{Accounting and Auditing Update}

JANUARY 2016

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Topics

HOT NEW AND PENDING ACCOUNTING STANDARDS

- Revenue Recognition
- Leases
- FASB Simplification Initiative Final Guidance
  - Extraordinary Items
  - Presentation of Debt Issuance Costs
  - Disclosures for Investments in Certain Entities that Calculate NAV per Share
  - Accounting for Measurement Period Adjustments in a Business Combination
- Going Concern
- Financial Statement Presentation for Not-for-Profit Entities
- Goodwill for Not-for-Profit Entities
- Simplifying the Balance Sheet Classification of Debt
- Other Projects

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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.

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Revenue Recognition

Effective Date and Transition:

- Public entities:
  - Annual reporting periods beginning after December 15, 2017, including interim reporting periods therein.
  - May be early adopted as of the original effective date (one year early).
- Nonpublic entities:
  - Annual reporting periods beginning after December 15, 2018, including interim reporting periods thereafter.
  - May be adopted as early as the original public effective date.
- Entities can choose to adopt the standard either a full retrospective approach or a modified retrospective approach.

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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

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Health Care Issues Identified

The AICPA Healthcare Revenue Recognition Task Force is analyzing the following issues as they relate to providers:

- Application of Steps 1 and 3 for self-pay patients
- Identifying performance obligations and accounting for refundable and non-refundable entrance fees of CCRCs
- Scope of prepaid health services
- Disclosure requirements as compared to ASU 2011-07
- Contract acquisition costs for prepaid health services and CCRC entrance fees
- Determination of the transaction price as it relates to third-party settlements

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Health Care Issues Identified

The AICPA Healthcare Revenue Recognition Task Force has been drafting several implementation issue whitepapers. The current issues being addressed in whitepapers include:

Implementation Issue	Whitepaper Focus
Application of step 1 (determine if there is a contract) and step 3 (determine the transaction price) for healthcare services provided to self-pay patients, including uninsured patient balances and self-pay patient balances arising from co-payments and deductibles.	This implementation issue will discuss evaluating whether a contract exists and what the transaction price is to arrangements for health care services provided to self-pay patients and balances arising from co-payments and deductibles.
Implicit price concessions related to self-pay balances.	This implementation issue provides two views over the initial accounting for implicit price concessions for services provided to uninsured patients and two views for the subsequent accounting for these types of contracts and whether changes in the estimates of variable consideration represent changes in price concessions or impairments.
Application of the portfolio approach to contracts with patients.	This implementation issue will discuss how to apply the portfolio approach to revenue from self-pay patients and third party payors.

Health Care Issues Identified

The AICPA Healthcare Revenue Recognition Task Force has been drafting several implementation issue whitepapers. The current issues being addressed in whitepapers include:

Implementation Issue	Whitepaper Focus
CCRC: Identifying and satisfying the performance obligation(s) and recognizing the monthly/periodic fees and nonrefundable entrance fees under Type A or "life care" contracts for continuing care retirement communities.	This implementation issue will discuss the performance obligations under a typical Type A (life care) continuing care retirement community (CCRC) resident agreement and, given these performance obligations, how a Type A CCRC will estimate a transaction price and recognize nonrefundable entrance fees and monthly/periodic fees received from residents under the new model.
CCRC: Identifying and satisfying the performance obligation(s) and recognizing the performance obligation(s) to provide future services and use of facilities	This implementation issue will describe the changes to a continuing care retirement community's calculation of the obligation to provide future services and use of the facilities of a result of the new model.
Accounting for contract costs.	This implementation issue will discuss how health care organizations will account for certain costs of acquiring and fulfilling contracts under the new model.

Revenue Recognition

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
- 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

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

Does an Enforceable Contract Exist?

- Enforceability is a matter of law.
- Contracts may be written, oral or implied by an entity's customary business practice.
  - Unconscious patient admitted through ER?
  - Patients admitted against their will?

Does a contract exist?

- The parties have approved and are committed to performing their obligations.
- Each party's rights regarding services can be identified.
- Payment terms can be identified.
- The contract has commercial substance.
- It is probable that the entity will collect the consideration to which it will be entitled.
  - Consider customer's ability and intent.
  - Consideration may be less than price if the consideration is variable.

Revenue Recognition

If contract does not meet the criteria in ASC 606-10-25-1

Record the consideration received from the customer as a contract liability until conditions below are met

Continually reassess the arrangement…if Step 1 criteria are met, begin applying the revenue model, otherwise:

Recognize revenue when either of the following events has occurred:

1) No remaining obligations to transfer goods or services and substantially all consideration is collected and is non-refundable **or**

2) The contract is terminated and the consideration is non-refundable

Revenue Recognition

Determining the Transaction Price- Variable Consideration:

- Consideration may be variable due to contractual allowances, charity, prompt pay discounts, uninsured discounts, incentives, penalties, etc.
  - The patient may have a valid expectation based on published policies, specific statements, or customary business practices OR
  - Facts and circumstances may indicate an entity's intention when entering into a contract to offer a price concession.
- Recognize revenue only to the extent that a significant reversal is not probable.
- Reassess at the end of each reporting period.

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Revenue Recognition

Assessing for Implicit Price Concession

- Does the patient expect a price concession?
- Do facts indicate that the provider's intention is to provide a price concession?
- Is a credit assessment performed prior to providing services?
- Does the provider continue to provide services to patients even if historical collections are less than the stated transaction price?
- Must implicit price concessions be communicated to the patient?
- In estimating the variable revenue, it should be probable that there will not be a significant reversal.

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Revenue Recognition

Subsequent Changes in Transaction Price

- If an implicit price concession is provided the entity must:
  - Determine how to account for subsequent changes
  - Update the estimated price at the end of each reporting period
- In general, subsequent changes to estimated variable consideration should be accounted for as increases or decreases in the implicit price concession- adjustments to net patient service revenue.
- If a healthcare entity does not grant price concessions:
  - It may conclude there is no contract (and no revenue, initially) OR
  - It may conclude there is a contract. Revenue would be recognized, and subsequent AR allowance/write off would be bad debt expense
- Bad debt expense may include:
  - Write off of a patient bill, when credit risk was evaluated and credit extended
  - Third party payor files bankruptcy

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Revenue Recognition

Example: Impact of Contract and Price Conclusions:

- Background: Service is provided to an uninsured patient. Charges total $10,000. Uninsured patient class generally pays 10% of charges. This patient eventually pays $900, and the remaining balance is written off.
  - Scenario 1: Hospital determines that no contract exists.
  - Scenario 2: Hospital determines that contract does exist, and the hospital is entitled to receive full charges.
  - Scenario 3: Hospital determines that a contract exists, but that an implicit price concession for 90% of charges will be provided.

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Revenue Recognition

Scenario 1: Hospital determines that no contract exists

	Scenario 1		
	Revenue	Bad Debt	Liability
Service Provided			
Cash Received			$900
AR deemed uncollectible			
Contract terminated	$900		($900)
Total	$900	$0	$0

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Revenue Recognition

Scenario 2: Hospital determines that contract does exist, and the hospital is entitled to receive full charges.

	Scenario 2	
	Revenue	Bad Debt
Service Provided	$10,000	
Cash Received		
AR deemed uncollectible		$9,100
Contract terminated		
Total	$10,000	$9,100

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Revenue Recognition

Scenario 3: Hospital determines that a contract exists, but that an implicit price concession for 90% of charges will be provided.

	Scenario 3	
	Revenue	**Bad Debt**
Service Provided	$1,000	
Cash Received		
AR deemed uncollectible	($100)	
Contract terminated		
Total	$900	$0

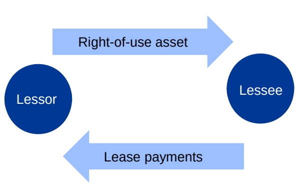
Lease Accounting

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.
- Final standard expected to be issued by early next year
- Effective dates:
  - Public Entities – Fiscal years and interim periods within those fiscal years, beginning after December 15, 2018
  - Nonpublic entities- Fiscal years and interim periods within those fiscal years, beginning after December 15, 2019
- Retrospective application
- Early adoption permitted

Proposed Right-of-Use Model

A lease contract conveys the right to use an **asset** (the underlying asset) for a period of time in exchange for consideration



Lessee Accounting Overview

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

Lessor Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
Type A	Net Investment in the lease	Interest income and any profit on the lease	Cash received for lease payments
Type B	Continue to recognize underlying asset	Lease income, typically on a straight-line basis	Cash received for lease payments

Lease Accounting

Key Exemptions:

- Economic life classification criterion not consider for leases that commence at or near the end of the underlying asset's economic life.
- Lease with a term of 12 months or less

FASB Simplification Initiative-Final Guidance

Extraordinary Items (ASU 2015-01):

- Concept eliminated from GAAP
- Effective for 2016 calendar year ends and 2017 fiscal year ends

Presentation of Debt Issuance Costs (ASU 2015-03)

- To be reported as direct reduction of debt liability for issued debt (like debt discounts), rather than as separate assets
- Effective for 2016 calendar year ends and 2017 fiscal year ends
- ASU 2015-15: SEC staff would not object to recognition of an asset for costs associated with lines of credit

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FASB Simplification Initiative-Final Guidance

Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (ASU 2015-07):

- No longer require investments for which FV is measured at NAV (or its equivalent) using practical expedient to be categorized in FV hierarchy
- Clarifies that certain disclosures (redemption restrictions) only required when practical expedient is actually used
- Effective for 2016 calendar year ends and 2017 fiscal year ends

Accounting for Measurement Period Adjustments in a Business Combination (ASU - 2015-06)

- No longer have to retrospectively adjust comparative prior year information for adjustments identified in the current year to provisional amounts recognized in a business combination
- Effective for 2016 calendar year ends and 2017 fiscal year ends

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Going Concern

OVERVIEW:

- Objective is to provide guidance on assessing uncertainties about an entity's going concern presumption and related disclosures
- No guidance in US GAAP, only in auditing standards
- ASU 2014-15 Shifts responsibility to management to evaluate
- Effective for annual periods ending after December 31, 2016
- Early application is permitted

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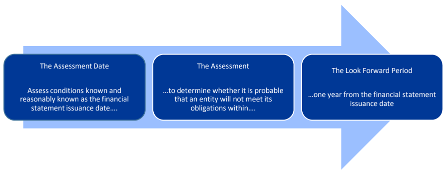
Going Concern



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Financial Statement Presentation for Not-for-Profit Entities (NFP's)

Overview

- FASB re-examining existing standards for financial statement presentation for NFP's with the goal to enable NFP's to tell their financial story better
- Areas of focus:
  - Net Asset Classification
  - Liquidity
  - Financial Performance: Operating Measures
  - Financial Performance: Cash Flow Statement
  - Reporting of Expenses
  - NFP Note Disclosures

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Financial Statement Presentation for Not-for-Profit Entities (NFP's)

Area	Current GAAP	Proposed Changes
Net Asset Classifications	Three classifications: unrestricted, temporarily restricted, permanently restricted Underwater endowment amounts reported in unrestricted net assets	Two classification: without donor restrictions, with donor restrictions Underwater endowment amounts reported in net assets with donor restrictions, with enhanced disclosure
Cash Flow	Present the net amount of operating cash flows using indirect (reconciliation) method of reporting, with additional presentation of the direct method permitted	Present the net amount for operating cash flows using the direct method of reporting with additional presentation of the indirect method permitted but no longer required Certain items reclassified among cash flow categories to improve alignment with statement of activities

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Financial Statement Presentation for Not-for-Profit Entities (NFP's)

Area	Current GAAP	Proposed Changes
Statement of Activities	Present the amounts of the net changes in three classes of net assets and of total new assets	Present the amounts of the net changes in two classes of net assets and of total net assets Present two measures of operating activities (before and after internal transfers) both of which are within changes in net assets without donor restrictions Current performance indicator measure (excess of revenue over expenses) is no longer required Present information about expense by function, nature, or both with enhanced disclosure in notes if both are not on the face of the statement. Present investment return net of related investment expenses
Liquidity		Enhanced disclosures

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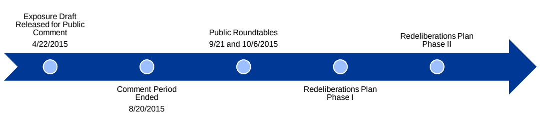
Project Timeline



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Financial Statement Presentation for Not-for-Profit Entities (NFP's)

First Phase:

- Changes to net asset classification, including:
  - Classifying net assets into two categories – net assets without donor restrictions and net assets with donor restrictions
  - Disclosure of board-designated funds
  - Shifting the amount by which permanent endowments are underwater from net assets without donor restriction to net assets with donor restriction and requiring expanded disclosures about underwater endowments
- Presentation of expenses by both their natural and functional classification
- Enhancing disclosures by not-for-profit entities that choose to present an operating measure
- Improving disclosures of information useful in assessing liquidity
- Requiring the direct method presentation in the statement of cash flows

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Financial Statement Presentation for Not-for-Profit Entities (NFP's)

Second Phase:

- Presentation of an operating measure on the statement of activities
- Realignment of certain items on the statement of cash flows

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Goodwill for Not-for-Profit Entities

- FASB has a project on its agenda for public business entities and not-for-profit entities concerning goodwill
- Four alternatives
  - The PCC alternative (ASU 2014-02)
  - Amortization of goodwill over its useful life not to exceed a maximum number of years
  - Direct write-off of goodwill
  - Simplified impairment test
- FASB's tentative decisions
  - Decided not to allow not-for-profit entities the PCC alternative
  - Eliminate step 2 of the goodwill impairment testing
  - Work concurrently with the IASB to address concerns about the subsequent accounting for goodwill

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Simplifying the Balance Sheet Presentation of Debt

Current GAAP:

- The term current liabilities is defined in Topic 210 (Balance Sheet) but the term noncurrent is not explicitly defined
- Topic 470 (Debt) includes narrow-scope guidance on various debt transactions
- Balance sheet classification is based on facts and circumstances as of the financial statement issuance date for some debt transactions and as of the balance sheet date for others
- Current GAAP allows the application of judgement about intent and probability

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Simplifying the Balance Sheet Presentation of Debt

Proposed Guidance:

- Debt would be classified as noncurrent if one or both of the following criteria are met as of the balance sheet date:
  - The liability is contractually due to be settled more than 12 months (or operating cycle, if longer) after the balance sheet date
  - The entity has a contractual right to defer settlement of the liability for at least 12 months (or operating cycle, if longer) after the balance sheet date
- Decisions about classification of debt should be made based on facts and circumstances that exist as of balance sheet date
- One exception: When an organization violates a debt covenant at year-end but obtains the waiver before financial statement issuance that waiver may be considered when determining the balance sheet classification, unless the waiver results in an extinguishment of debt

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Simplifying the Balance Sheet Classification of Debt

Current GAAP

- The term ***current liabilities*** is defined in Topic 210 (Balance Sheet) but the term ***noncurrent*** is not explicitly defined
- Topic 470 (Debt) includes narrow-scope guidance on various debt transactions
- Balance sheet classification is based on facts and circumstances as of the financial statement issuance date for some debt transactions and as of the balance sheet date for others
- Current GAAP allows the application of judgement about intent and probability

Solution

- Debt would be classified as ***noncurrent*** if one or both of the following criteria are met as of the balance sheet date:
  - ✓ **The liability is contractually due to be settled more than 12 months (or operating cycle, if longer) after the balance sheet date**
  - ✓ **The entity has a contractual right to defer settlement of the liability for at least 12 months (or operating cycle, if longer) after the balance sheet date**

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Other FASB Exposure Drafts and Projects

- Improving Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Costs
- Fair Value Disclosures
- Accounting for Investments – Equity Method and Joint Ventures

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Healthcare Landscape

Trends Hospitals are Currently Facing:
- Shifts in services and patient responsibility
- Changing payment models
- Retail revolution in healthcare
- Transparency
- Digital era
- Physician demand
- Continuum of affiliations

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Any Questions?

Thank you!