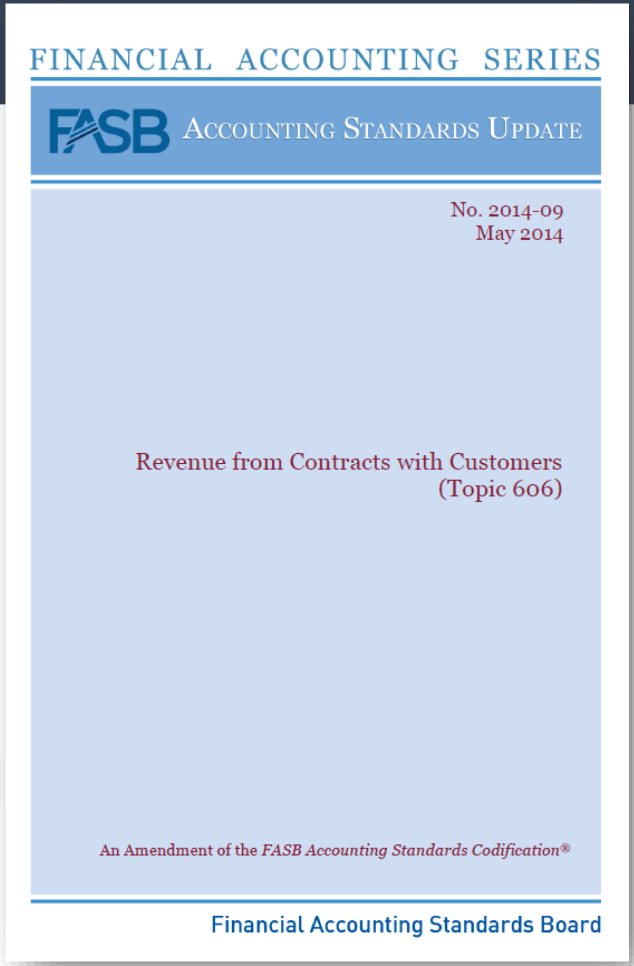
OBJECTIVES

1. Identify the requirements of the new Accounting Standards Codification Topic 606
2. Describe the five-step model to apply in recognizing revenue
3. Recognize the related financial reporting and disclosure implications specific to the healthcare industry
4. Learn practical adoption strategies
5. Understand best practices in communicating the changes to stakeholders

Background, Key Principles, and Transition

ASU 2014-09
REVENUE FROM CONTRACTS WITH CUSTOMERS


FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2014-09
May 2014

Revenue from Contracts with Customers
(Topic 606)

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

- Effective for Public Business Entities (& not-for-profit entities that are conduit debt obligors) in fiscal years & interim periods beginning after **December 15, 2017**
- Effective for all other entities in fiscal years beginning after **December 15, 2018**
- Principles based approach instead of a rules based approach
- Attempt to streamline, make consistent and enhance all revenue recognition guidance for all industries

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ASU 2014-09
REVENUE FROM CONTRACTS WITH CUSTOMERS

This ASU superseded health care industry-specific guidance & substantially all existing revenue recognition guidance & added significant interim & annual disclosures.

PROMISED GOODS OR SERVICES TO CUSTOMERS

CORE PRINCIPLE

recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity ***expects*** to be entitled in exchange for those goods or services

CONSIDERATION TO WHICH THE ENTITY EXPECTS TO BE ENTITLED

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NEW REVENUE RECOGNITION PROCESS

1. Identify Contract with a Customer
2. Identify Performance Obligations
3. Determine the Transaction Price
4. Allocate the Transaction Price
5. Recognize Revenue When/As a Performance Obligation is Satisfied

ASU 2014-09
REVENUE FROM CONTRACTS WITH CUSTOMERS

SCOPE OF NEW STANDARD

All entities that enter into contracts with customers and follow US GAAP:

- Public, private, not-for-profit
- Regardless of industry

EXCEPTIONS

- Lease contracts
- Insurance contracts
- Financial instruments
- Guarantees
- Non-monetary exchanges in the same line of business to facilitate sales to customers

EXCLUSIONS

- Contributions (See ASC 2018-08)
- Collaborative agreements

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TRANSITION APPROACHES

*assumes a public entity with a December 31 year-end

Transition Approach	2017	2018	Date of Cumulative Effect Adjustment*
Full Retrospective	Restate for all contracts	Apply to all contracts	January 1, 2017
Full Retrospective Using One or More Practical Expedients	Restate for all contracts except contracts covered by practical expedients	Apply to all contracts	January 1, 2017
Modified Retrospective	No contracts restated; reported based on legacy guidance	Apply to all contracts	January 1, 2018

TRANSITION HELP

FASB/IASB	AICPA	SEC
TRG • Advises the Boards • Does not have standard-setting authority	AICPA Financial Reporting Executive Committee (FinREC)	Focus on consistent application
	AICPA Revenue Recognition Working Group	Focus on accounting questions that may require standard setting
	AICPA 16 Industry Task Forces (RRTF)	Focus on internal controls, systems & processes

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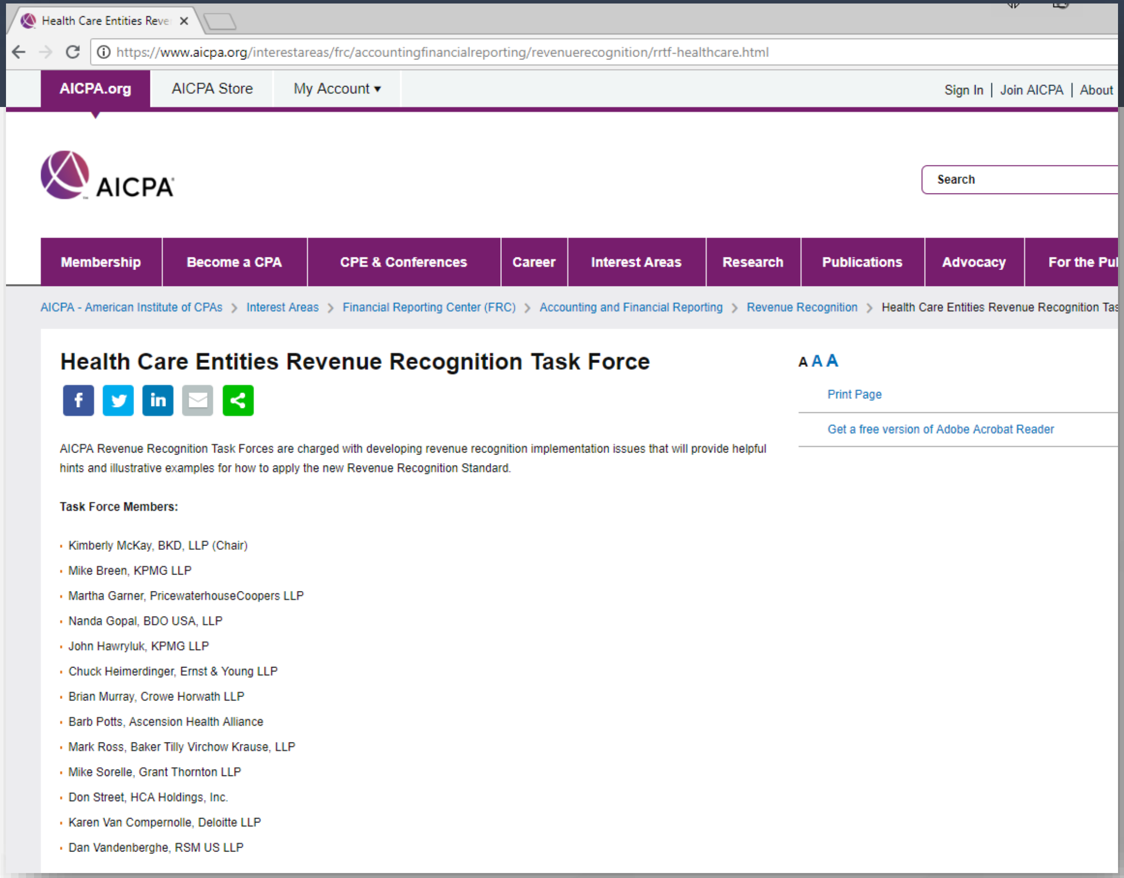
AICPA REVENUE RECOGNITION TASK FORCES (RRTG)


Health Care Entities Reve
https://www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/rrtf-healthcare.html
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Health Care Entities Revenue Recognition Task Force

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AICPA Revenue Recognition Task Forces are charged with developing revenue recognition implementation issues that will provide helpful hints and illustrative examples for how to apply the new Revenue Recognition Standard.

Task Force Members:

- Kimberly McKay, BKD, LLP (Chair)
- Mike Breen, KPMG LLP
- Martha Garner, PricewaterhouseCoopers LLP
- Nanda Gopal, BDO USA, LLP
- John Hawryluk, KPMG LLP
- Chuck Heimerdinger, Ernst & Young LLP
- Brian Murray, Crowe Horwath LLP
- Barb Potts, Ascension Health Alliance
- Mark Ross, Baker Tilly Virchow Krause, LLP
- Mike Sorelle, Grant Thornton LLP
- Don Street, HCA Holdings, Inc.
- Karen Van Compernolle, Deloitte LLP
- Dan Vandenberghe, RSM US LLP

- Develop a new Accounting Guide on Revenue Recognition
- Guide to provide helpful hints & illustrative examples on how to apply the standard
- Guidance will not be prescriptive but instead is intended to be a resource
- Full implementation issues are posted for comment after review from the overall Revenue Recognition Working Group & FinREC
- List of issues for the health care industry is posted on the AICPA website

https://www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/rrtf-healthcare.html

HEALTH CARE ISSUES IDENTIFIED BY THE AICPA REVENUE RECOGNITION TASK FORCE

Issues Identified and being addressed by Healthcare RRTF

- Revenue recognition for self-pay patients
    - Application of Steps 1 & 3
- Application of the portfolio approach
- Disclosure requirements
- Performance obligations (other than CCRCs)
- Third-party settlements
- Bundled payments & risk sharing arrangements
- Contract acquisition costs
- Performance obligations, etc. for CCRCs

HEALTH CARE ISSUES BEING CONSIDERED BY HFMA PRINCIPLES & PRACTICES BOARD

- Capitation revenue
- Update of HFMA Statement 15 on Bad debt & Charity Care
- Medicaid supplemental payment programs
- The effect of revenue recognition on Medicare cost reporting

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Common Industry Implementation Challenges

NEW REVENUE RECOGNITION PROCESS – RECAP:

1. Identify Contract with a Customer
2. Identify Performance Obligations
3. Determine the Transaction Price
4. Allocate the Transaction Price
5. Recognize Revenue When/As a Performance Obligation is Satisfied

1

STEP 1 – IDENTIFY CONTRACT(S) WITH A CUSTOMER

A legally enforceable contract can be ***written, oral or implied*** ***by an entity's customary business practices****, & needs to meet all of the following requirements:*

- It has commercial substance
- The parties have approved the contract & are committed to their obligations
- The entity can identify each party's rights regarding goods or services
- The entity can identify the payment terms for the goods or services
- It is probable the entity will collect the amount of consideration to which it will be entitled

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COLLECTIBILITY CONSIDERATIONS

Before applying the model in the standard to a contract, it ***must be probable that the entity will collect substantially all of the consideration*** to which it is entitled in exchange for the goods & services that will be transferred to the customer

If this collectability threshold is not met, a contract with a patient does not exist within the scope of the standard

A health care entity may make this determination based on past experience with that patient or class of similar patients

Assessment is based on both the customer's ability & intent to pay as amounts become due

May be difficult for entities to assess

No such thing as cash basis

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3

STEP 3 – IDENTIFYING THE TRANSACTION PRICE

Transaction price is the amount of consideration an entity expects to be entitled to

- Variable consideration
- Significant financing component
- Consideration payable to a customer
- Explicit & implicit price concessions
- Constraint of revenue

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IMPLICIT PRICE CONCESSION CONSIDERATIONS

What should we consider?

Customary business practice of not performing a credit assessment prior to providing services

Continues to provide services to a patient (or patient class) even when historical experience indicates that it is not probable that the entity will collect substantially all of the discounted charges (gross or standard charges less any contractual adjustments or discounts) in the contract

If one is present…

FinREC believes that the health care entity has implicitly provided a price concession to the patient (or patients in the patient class), **even if it will continue to attempt to collect** the full amount of discounted charges.

REASSESSMENT OF VARIABLE CONSIDERATION

Do we reassess?

An entity is required to update the estimated transaction price ***at the end of each reporting period***

If an entity experiences subsequent adjustments that result in decreases to patient revenue, the entity should re-assess whether its estimation process is appropriate

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Subsequent adjustments…

FinREC believes that changes in the entity's expectation of the amount it will receive from the patient (or patient class) will be recorded in revenue unless there is a patient-specific event that is known to the entity that suggests that the patient no longer has the ability & intent to pay the amount due & therefore the changes in its estimate of variable consideration better represent an impairment (bad debt).

BAD DEBT EXPENSE

So when would there be bad debt expense?

When a health care entity performs a credit assessment prior to providing services to a patient & expects to collect substantially all of the discounted charges

What's the impact?

For example, an elective procedure in which historical experience supports collection of substantially all of the discounted charges

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What's the expected impact?

Many health care providers expect a **significant decrease** in the provision for bad debts for services provided to uninsured & insured patients with co-payments & deductibles, in comparison to what is currently recorded under U.S. GAAP

PORTFOLIO APPROACH

Entities can apply the standard to a portfolio of contracts or performance obligations with similar characteristics

Entities must reasonably expect that the financial statement effect of using the portfolio approach will not differ materially from applying the standard on a contract-by-contract basis

Key considerations

How to apply a portfolio approach

How to establish portfolios

How to determine effect would not differ materially

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PORTFOLIO APPROACH

More on key considerations:

- Portfolio approach may be applied to all aspects of the model or only to certain steps
- If establishing portfolios, an entity will need to use judgment to determine the size, composition & number of portfolios
  - Health care entities may consider segregating by payor class, type of service & other categories
- An entity also will need to consider materiality & documentation requirements

PORTFOLIO APPROACH

- Considerations for a health care entity to determine in grouping contracts with similar characteristics for inclusion in a portfolio:
  - Type of service – e.g., inpatient, outpatient, skilled nursing, home health
  - Type of payors – e.g., insurance, governmental program, self-pay
  - Whether contracts are entered into at or near the same time
- A health care entity may include some or a combination of the above considerations in its determination of a portfolio
- A health care entity may reclassify the remaining self pay balance (co-pay or deductibles) into a separate portfolio after insurance company has paid

PORTFOLIO APPROACH

Portfolios Considerations

Service Type			Payer Type	
Current	Considerations		Current	Considerations
Inpatient	Inpatient		Medicare	Medicare / Mcr Adv
IP Rehab	IP Rehab		Medicaid	Medicaid
IP Psych	IP Psych		Medicaid Pend	Medicaid Pend
IP SNF	IP SNF		Exchange	Exchange A/B
Outpatient	Outpatient		MVA/TPL	MVA/TPL
	Emergency		Other	BCBS (Major)
	Elective		Patient Portion	HMO/PPO
	Revolving			Work Comp
	Sub-type (Lab)			Comm - High Deduct
				Other Comm
				Other Gov
			Uninsured	Uninsured - Elective
				Uninsured - Other
			Charity	Charity

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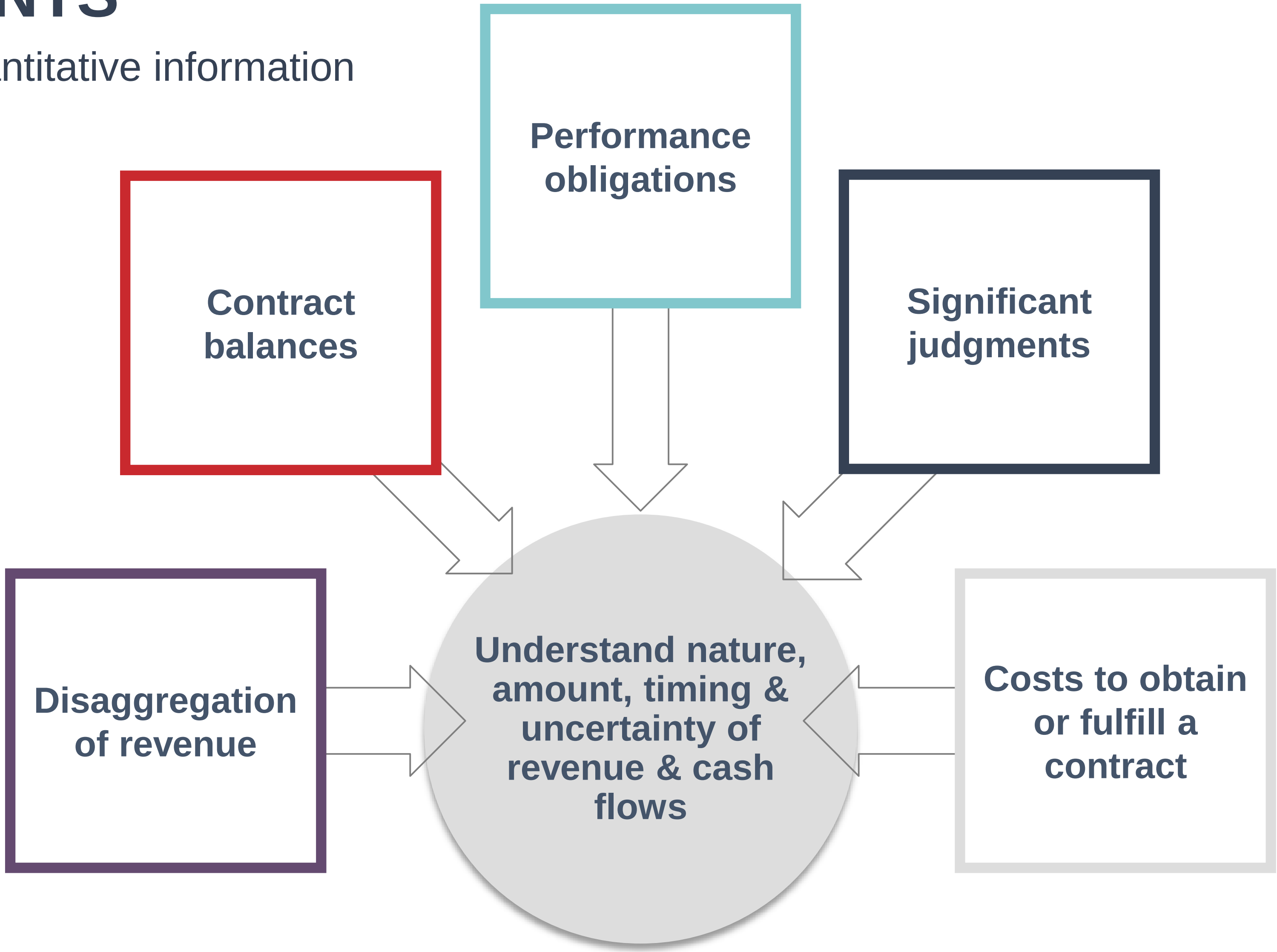
COMMON QUESTIONS IN ADOPTION

1. Do we need any new systems? Will our general ledger change?
2. Will we have any bad debt expense?
3. What about patients “in-house” at period end?
4. Who should be involved in the implementation process?
5. How does this standard change the IRS Form 990, community benefit reporting & the cost report requirements?

Disclosure & Other Considerations

DISCLOSURE REQUIREMENTS

both qualitative & quantitative information



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DISAGGREGATION OF REVENUE FOR HEALTH CARE

Example categories

- Timing of transfer of goods or service
- Type of customer (e.g., Medicare, Medicaid, Self-Pay)
- Type of service (e.g., independent living, assisted living, nursing home)
- Type of contract (e.g., type A, B,C)
- Geographical location

DISAGGREGATION OF REVENUE FOR HEALTH CARE

Revenue Disaggregation by Payor

The composition of patient care service revenue by primary payor for the years ended December 31 is as follows:

	20x2	20x1
Medicare	$ 16,000	$ 15,000
Medicaid	6,000	5,000
Managed care	11,000	10,500
Commercial insurers	4,000	3,500
Uninsured	1,800	1,900
Other	1,000	1,000
	$ 39,800	$ 36,900

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DISAGGREGATION OF REVENUE FOR HEALTH CARE

Revenue Disaggregation by Region, Service Line, Reimbursement & Timing

	20x2			
	Northeast	Central	Southeast	Total
Services lines:				
Hospital-inpatient	$ 3,500	$ 1,000	$ 3,000	$ 7,500
Hospital-outpatient	4,500	2,000	2,000	8,500
Physician services	3,000	3,000	5,000	11,000
Home health & hospice	1,000	800	2,000	3,800
Retail sales	2,000	2,000	4,000	8,000
Other	400	200	400	1,000
	$ 14,400	$ 9,000	$ 16,400	$ 39,800
Method of reimbursement:				
Fee for service	$ 8,900	$ 5,300	$ 6,000	$ 20,200
Capitation & risk sharing	3,100	1,500	6,000	10,600
Other	2,400	2,200	4,400	9,000
	$ 14,400	$ 9,000	$ 16,400	$ 39,800
Timing of revenue & recognition:				
Health care services transferred over time	$ 12,400	$ 7,000	$ 12,400	$ 31,800
Retail pharmacy & equipment sales at point in time	2,000	2,000	4,000	8,000
	$ 14,400	$ 9,000	$ 16,400	$ 39,800

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DISCLOSURE REQUIREMENTS

Quantitative & Qualitative Disclosures

- Contracts with Customers
- Significant Judgements
- Assets Recognized

Level of Detail

- Need enough to explain, not so much it confuses

Performance Obligations

- Over time or a Point in time

Transaction price

- Allocation & subsequent changes
- Optional disclosures
  - Implicit price concessions

THIRD PARTY SETTLEMENTS

- Determination of the transaction price for third party settlements
    - Medicare/Medicaid cost report settlements
    - RAC accruals
    - Risk adjustments for prepaid health plans
    - Other
- Use method which entity expects to better predict the amount of consideration to which it will be entitled
    - Use of Expected Value (probability-weighted amount)
    - Use of Most Likely Amount (single most likely amount in a range of possible considerations)

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THIRD PARTY SETTLEMENTS

EXPECTED VALUE	MOST LIKELY AMOUNT
• Sum of the probability-weighted amounts in a range of possible outcomes • Most predictive when the transaction has a large number of possible outcomes	• The single most likely amount in a range of possible outcomes • Most predictive when the transaction has two possible outcomes

- Required to evaluate whether to "constrain" amounts of variable consideration included in transaction price
- Objective of the constraint – include variable consideration in the transaction price only to the extent it is "probable" that a significant revenue reversal will not occur
- Estimates must be updated each reporting period

BUNDLED PAYMENT ARRANGEMENTS

Step 1 | Identification of The Contract

FinREC believes the contract is with the patient not the third party payer

Step 2 | Performance Obligation

Care Coordination is not necessarily a performance obligation. Need to assess each contract & in addition consider implied promises & if so are they a distinct performance obligation

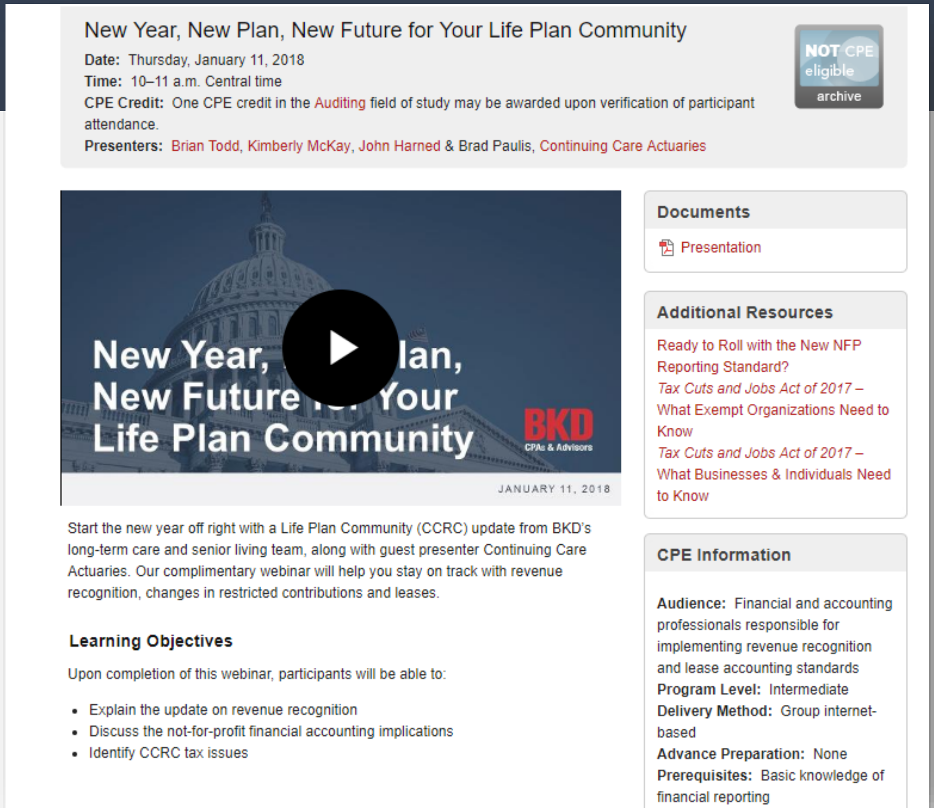
Step 3 | Transaction price considerations

- Variable consideration
- Constraint of revenue
- Use of portfolios
- Significant financing component
- Do you have historical information to estimate the variable consideration
- Exposed an example for CJR

CCRC SPECIFIC CONSIDERATIONS

- Accounting for monthly / periodic fees
- Accounting for nonrefundable entrance fees under the different contract types (focus has been primarily on Type A Contracts)
- Significant financing component considerations for refundable & nonrefundable entrance fees
- Obligation to provide future services & use of facilities
- Contract acquisition costs

Want more in depth training on CCRC-specific implications?
Visit **bkd.com/TheLink** *to access our on-demand presentation.*



Accounting Guidance for Contributions Received & Contributions Made

ASU 2018-08

CLARIFYING THE SCOPE & ACCOUNTING GUIDANCE FOR CONTRIBUTIONS RECEIVED & CONTRIBUTIONS MADE

Contributions & Grants

- One June 21, 2018, the FASB Issued ASU 2018-08, *Clarifying the Scope & the Accounting Guidance for Contributions Received & Contributions Made*

- The ASU clarifies:
  - Whether an asset transfer is a contribution or an exchange transaction
  - The criteria for determining whether contributions are unconditional (& recognized immediately into income) or conditional (& deferred)

- Issued as a result of seeing diversity in practice among NFP entities, even after considering the issuance of ASC 606

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ASU 2018-08, CLARIFYING THE SCOPE & THE ACCOUNTING GUIDANCE FOR CONTRIBUTIONS RECEIVED & CONTRIBUTIONS MADE

Effective Date & Transition

Effective Dates
ASU 2018-08

Public Entities[1]
Annual and interim reporting periods beginning after June 15, 2018

All Others
Annual reporting periods beginning after December 15, 2018

The final standard should be applied on a modified prospective basis following the effective date to agreements that are either (a) incomplete as of the effective date or (b) entered into after the effective date. Retrospective application is permitted.

Resource providers have an additional year to implement the provisions on the standard.

1 – Public entities include NFPs with conduit debt obligations

CONTRIBUTIONS VERSUS EXCHANGE TRANSACTIONS

FASB expects the new guidance could result in more grants & contracts being accounted for as contributions (often conditional contributions) than under current practice. Because of this, it believes the clarifying guidance about whether a contribution is conditional or unconditional, which affects the timing of revenue recognition, is important.

Exchange Transaction

If commensurate value **is received** by the resource provider, the transaction should be accounted for as an exchange transaction by applying ASC 606 or other topics.

Contribution Transaction

If commensurate value **is not received** by the resource provider, *i.e.*, the transaction is nonexchange, the recipient organization would record the transaction as a contribution under ASC 958 & determine whether the contribution is conditional or unconditional.

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CONTRIBUTIONS:
CONDITIONAL OR UNCONDITIONAL?

Organizations would evaluate whether contributions (“nonexchange” transactions) are conditional or unconditional by determining whether there **is a barrier or hurdle that must be overcome** & whether the agreement or other referenced document includes either a **right of return of assets transferred** or a **right of release of a promisor’s obligation to transfer assets**.

To determine if there is a barrier, an NFP will consider indicators, which include, but are not limited to:

- The inclusion of a measurable performance-related barrier or other measurable barrier
- The extent to which a stipulation limits discretion by the recipients on the conduct of an activity
- The extent to which a stipulation is related to the purpose of the agreement

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WHAT TO DO NOW?

1. Read the standard & related resources
2. Identify a champion or task force to study the new standard
3. Determine if resource bandwidth & competencies exist within the organization or if outside assistance is needed
4. Engage Reimbursement, IT, & Finance staff (& third party, if deemed necessary)
5. Identify revenue streams & the related portfolios
6. Concentrate on disclosures & if any changes are needed to gather the information
7. Educate audit committees, boards, and other stakeholders

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Questions?

Thank You!

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