

## Preparing for the Revenue Recognition Standard—Health Care Industry

In May 2014, the Financial Accounting Standards Board (FASB) completed its revenue recognition project by issuing Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, which can be found in the new Accounting Standards Codification (ASC) Topic 606.

The new standard is effective for periods beginning after December 15, 2017, for public entities which include not-for-profit entities that have issued or are a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market. The standard is effective for all other entities effective for periods beginning after Dec. 15, 2018.

### Who will be impacted?

A common misconception is that the new standard applies only to certain entities. In fact, the standard will apply to all entities that generate revenue from contracts with customers (i.e. patients). No doubt certain entities and industries will be impacted to a greater extent, but all entities will have to comply with the new revenue recognition standard.

### What is the revenue recognition core principle?

The core principle of the standard is that an entity should recognize revenue to depict the transfer of promised goods to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Entities must follow the following five-step process to achieve the core principle under the new standard:

1. Identify the contract(s) with the customer (i.e. patient).
2. Identify the separate performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the separate performance obligations in the contract.
5. Recognize revenue when the entity satisfies a performance obligation.

### Are there any implementation issues specific to the health care industry?

There are seven specific implementation issues impacting the health care industry:

1. Revenue recognition for patients with uninsured balances (self-pay)
2. Application of portfolio approach
3. Identifying the purchase obligations and recognition of revenue for Continuing Care Retirement Community (“CCRC”) residents and the recording of nonrefundable entrance fees for CCRCs
4. Determination of the transaction price as it relates to third-party estimates
5. Disclosure requirements
6. Contract acquisition costs
7. Bundled payments and risk sharing arrangements

The AICPA Healthcare Task Force has issued implementation guidance on revenue recognition for self-pay patients and the application of the portfolio approach to provide clarity for the health care industry. The timing of when the AICPA’s Healthcare Task Force will issue implementation guidance on the remaining issues is unclear.

What is changing for hospitals and clinics under the revenue standard?

- Bad debt expense is moving back down to an operating expense. The definition of a bad debt changes dramatically under the revenue recognition standard. Under the revenue recognition standard, organizations will classify patient account balances that are written off as bad debt expense only when one of the following exists:
  - The organization performs a credit assessment on a patient prior to providing the services and ultimately expects to collect the gross charges.
  - The organization has a policy establishing when a patient account or a portfolio of patient accounts is written off as uncollectible due to a change in the patient’s or a portfolio of patients’ credit that was not known at the time services were provided. Acceptable changes in a patient’s credit that may warrant the write-off to be reflected as bad debt could include, but are not limited to, qualifying life events like changes in employment or birth of a child.

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- All other write-offs of self-pay accounts (including coinsurance and deductibles) will be considered implicit price concessions and recorded as contractual allowances and discounts within net patient service revenue
- Enhanced disclosures within the notes to the financial statements will explain the organization's policy to record revenue under this standard.

**What is not changing significantly for hospitals and clinics under the revenue recognition standard?**

- Charity care is excluded from the revenue recognition standard.
- Recognition of revenue from third-party insurances will continue to be recorded as gross patient service revenue and contractual allowances and discounts.
- Third-party settlements will continue to be estimated and evaluated in a similar manner under the revenue recognition standard.

**How will other types of health care providers be impacted by the revenue recognition standard?**

- CCRCs that have Type A – Life Care Contracts are expected to have a significant change in how revenue is recorded under the revenue recognition standard. CCRCs will no longer be able to recognize refundable entrance into income over time. The AICPA's Healthcare Task Force has had many deliberations on how CCRCs are impacted by the revenue recognition standard and is still working to create implementation guidance for how revenue will be recorded for CCRCs in the future.
- Skilled Nursing Facilities (SNFs) will see likely little to no impact from the revenue recognition standard. SNFs typically perform credit assessments on private pay residents and expect to collect the full amount of charges. Bad debt expense is currently reported as an operating expense and write-offs of residents accounts are commonly due to a change in the resident's credit.

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