Revenue Recognition – ASU No. 2014-09

April 19, 2018

CliftonLarsonAllen UNIVERSITY

Continuous Learning in Action

Learning Objectives

At the end of this session, you will be able to:

- Describe and understand the core principles of the revenue recognition standard
- Identify risks, challenges and concerns
- Review examples of how the standard might be applied
- Understand how to begin the implementation process

Revenue Recognition – Effective Date

Effective for reporting periods beginning on or after:

- December 15, 2017 for public companies (including certain NFPs with conduit debt)
  - ◊ December 31, 2018/June 30, 2019
- December 15, 2018 for private companies and not-for-profit organizations
  - ◊ December 31, 2019/June 30, 2020

Not-For-Profit Public Business Entity Consideration

- Under ASU 2014-09, NFPs are considered public entities if they have 'issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market'
- ACIPA Technical Questions and Answers Sections 7100.01-7100.16 provides non-authoritative guidance for consideration of the criteria
- If management determines securities don't meet the criteria, a NFP might not be considered a public entity
  - Not required to implement until years beginning after 12/15/18
  - Not required to include public entity disclosures

Not-For-Profit Public Entity Consideration

- Circumstances when securities might not be considered 'traded, listed, or quoted on an exchange or an over-the-counter market'
  - The sale of securities is limited to certain institutional or accredited investors and not available to the general public at the initial public offering or in subsequent sales
  - Management approval is required for resale
  - All securities are held by a parent, creating an implicit restriction on resale
  - Securities are issued in a private placement offering

AICPA Revenue Recognition Task Force

Overall Status by Industry

Ref.	Industry	Total Number of Identified Implementation Issues	Submitted to AICPA RRWG	Submitted to FinREC	Posted to AICPA Website for Exposure	Resubmitted to AICPA RRWG	Resubmitted to FinREC	Finalized for Guides
1	A&D	13	13	13	13	12	12	12
2	Airlines	14	14	14	14	14	12	12
3	Broker Dealers	9	9	9	9	7	6	5
4	Engineering & Construction	7	7	7	7	6	5	5
5	Depository	2	2	2	2	2	2	2
6	Gaming	17	17	16	16	12	12	12
7	Hospitality	5	5	5	4	4	4	4
8	Healthcare	8	8	8	8	4	3	3
9	Insurance	2	2	2	2	1	1	1
10	Investment Asset Management	10	10	10	10	10	10	10
11	Not-for-Profit	4	4	4	4	3	3	3
12	Oil & Gas	5	5	5	5	5		
13	Power Utility	10	10	10	10	10	3	3
14	Software	10	10	10	9	9	9	9
15	Telecomm	12	12	12	11	8	7	7
16	Timeshare	7	7	6	6	4	4	4
	TOTALS	135	135	133	130	111	93	92

Revenue Recognition—Model

- Core Principle:

> **Recognize 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**

- Steps to apply the core principle:

1. Identify contract(s) with the customer

2. Identify performance obligations

3. Determine transaction price

4. Allocate transaction price

5. Recognize revenue when (or as) a performance obligation is satisfied

Step 1 - Identify the contract

<u>Definition</u>

A contract is an agreement between parties that creates enforceable rights and obligations and may be written, verbal or implied by customary business practices.

Revenue can be recognized only when **ALL** of the following are met:

1) Parties have an “approved” contract
2) The entity can identify each party’s rights regarding goods or services to be transferred
3) The entity can identify payment terms for the goods or services transferred
4) Contract has commercial substance (expected change in cash flow)
5) It is ***probable*** that the entity will collect substantially all of the consideration to which it will be entitled

Step 1 - Identify the contract

- Approved by the parties to the contract
  - Written – patient responsibility, consent forms, etc.
  - Oral or implied - in accordance with customary business practices
- Determine that the patient or other payor is committed to perform their obligation (ability and intent to pay or services)
  - Inability to determine commitment to perform their obligation (payment) results in no contract

Step 1 - Identify the contract

- Payment terms not required to be fixed (implicit price concession)
- Patient’s ability and intent to pay the amount entity is entitled
  - Insured or uninsured?
  - Qualify for subsidies (Medicaid)?
  - Qualify for charity care?
- Collection must be probable
  - Probable definition is consistent with existing guidance
- International threshold is “more likely than not”

Step 2 - Identify performance obligations

<u>Definition</u>

A "performance obligation" represents the transfer of goods and services (or a bundle of goods or services) that is distinct.

At the inception of the contract with the patient, the entity will identify as a performance obligation each promise to transfer to a patient either:

1) A good or service that is distinct
2) A series of distinct goods or services that are substantially the same and that have the same patterns of transfer to the patient

Step 2 - Identify performance obligations

A good or service that is promised to a patient is distinct if **both** of the following criteria are met:

- The patient can benefit from the good or service either on its own or together with other resources that are available.
- The promise to transfer the goods or services to the patient are separately identifiable from other promises in the contract. (the promise to transfer the good or service is distinct within the context of the contract).

Note:

- If a promised service is not distinct, the entity should ***combine with other promised goods or services in a contract as a single performance obligation***.

Step 3 - Determining the transaction price

Definition

"The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a patient, excluding amounts collected on behalf of third parties."

Concept

The entity should project a revenue stream considering stand-alone prices as well as the amount of time estimated to be at each level of care.

To determine the transaction price, the entity should consider:

- Variable consideration
- Constraining estimates of variable consideration
- Existence of significant financing component
- Noncash consideration (measured at contract inception)
- Consideration payable to the patient

Step 3 - Determining the transaction price

Constraining Estimates of Variable Consideration

Variable Consideration: The expected value (probability-weighted amount) or most likely amount of consideration to which an entity is entitled

Variable consideration should be included in the transaction price only to the extent that it is probable that a significant reversal in the amount of cumulative revenue will **NOT** occur.

In making this assessment, the following should be considered:

- Uncertainty of the amount of consideration is not expected to be resolved for a long period of time.
- The entity's experience with similar contract types is limited (less predictive).
- The entity has a practice of offering a broad range of price concessions or changing payments terms and conditions.
- Contract has a large number and a broad range of possible consideration.

Step 3 - Determining the transaction price

Variable Consideration Examples

- Explicit price concessions
  - Third party payor adjustments
  - Sliding fee or financial assistance policy adjustments
  - Administrative adjustments
- Implicit price concessions
  - Discounts on uninsured patients based on probability of collection

Step 4 - Allocation of the transaction price

- Specific considerations:
  - Stand-alone purchase price-the price at which an entity would sell a promised good or service to the patient
  - Allocation of discount
  - Allocation of variable consideration
  - Change in transaction price
- ASU 2014-09 specifies that the standard should be applied on an individual contract basis with the option of a practical expedient to use a portfolio approach

Step 4 - Allocation of the transaction price

Practical Expedient:

- The guidance may be applied to a portfolio of contracts (or performance obligations) with similar characteristics **if it can be reasonably expected that the effects on the financial statements would not differ materially from applying this guidance to individual contracts within the portfolio.**
- An entity must use judgement in selecting the composition of the portfolio
- A quantitative analysis is not necessary; a reasonable approach to determine the portfolios would be acceptable
- Consider all information (historical, current, forecasted) that is reasonably available to estimate the variable consideration

Step 4 - Allocation of the transaction price

- Potential Portfolios
  - Types of services (inpatient, ancillary services, ER, physician visit)
  - Uninsured patients
  - Payment plans
  - Individual third party payors (often explicit price concession)
  - Deductibles and coinsurance (high deductible plans)
- Use of a portfolio of data is not the same as applying the portfolio practical expedient

Step 5 - Recognize revenue when performance obligation is satisfied

- Performance obligations are "satisfied" and revenue is recognized as "control" of the assets and services passes to the patient.
- Recognize when (or as) performance obligations satisfied, either:
  - Satisfied ***over time*** *(*patient simultaneously receives and consumes benefit)
  - Satisfied at ***point in time*** *(if not over time)*

Step 5 - Recognize revenue when performance obligation is satisfied

- Recognition methods – the objective is to measure progress in a way that depicts an entity's performance in transferring control of goods or services
  - Output method – may be based on undiscounted charges
  - Input method – may be based on costs of providing goods or services
- The methodology for measuring progress should be applied consistently to similar performance indicators

AICPA Health Care RRTF –

Approved Issues included in audit guide

- Issue 8-1: Consideration of Self Pay Balances
  - Application of step 1 (determination if there is a contract) and step 3 (determine the contract price) for self pay, uninsured and self pay deductibles and coinsurance
  - Includes the evaluation of implicit price concessions in determining if a contract exists and the contract price
- Issue 8-2: Application of portfolio approach to contracts with patient
  - Addresses how to apply the portfolio approach to revenue from self pay and third party payors

Price Concessions and Bad Debt Expense

- Explicit Price Concession
  - Generally based on contractual reimbursement or established schedules (third party payor, financial assistance policy)
  - Reflected as a contractual adjustment from gross revenue
  - Collection is not pursued
- Subsequent changes in expected collections, in the absence of an intent to provide an implicit price concession, are considered an impairment loss (bad debt)
  - Bad debt will be presented as an **operating expense**

Price Concessions and Bad Debt Expense

- Implicit Price Concession
  - Estimated transaction price based on likelihood of collection from historical experience (e.g. Allowance of 40%)
  - May continue to pursue collection
- Subsequent changes in expected collections are considered changes to the implicit price concession
  - Increase or Reduction in the **transaction price**
  - Exception if any adverse information is obtained regarding the patient's financial condition

Self Pay Contract - Example 1

- Services are provided to a patient without assessing the patient's ability to pay at the time of the service
- During the provision of services it is determined the patient does not have insurance and does not qualify for financial assistance
- Standard charges for the services provided are $5,000, which are billed to the patient.
- The Hospital will pursue collection of the entire amount, but expects to collect less than the customary charge for services provided, resulting in variable consideration

Self Pay Contract - Example 1 (continued)

- The Hospital concludes it is probable it will collect $1,000 based on historical collection experience.
- Collection is considered probable and all other steps are met, therefore the Hospital records revenue and a receivable of $1,000

Standard Charges	5,000
Implicit Price Concession	(4,000)
Transaction Price (expected collection)	1,000
Accounts Receivable	5,000
Allowance for Uncollectible Accounts	(4,000)

- Revenue is reflected at the determined transaction price of $1,000. There is no distinction between gross and net revenue.

Self Pay Contract - Example 1 (continued)

- The Hospital is required to update the estimated transaction price of variable consideration at the end of each reporting period.
- Subsequent change in transaction price
  - It is subsequently determined it may collect $1,100, resulting in a reduction in the implicit price concession.
  - The Hospital subsequently collects only $900. The difference between the original estimate and amount collected are reflected as an increase in the implicit price concession
- The intent of the Hospital to provide an implicit price concession results in reflecting as a change in the implicit price concession

Self Pay Contract - Example 2

- Services are provided to a patient without assessing the patient's ability to pay at the time of the service
- During the patient's stay the Hospital determines the patient does not have insurance but qualifies under the financial assistance policy and grants a 75% discount.
- Standard charges for the services provided are $10,000. Upon billing, the charges are discounted by 75% or $7,500.
- The Hospital will pursue collection of the entire undiscounted amount of $2,500.
- Historical experience indicates they will collect 10% of the bill, so they conclude it is probable they will collect $250

Self Pay Contract - Example 2 (continued)

- An explicit price concession is recognized for $7,500
- An implicit price concession is recognized for $2,250
- Collection is considered probable and all other steps are met, therefore the Hospital records revenue and a receivable of $250

Standard Charges	10,000
Discount(Explicit Price Concession)	(7,500)
Implicit Price Concession	(2,250)
Expected Collection	250
Accounts Receivable	2,500
Allowance for Uncollectible Accounts	(2,250)

- Subsequent changes in estimates and activity for the account are recorded the same as in Example 1.

Self Pay Contract - Example 3

- An uninsured patient schedules elective surgery with a provider that has a policy of performing prior credit assessments
- The provider assesses the patient's ability to pay and reduces the price of the surgery from $5,000 to $4,000. The $1,000 is considered a contractual adjustment and netted against revenue
- 100% of the remaining cost is expected to be received from the patient based on the credit assessment.

Standard Charges	5,000
Explicit Price Concession	(1,000)
Implicit Price Concession	0
Transaction Price (expected collection)	4,000

- An implicit price concession is not intended to be made by the provider. Therefore, any amount of the remaining balance that is not collected represents an impairment loss (bad debt)

Third Party Payor - Example 4

- A Hospital provides services to a patient covered by health insurance and a deductible. The insurance contract results in a reduction of 40% of gross charges, and the patient has a deductible of $1,000.
- Standard charges are $10,000, therefore $4,000 will be reflected as a contractual adjustment.
- $5,000 due under the insurance contract will be recorded as revenue and a receivable.
- Collection of the $1,000 patient deductible will be assessed based on historical experience and the amount expected to be collected will be recorded as revenue and a receivable (assume 40% collection history).

Third Party Payor - Example 4 (continued)

Standard Charges	10,000
Contractual Adjustment (Explicit Price Concession)	(4,000)
Implicit Price Concession	(600)
Expected Collection (Revenue)	5,400
Accounts Receivable	10,000
Allowance for Uncollectible Accounts	(600)
Contractual Allowance	(4,000)

- Subsequent changes to the estimated implicit price concession will be recorded as in Example 1.

AICPA Health Care RRTF –
Approved to include in audit guide

- Issue 8-6: Disclosure Requirements

Disaggregation of revenue
- Qualitative and quantitative* disaggregation of revenue into categories that depict how revenue and cash flows are affected by economic factors

Information about contract balances
- Opening and closing balances *
- Amount of revenue recognized from contract liabilities *
- Explanation of significant changes in contract balances *

Remaining performance obligations
- Transaction price allocated to remaining performance obligations *
- Quantitative or qualitative explanation of when amounts will be recognized as revenue *

Interim requirements
- Quantitative disclosures *

* for public entities only

Disclosure Requirements

- Objective of disclosure requirements :
  - Disclose sufficient information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows
- Disclose qualitative and quantitative information about:
  - Contracts with customers
  - Significant judgements and changes in judgements made in applying guidance
- Specific guidance was intentionally not provided regarding disclosure of explicit and implicit rate subsidies

Disclosure Requirements

- Consider the level of detail necessary to satisfy the disclosure objective
- Aggregate or disaggregate disclosures in order to not obscure useful information
- Level of detail is subject to judgement – entities 'may' disclose (disaggregation of revenue by payor, additional factors in determining collection)
- Other items noted that 'shall' or 'will' be disclosed (revenue recognized from performance obligations satisfied in previous periods
- Distinguish performance obligations satisfied at a point in time vs over time (quantitative and qualitative)

Disclosure Requirements

- How transaction prices are determined (explicit and implicit price concessions)
- Not-for-profit entities without conduit debt may exclude certain quantitative disclosure requirements
  - Disaggregation of revenue
  - Performance obligations
  - Contract balances
- Continuing disclosures not addressed in 606 (still applicable)
  - Charity Care – policy for providing and level of charity care
  - Concentrations
  - Major customers

AICPA Health Care RRTF – under review for final approval

- Issue 8-8: Third Party Settlement Estimates
  - Third Party Payor contracts are not considered a 'contract with customers' under ASC 606 (also addressed at 954-280-45). However, these agreements should still be considered in determining transaction prices
  - Often contain a variable element that requires an estimate of expected cash flows

AICPA Health Care RRTF

- Methods of determining variable consideration
  - Expected Value Method: Calculation of expected reimbursement, considering probability of collections
  - Most Likely Amount Method: Single most likely amount in a range of possible consideration. May be an appropriate estimate if there are only two outcomes, however, it can used with more than two potential outcomes if it is considered more accurate
- Must determine it is probable there will not be a significant revenue reversal upon final settlement

AICPA Health Care RRTF – under review for final approval

- Issue 8-9: Risk Sharing Arrangements/Bundled Payments
  - Focus of proposed guidance is on risk sharing arrangements, specifically CMS's Comprehensive Care for Joint Replacement Model.
  - The initial transaction is recorded based on existing payments under fee-for-service arrangements, with settlement amounts calculated and recorded similarly to the proposed third party payor settlement guidance
  - Variability for penalty or bonus payments within the payment model
    - ◊ Constraints on determining estimates for variable component include performance history of provider, history of program payments, performance of post acute providers related to episodes of care
  - **Issue 8-9 does not address other bundled payment arrangements**

AICPA Health Care RRTF – under discussion

- Issue 8-9a: Risk Sharing Arrangements/Capitation Arrangements
  - Initial conclusion is that the contract is between the provider and the risk transferring entity and not the patient as concluded in the other issue papers

AICPA Health Care RRTF – under review for final approval

- Issue 8-10: Performance Obligations (other than CCRCs)
  - Addresses when a series of distinct services should be considered a single performance obligation
  - Service is Distinct if:
    - ◊ Patient can benefit from the service on its own
    - ◊ Health care provider's promise to provide services is separately identifiable from other promises
  - Is the nature of the promise within the contract to provide services individually, or to transfer a combined service? Indicators might include:
    - ◊ Entity provides integrates services under the contract into a bundle of services
    - ◊ One or more goods or services significantly modifies another within the contract
    - ◊ Goods or services are highly interdependent or interrelated

AICPA Health Care RRTF – Additional Issues

- Issue 8-11: Voluntary Medicaid Tax Programs
- Issue 8-12: Consideration if CCRCs will need to follow the leasing standard

Identification of Performance Obligations-

Inpatient Services example from the RRTF

- Patient is provided a surgical procedure that requires multiple days of inpatient care
- During the course of the inpatient stay patient receives use of room, meals, nursing care, physician services, ancillary services, drugs, etc.
- Patient has third party insurance that will pay for the service under a DRG code

Identification of Performance Obligations-
Inpatient Services example from the RRTF

- What are the performance obligations?
- Certain services may provide a benefit on their own and qualify as distinct, however:
  - The nature of the promise to the patient was to transfer a combined service
  - Most of them are highly dependent on each other or highly interrelated
  - The goods or services are not substantially the same each, so it is determined they do not constitute a series of distinct services
- Revenue will be recognized over time as the patient receives and consumes the benefit simultaneously

Identification of Performance Obligations-
Physician visit example from the RRTF

- Physician provides patient an annual physical exam
- Provision of the exam includes inquiry of the patient, obtaining vital statistics, performance of lab tests or other needed goods or services normally part of an annual physical exam
- Patient has third party insurance that will pay for the service based on CPT code

Identification of Performance Obligations-

Physician visit example from the RRTF

- What are the performance obligations?
- While the goods or services provided in each exam may vary, they represent a single performance obligation
- Additional services resulting from the exam but outside of it (e.g. flu shot) would likely be a separate performance obligation
- Follow up visits or procedures should be assessed for inclusion in the performance obligation
  - Administrative in nature only, continuation of exam, new procedure

Identification of Performance Obligations-

Outpatient services example from the RRTF

- Physician orders patient 12 physical therapy visits over 4 weeks
- Patient’s insurance will pay for up to 12 visits
- What are the performance obligations?
- The physician ordered 12 PT visits, however, the patient could terminate at any time, or could receive therapy from a different provider
- Each subsequent visit is an option for which there is not a material right - each visit is charged and billed separately

Identification of Performance Obligations-
Skilled Nursing example from the RRTF

- Resident receives short term skilled nursing care
- Stay consists of room, meals, medication, supplies, physical therapy as determined in plan of care
- Resident has an initial expected stay of 30 days, however, depending on assessment stay may be extended

Identification of Performance Obligations-
Skilled Nursing example from the RRTF

- What are the performance obligations?
- Initial period of care is expected to be 30 days, however, the resident has the right to terminate, discharge to home or different skilled nursing facility, or extend as needed
- Similar to IP stay, the nature of the promise to the patient was to transfer a combined service for goods and services provided
- Each day is considered a performance obligation
- Physical Therapy – included in daily services?

Implementation Considerations

- All organizations should assess the impact of implementing the revenue recognition standard
- Public vs Non-Public Business Entity
- Materiality is a consideration
- Disclosure requirements and desired level of reporting detail may impact portfolios used and level of detail recorded when recognizing revenue

Implementation Considerations

- Evaluate the changes from current gaap to the new revenue recognition principles
- Identify Revenue Streams
  - Identify performance obligations
  - Identify how transaction price is determined
- Identify required and desired disclosures
- Identify changes needed in processes and information systems
  - Existing systems and processes may provide much of the required information under the new requirements

Implementation Considerations

- Identify portfolios
  - Potential significant financial classes and payors
    - ◊ Government payors
    - ◊ Commercial insurers
    - ◊ Self pay - uninsured, deductibles and coinsurance by primary payor, high deductible plans, partial financial assistance
  - Identify types of services provided and related performance obligations
    - ◊ Inpatient
    - ◊ Outpatient
    - ◊ Emergency
    - ◊ Clinic visits
    - ◊ Home Health
    - ◊ Ambulatory surgery

Implementation Considerations

- Assess level of detail for footnote disclosures
  - Level of detail is subject to judgement - information should be aggregated or disaggregated so that useful information is not obscured by a large amount of insignificant detail or the aggregation of information that has significantly different characteristics
  - Changes in implicit price concessions
  - Disaggregation of revenue

Questions?

Trent Fast, CPA
Principal
507.446.7118
trenton.fast@CLAconnect.com

CLAconnect.com