Healthcare Accounting Updates
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Topics

NEW ACCOUNTING STANDARDS

- Financial Statement Presentation for Not-for-Profit Entities
- Leases
- Revenue Recognition
- Other

Financial Statement Presentation for Not-for-Profit Entities

Overview:

- Goal of the ASU was to improve the financial statement presentation for not-for-profit entities to provide better information to donors, creditors, and other users of the financial statements
- Results of Phase I issued in August 2016 impacted the following areas:
  - Net asset classes
  - Liquidity and availability of resources
  - Expenses
  - Reporting of investment return
  - Presentation of operating cash flows
- Effective date for implementation: December 31, 2018, fiscal years ending in 2019

Financial Statement Presentation for Not-for-Profit Entities- Changes to Net Assets Classification

Current GAAP	Unrestricted	Temp. Restricted	Perm Restricted
ASU 2016-14	Without Donor Restrictions	With Donor Restrictions	
+			
Disclosures	Amount and purpose of board designations	Nature and amount of donor restrictions	

Financial Statement Presentation for Not-for-Profit Entities- New Statement of Financial Position – Classified

Assets:		
Current assets		
	Cash and cash equivalents	$ 4,575
	Contribution receivables	1,825
Noncurrent assets		
	Contribution receivables	1,200
	Long-term investments	10,000
Total assets		$ 17,600
Liabilities and net assets:		
Current liabilities:		
	Accounts payable	$ 2,570
	Grants payable	550
Noncurrent liabilities:		
	Notes payable	5,500
Net assets:		
	Without donor restrictions	1,275
	With donor restrictions	7,705
Total liabilities and net assets		$ 17,600

Financial Statement Presentation for Not-for-Profit Entities - Increased Disclosures surrounding Liquidity and Availability

- Quantitative information about the availability of a NFP's financial assets at the balance sheet date to meet the cash needs for general expenditures within one year of the balance sheet date.
- Examples include disclosing:
  - The total amount of financial assets
  - Amounts that are not available to meet cash needs within the time horizon because of (1) external limits and (2) internal actions of a governing board
  - The total amount of financial liabilities that are due within that time horizon
- Can be accomplished through either:
  - Classified balance sheet
  - Segregation and disclosure of assets whose use is limited
  - Additional disclosures in the footnotes

Financial Statement Presentation for Not-for-Profit Entities - Increased Disclosures surrounding Liquidity and Availability

- Qualitative information about how the entity manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date
- Examples of relevant qualitative information
  - Minimum cash balance goals
  - Use of a line of credit
  - Policy for managing excess cash

Financial Statement Presentation for Not-for-Profit Entities- Information about Expenses

- Expenses to be shown by both their function (required by current GAAP) and their nature, as well as analysis of expense by both function and nature
  - Face of the Statement of Activities
  - Separate statement,
  - Notes to Financial Statements
- Enhanced disclosures about the methods used to allocate costs between functions
- Management and general activities are now more clearly defined as items not identifiable with one or more programs, fundraising or membership development activities.

Financial Statement Presentation for Not-for-Profit Entities- Expense by nature and function one place in the F/S (statements of activities, separate statement, or schedule in notes)

	Program Activities		Supporting Activities		
	Program A	Program B	M&G	Fundraising	Total Expenses
Salareis & Benefits					
Grants to Others					
Equipment Rental & Maintenance					
Occupancy Cost					
Depreciation					
Information Technology					
Professional Service Fees					
Supplies					
Travel					
Printing and Publication					
Interest					
Other					
Total					

*By function is across the columns and by nature is down the left rows

Financial Statement Presentation for Not-for-Profit Entities - Other Changes

- Presentation of operating cash flows
  - Option to present operating cash flows using either direct method or indirect method
  - Removes requirement to present or disclose the indirect method reconciliation when using the direct method of reporting cash flows
- Investment income
  - Requires reporting of investment return net of external and direct internal investment expenses
  - No longer requires disclosures of netted expenses
- Long-lived assets
  - Requirement to release donor restrictions that are for the acquisition or construction of long-lived assets when the asset is placed-in-service
  - Eliminates the option to release the restriction over time as the asset is depreciated

Financial Statement Presentation for Not-for-Profit Entities

Phase II

- Operating measure (all elements not addressed in Phase I)
- Statement of cash flows (realignment of certain items)
- Currently being redeliberated

Financial Statement Presentation for Not-for-Profit Entities

What you might be thinking about….

- In light of other forthcoming standards, should you early adopt?
- Would direct method cash flow provide better information for our board and external users?
- What is the most meaningful way to disclose limitations on board designated net assets?
- Will improvements require any changes to accounting policies or processes?

Lease Accounting

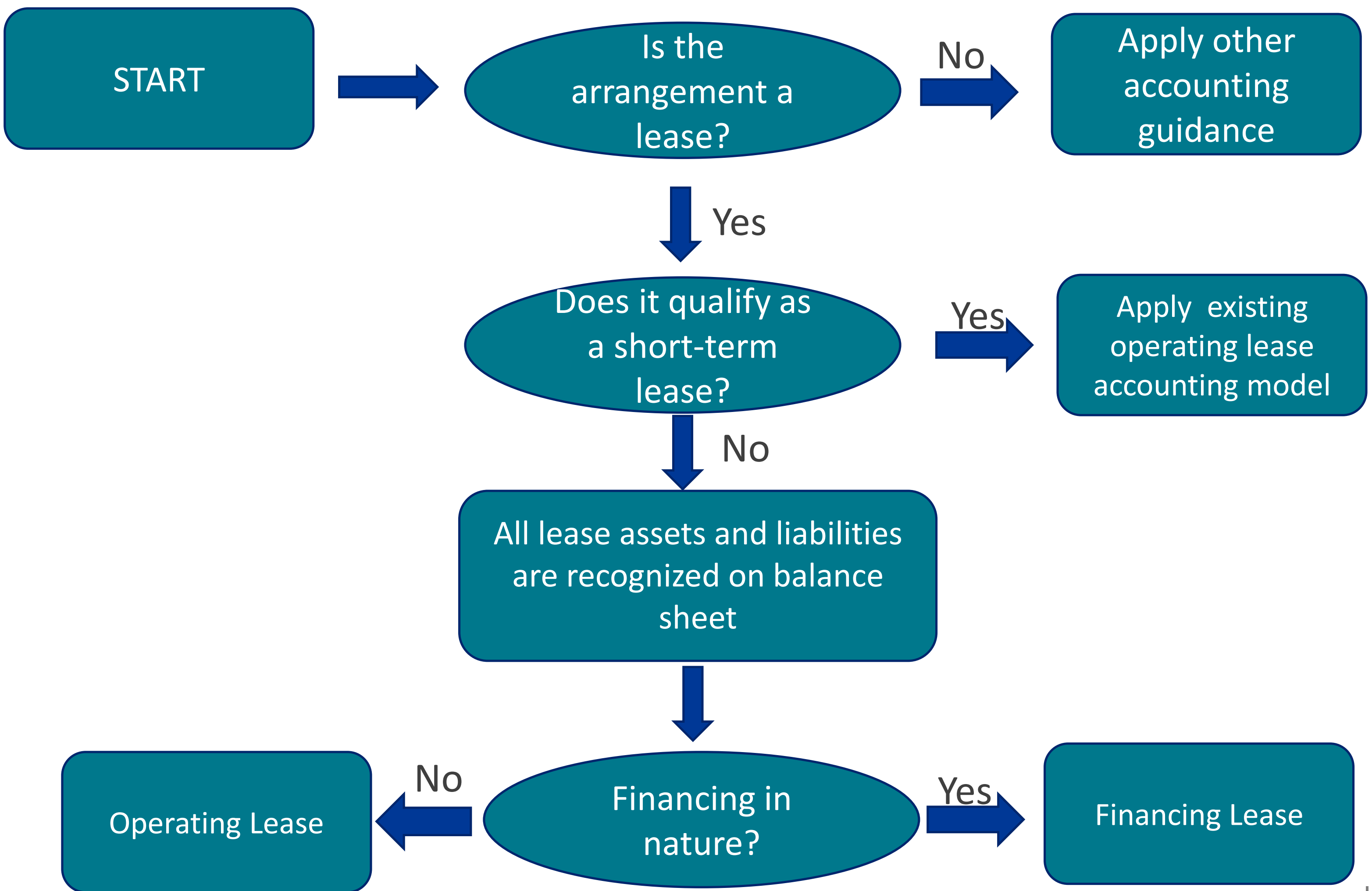
Overview:

- Objective of the lease accounting standard was to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet.
- Operating lease vs. financing lease
- Accounting applied by a lessor will largely be unchanged from current GAAP.
- Effective date for implementation - years ending December 31, 2019 for public entities (including entities with publicly held debt), and December 31, 2020 for non-public entities
- Standard to be applied using a modified retrospective approach

Lease Accounting

- Lease contracts in scope of ASC 842
  - An identified asset
    - That is explicitly or implicitly specified
    - Supplier has no practical ability to substitute and would not economically benefit from substituting the asset
  - The right to control the use during the lease term
    - Decision-making authority over the use of the asset
    - The ability to obtain substantially all economic benefits from the use of the asset

Lease Accounting- New Model



Lease Accounting

If a lease meets any of the following 5 conditions, it is a financing lease:

- Transfer of ownership
- Option to purchase is reasonably certain
- Lease term is a “major part” of the economic life
- Present value of lease payments is “substantially all” of the fair value
- Specialized nature

Lessee Accounting

Balance sheet

- Asset representing the right to use the leased asset for the lease term – (valued initially at the present value of the lease payments)

- Liability to make lease payments – (also valued initially at the present value of the lease payments)

Lessee Accounting – Example

- Lease term = 10 years
- Rent = $4 psf, 500,000 sq ft; annual rent = $2 million
- Discount rate = 6%
- Calculated present value = approx. $15 million

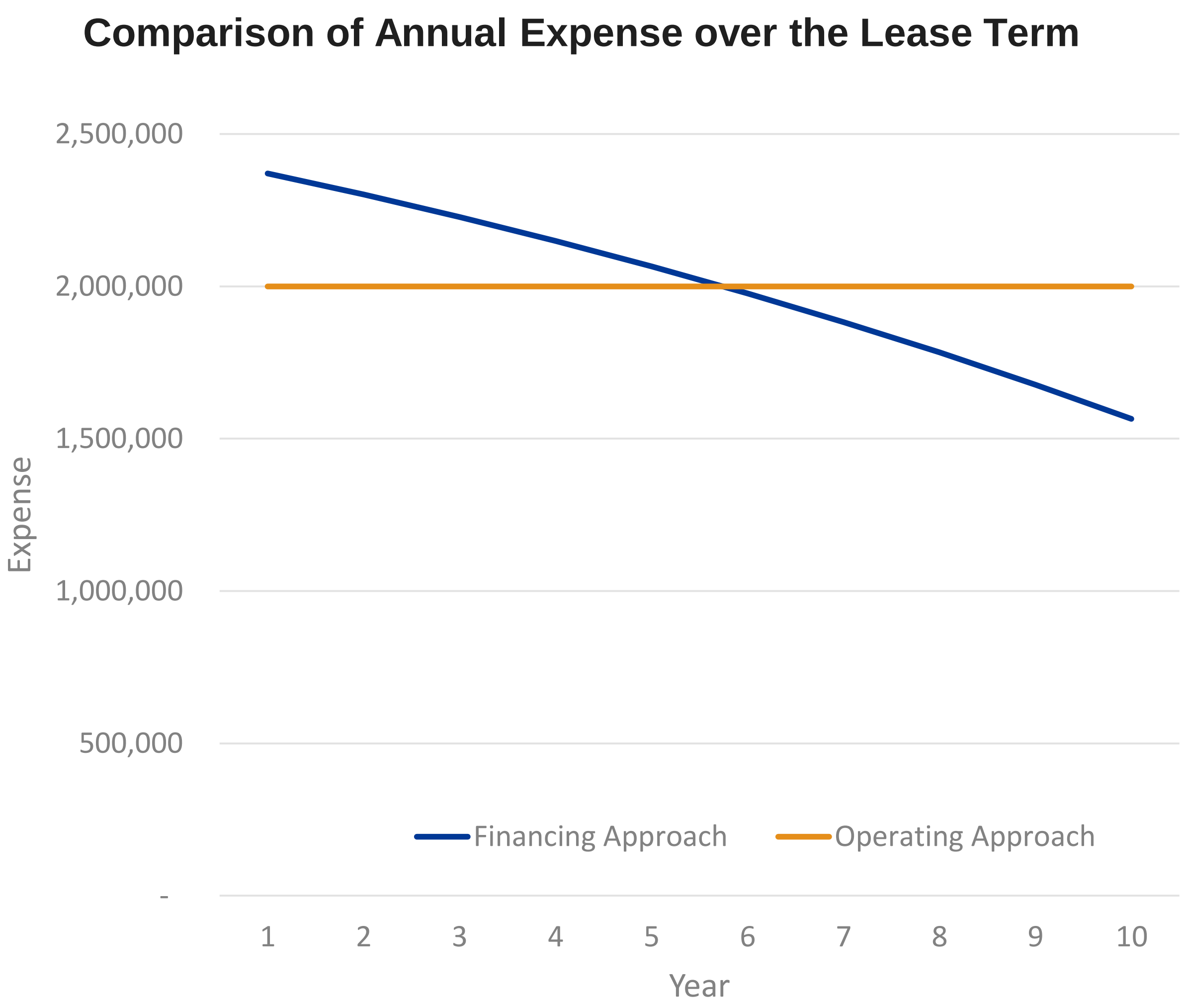
Journal entry at lease inception:

	Debit	Credit
Right-of-use Asset	$15,000,000	
Lease Obligation Payable		$15,000,000

Lessee Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
Financing Lease	Right-of-use asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payments
Operating Lease	Right-of-use asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payments

Lessee Income Statement Impact



Finance Lease Example

Hospital leases equipment. Facts:

• Lease term: 60 months with option to extend for 24 months	At Inception:
• Lease payments: $2,500 per month during initial term; $2,750 during extension	• Hospital makes first month's payment of $2,500 and incurs $7,000 initial direct costs
• 10% increase during extension is NOT considered a significant financing incentive; therefore, lease is 60 months	• Lease liability measured at PV of 60 payments due at beginning of month at 5.25% totals $132,252.
• Initial direct costs: $7,000	
• Discount rate: cannot determine rate implicit in lease. Incremental borrowing rate is 5.25%	

ROU Asset

139,252	

Lease Liability

2,500	132,252
	129,752

Cash

	2,500
	7,000

Finance Lease Example

Hospital leases equipment.   Facts:

	Subsequent accounting:
	• ROU asset depreciated straight line over 5 year lease term ($139,252 /5 = $27,850)
	• Interest expense using interest method and 5.25% discount rate ($6,246)
	• Annual lease payments ($30,000)

ROU Asset	
139,252	27,850
111,402	

Lease Liability	
30,000	129,752
	6,246
	105,998

Depreciation Exp.	
27,850	

Interest Exp.	
6,246	

Cash	
	30,000

Operating Lease Example

Hospital leases equipment. Facts:

• Lease term: 60 months with option to extend for 24 months	• At Inception, the Hospital makes first month's payment of $2,500 and incurs $7,000 initial direct costs
• Lease payments: $2,500 per month during initial term; $2,750 during extension	• Lease liability measured at PV of 60 payments due at beginning of month at 5.25% totals $132,252.
• 10% increase during extension is NOT considered a significant financing incentive; therefore, lease is 60 months	
• Initial direct costs: $7,000	
• Discount rate: cannot determine rate implicit in lease. Incremental borrowing rate is 5.25%	

ROU Asset

Debit	Credit
139,252	

Lease Liability

Debit	Credit
2,500	132,252
	129,752

Cash

Debit	Credit
	2,500
	7,000

Operating Lease Example

Hospital leases equipment. Facts:

Subsequent accounting in year one:

- Lease expense; 1/5 of cash payments to be made during the lease term (30,000) plus 1/5 of initial direct costs ($1,400) Total $31, 400
- Interest expense is the same as financing
- Remaining expense amount is credited against the ROU asset ($31,400 less $6,248)

ROU Asset	
$ 139,820	$ 25,152
$ 114,100	

Lease Liability	
$ 30,000	$ 130,320
	$ 6,248
	$ 106,568

Lease expense	
$ 31,400	

Cash	
	$ 30,000

Transition: Practical Expedients

Option to elect “practical expedients” to ease the burden of adoption

- No need to reassess whether expired or existing contracts are or contains leases
- No need to reassess lease classification for any expired or existing leases
- No need to reassess initial direct cost for existing leases
- May use hindsight in determining lease terms

Lease Accounting

What you might be thinking about….

- How do you start creating an inventory of leases?
- What would be considered an appropriate capitalization threshold for leases?
- How granular do you need to get on identifying embedded leases?
- Will you opt to elect some of the practical expedients available to you under the standard?
- Will your debt covenants be impacted?
- Will you need a new lease accounting system?
- May affect lease vs. buy decisions
- How will this standard interact with the new revenue recognition standard?

Revenue Recognition

Overview:

- FASB and IASB have issued a new global revenue recognition standard.
- The standard replaces virtually all existing US GAAP and IFRS guidance on revenue recognition.
- The revenue recognition standard is principles based.
- FASB-IASB transition resource group and other implementation resource groups have been created.
- Effective date for implementation - years ending December 31, 2018 for public entities, December 31, 2019 for non-public entities

Revenue Recognition

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

Step 1	• Identify the contract with a customer
Step 2	• Identify the separate performance obligations in the contract
Step 3	• Determine the transaction price
Step 4	• Allocate the transaction price to the separate performance obligations
Step 5	• Recognize revenue when (or as) the entity satisfies a performance obligation

AICPA Health Care Task Force Issues Identified

- Revenue recognition for patients with uninsured balances (self pay)
- Determine the transaction price as it relates to third-party estimates
- Application of portfolio approach
- Disclosure requirements
- Identify the performance obligations and recognition of refundable and non-refundable entrance fees for CCRC's
- Contract acquisition costs
- Recently added: Bundled payments and risk sharing arrangements

Revenue Recognition

Issue #8-2: Portfolio Approach:

- Entities can apply the standard or aspects of it to a portfolio of contracts or performance obligations with similar characteristics.
- May segregate by payor class, type of service or other categories
  - System-wide or tailored
  - By facility
  - Whether patients are denied service based on ability to pay
  - Large balance accounts
  - Timing of when contracts are entered into (at or near the same time)
- A provider may apply the portfolio approach to one class of patients but not to another.
- A contract should be removed from a portfolio if the provider later determines that the contract does not have similar characteristics with others in the portfolio.
- Entities must reasonably expect that the financial statement impact from using the portfolio approach would not differ materially from applying the standard on a contract by contact basis.

Revenue Recognition

Portfolio Approach Example

- The healthcare entity provides services to patients covered by insurance carrier B and does not perform a credit assessment prior to providing services
- Each patient has a patient responsibility (co-payment)
- The entity identifies these patients as a portfolio of contracts and applies a portfolio approach based on quantitative and qualitative factors
- Standard charges amount to $1,000,000 for these patients and consists of both the insurance and co-payment amounts
- Entity has a contractual agreement with insurance carrier B that results in 50% contractual allowance
- Remaining charges include $475,000 in amounts due from insurance carrier B and $25,000 in co-payment amounts
- Entity expects to collect 100% of insurance carrier B and 40% of the co-payment amounts based on historical experience

Revenue Recognition

Portfolio Approach Example

- The contractual adjustment of $500,000 is a reduction of the transaction price
- The $15,000 ($25,000 * 60%) that the entity does not expect to collect of the patient co-payments represent an implicit price concession and is recoded as a reduction of the transaction price
- The total transaction price for this portfolio is $485,000 ($475,000 from insurance carrier B and $10,000 from co-payment amounts)
- The entity would only include the estimate of variable consideration ($485,000) in the transaction price after consideration of the constraint
- The entity recognizes patient revenue and patient account receivable of $485,000 after going through the 5 step model

Revenue Recognition

Issue #8-1: Self-Pay Revenue Stream

- Identify the Contract (Step 1):
  - Does an enforceable contract exist?
  - Is the patient committed to performing obligations?
  - Is it probable that the entity will collect the consideration to which it expects to be entitled?
- Determining the Transaction Price (Step 3):
  - Does an implicit price concession exist?
  - How are subsequent changes accounted for?
  - What constitutes bad debt?

Revenue Recognition

Third-party Settlements

- Arrangements with third-party payors should be considered in determining the transaction price for services provided to a patient
- Variable consideration is estimated using an “expected value” or “most likely amount” approach. Factors to consider in either model:
    - Historical and current reimbursement information including third-party settlements
    - Historical and current experience with the fiscal intermediary
    - Current charges, allowable costs and relevant patient statistics

Revenue Recognition

Third-party Settlements

- Must evaluate whether it is probable that a significant revenue reversal will not occur when the cash is collected or paid based on final settlement
  - Historical experience in estimating third-party settlements
  - Third-party payor determines the amount of the settlement based on specific rules and regulations
  - Third-party payor has control over settlement process
  - Several years may elapse before third-party settlements are known with certainty
- Determine if there is a significant financing component

Revenue Recognition

What you might be thinking about….

- Who should be part of your team to lead the implementation process?
- What various contracts does your organization have with its customers?
- What changes will be necessary to be made to your accounting policies?
- Are your accounting systems and models adequate to compile the necessary information?

Revenue Recognition- Disclosures

Disaggregation of revenue

Contract balances

Costs to obtain or fulfill a contract

Understand nature, amount, timing and uncertainty of revenue and cash flows

Significant judgements

Performance obligations

Other Accounting Standards

Effective for calendar year 2016

- Going Concern
- Simplifying the Presentation of Debt Issuance Cost
- Extraordinary Items
- Accounting for Measurement Period Adjustments in a Business Combination (PBE 2016)

Effective in future years

- Equity Method of Accounting (2017)
- Classifying Certain Cash Receipts and Cash Payments (PBE 2018)
- Classification and Measurement of Financial Instruments (PBE 2019)

Questions?

Thank You!!!

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