Health Care Focused Accounting Standards Update

PRESENTED BY:

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WITH YOU TODAY

Ben Mack, CPA
Partner

Ben has practiced public accounting since 2000. He audits health care providers, medical groups, and governmental payers and works with large hospital systems, academic medical centers, medical groups, regional hospitals, and critical access care facilities.

Ben also works with risk-sharing groups and quasi-governmental agencies administering Medi-Cal funds. He has significant experience with controls-based auditing, evaluating information technology environments, third-party payer issues, and charity care.

Stelian Damu, CPA
Senior manager

Stelian has 12 years of experience in public accounting with over 10 years dedicated to servicing health care organizations. He specializes in providing assurance and consulting services to both for-profit and not-for-profit health care organizations, including hospitals, medical groups, and health plans, and long-term care organizations.

He is responsible for planning, preparing, conducting, and completing audits and consulting projects. In this capacity, he interacts with clients' personnel throughout the year and is responsible for directing the work of other field staff personnel on his engagements.

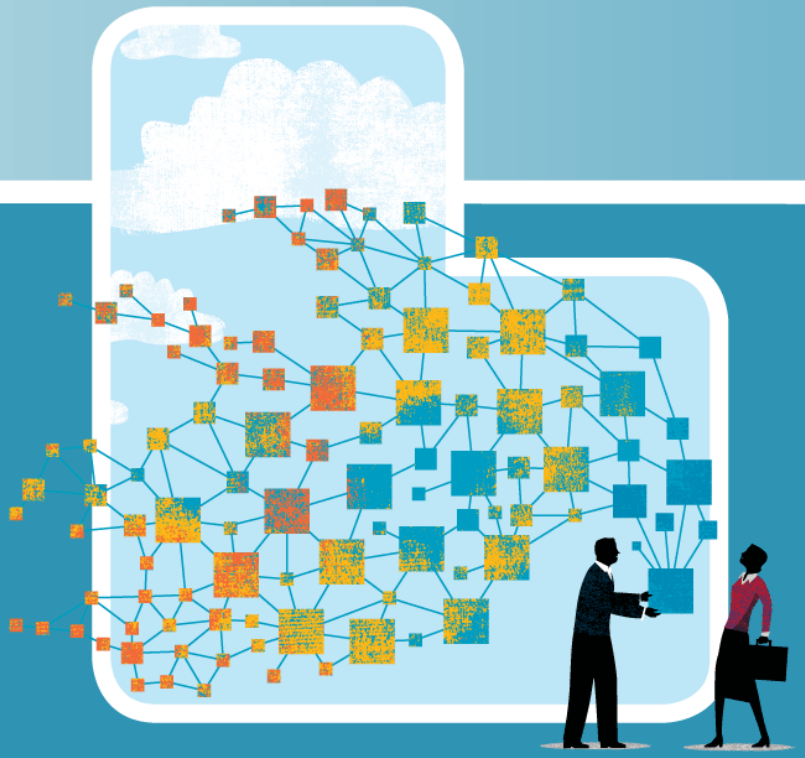
Recently Issued Standards

- ASU 2015-14 | Revenue
- ASU 2014-15 | Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern
- ASU 2015-01| Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items
- ASU 2015-03 | Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs
- ASU 2015-05 | Intangibles – Goodwill and Other Internal Use Software
- ASU 2015-07 | Fair Value Hierarchy Levels for Certain Investments Measured at Net Asset Value (Topic 820)

Recently Issued Standards (Continued)

- ASU 2015-16 | Simplifying the Accounting for Measurement – Period Adjustments
- ASU 2015-17| Income Taxes (Topic 740)
- ASU 2016-01 | Financial Instruments (Subtopic 825-10)
- ASU 2016-13 | Measurement of Credit Losses on Financial Instruments
- ASU 2016-02 | Financial Leases
- ASU 2016-14| Not-for-Profit Entities (Topic 958)
- ASU 2016-15| Statement of Cash Flows (Topic 320) Classification of Certain Cash Receipts and Cash Payments

REVENUE RECOGNITION



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ASU 2015-14: Revenue – Effective Date

- Original effective dates
  - CY 2017 (FY 2017-18) for public entities* (including interim)
  - CY 2018 (FY 2018-19) for nonpublic entities (no interim, just annual period; interims in subsequent years)
  - Nonpublic entities may adopt early, but no earlier than public entities
- Deferred effective dates
  - CY 2018 (FY 2018-19) for public entities* (including interim)
  - CY 2019 (FY 2019-20) for nonpublic entities (no interim, just annual period; interims in subsequent years)
  - Early adoption permitted, but not before original effective date

* Includes NFPs with publicly-traded conduit (or direct) debt.

FASB Recent Standard Setting

Identifying Performance Obligations and Licensing

- **Performance Obligations**
  - Distinct in the context of the contract
  - Immaterial promises
  - Shipping and handling
- **Licensing**
  - Nature of license: over time vs. point in time
  - Scope of constraint on sales-based and usage-based royalties

Principal vs. Agent (Reporting Revenue Gross vs. Net)

- Control principle: to provide (principal) vs. to arrange (agent)
- Unit of account
- Control principle in the context of services
- Control indicators
- Illustrative examples

Narrow-Scope Improvements and Practical Expedients

- **Narrow-Scope Improvements**
  - Noncash consideration
  - Collectibility
  - Completed contracts at transition
- **Practical Expedients**
  - Contract modifications at transition
  - Sales tax presentation (net)

ASU 2014-09 – AICPA Task Force Issues

- Overview of the AICPA Task Forces
  - 16 industry task forces
  - Charged with developing revenue recognition implementation issues that will provide helpful hints and illustrative examples for how to apply the new revenue recognition standard
  - Healthcare task force consists of members from public accounting and industry
    - Healthcare implementation issues have been identified and are in various stages of progress

Revenue Recognition

- Some areas of focus for healthcare and NFPs being discussed by AICPA Task Forces
  - Healthcare:
    - Self-pay patients
    - Medicare/Medicaid payments (and subsequent audits)
    - Continuing Care Retirement Communities:
      - Entrance and other fees
  - Government (and other) grants and contracts
  - Membership dues
  - Licenses and royalties

Five-Step Process

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

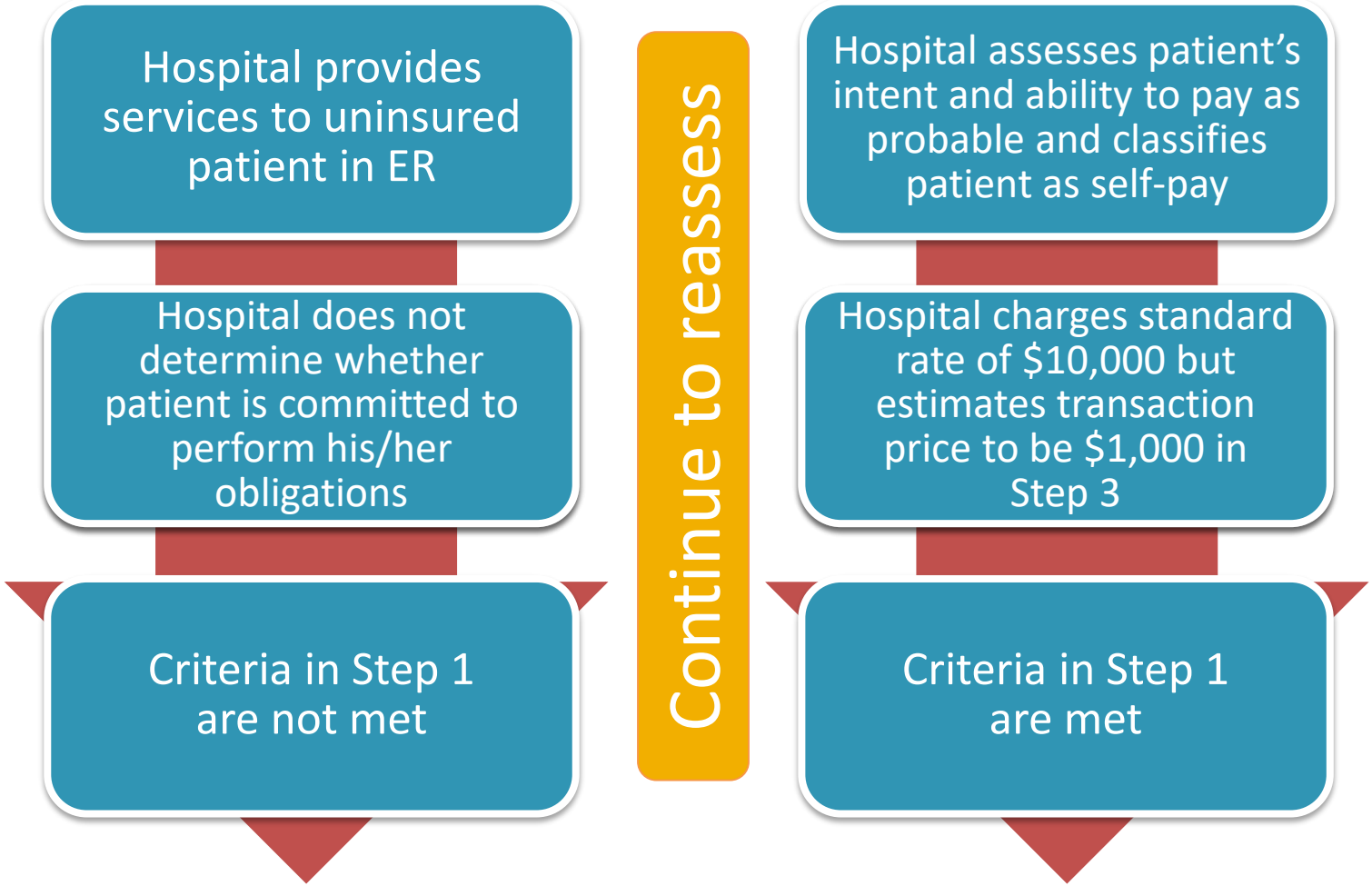
Healthcare Implementation Issues – Self Pay

- Current practice
  - Gross charges, net of self-pay discounts recorded as contractual adjustments
  - Bad debt expense recorded and presented separately as a reduction to net patient service revenue
- New guidance
  - Record revenue at amount entity expects to be entitled to (i.e., net patient service revenue)
  - Bad debt expense presented as operating expense
  - Use of judgment in determining what constitutes bad debt versus implicit price concessions
- No change in charity care guidance

Healthcare Implementation Issues – Self Pay (Continued)

- Implementation topics identified with respect to the application of the revenue model to the self-pay revenue stream:
  - Determining if an enforceable contract between a healthcare entity and a patient exists
  - Determining if a patient is committed to perform his or her obligations
  - Determining if it is probable that the entity will collect the consideration to which it expects to be entitled
  - Determining if uncollectible amounts from self-pay patients (including uninsured patient balances and self-pay patient balances arising from co-payments and deductibles) constitute implicit price concessions
  - Determining how to account for subsequent changes in the estimate of the transaction price
  - Determining what constitutes an impairment loss or bad debt

Healthcare Implementation Issues – Self-pay example



Healthcare Implementation Issues – Portfolio Approach

- Practical expedient – the revenue recognition guidance may be applied to a portfolio of contracts with similar characteristics
  - Portfolios could be
    - True self-pay
    - High deductible plans
    - Co-pays and deductibles
- Use of historical experience to determine collectability percentage
- Entities that evaluate credit risk would recognize change in transaction price as bad debt expense

Healthcare Implementation Issues – Medicaid Pending

- Option 1 – Portfolio approach
  - Estimated to eventually be Medicaid 40%, Self-pay 30%, and Charity 10%

- Option 2
  - Not a contract and no revenue is recognized until payor is identified

Healthcare Implementation Issues – Third-Party Estimates

- Determination (estimation) of transaction price (expected value vs. most likely amount) as it relates to third-party estimates

- "An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled."
  - Expected value method – sum of probability weighted amounts in a range of possible consideration amounts
  - Most likely amount method – single most likely amount in a range of possible consideration amounts (the single most likely outcome of the contract)

Healthcare Implementation Issues – Contract Costs

- Healthcare entities may enter into various types of contracts for which they incur incremental costs of obtaining a contract or costs to fulfill a contract
- The new revenue standard provides some accounting guidance for contract costs and, therefore, healthcare entities should carefully consider the different types of costs incurred to obtain and fulfill a contract and whether an asset should be recognized for those costs
- Certain costs of acquiring and fulfilling contracts are capitalized and amortized over a period based on the terms of the contract (i.e., transfer of performance obligations)
- Would need to consider amortization and impairment

Disclosures

- Disclose sufficient information to enable user of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

- Consider whether these matters are impacted by factors such as geographical considerations, market or type of customer, types of contracts, and whether the healthcare entity has operating segments or service lines

- For each significant third-party payor, provide a summary of activity for each operating period. The summary would distinguish settlements relating to prior years from those relating to the current year's activity and would identify current-year changes to settlement amounts estimated in prior periods

ASU 2014-15 | Going Concern (Topic 205)

- Requires management (not the auditor) to evaluate whether conditions or events raise substantial doubt (i.e., it is probable that the entity won't be able to meet its obligations as they become due) about the entity's ability to continue as a going concern
- Also clarifies the period of time to be considered, memorializing that management must consider one year past issuance date not one year past balance sheet date
- Requires certain disclosures when substantial doubt exists or is alleviated by management's plans
- Effective for annual periods ending after December 15, 2016

ASU 2014-15 | Going Concern – Management's Plans

- If substantial doubt exists:
  - Management needs to evaluate plans to mitigate the adverse conditions and determine whether such plans are sufficient to alleviate the substantial doubt
  - Mitigating effect should be considered ONLY if it is:
    - *Probable that the plans will be effectively implemented—and it is generally assumed that such plans have been approved by management before the financial statements are issued*
    - *Probable that the plans will mitigate the underlying conditions or events*

REQUIRED DISCLOSURES

Substantial doubt is raised, but is alleviated by management's plans

- Principal conditions or events
- Management's evaluation
- Management's plans

Substantial doubt is raised, but is not alleviated

- Principal conditions or events
- Management's evaluation
- Management's plans
- Statement that there is "substantial doubt" about the entity's ability to continue as a going concern

ASU 2015-01 | Extraordinary Items (Topic 225)

- Eliminated concept of “extraordinary items”
- An entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; and (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item
- Expanded previous disclosure requirements to encompass items that are both or either unusual or infrequent
- Effective prospectively for annual periods ending after December 15, 2015
- Early adoption permitted

ASU 2015-03 | Debt Issuance Costs (Topic 835)

- Debt issuance costs related to a recognized debt liability to be presented as a direct deduction form the debt liability rather than as an asset
- Recognition and measurement not affected – cost continued to be amortized as interest expense
- Clients should consider how their debt service coverage covenant is worded (i.e., if it's based on "interest paid" this will not have an impact but if it's based on "interest expense" this will change the calculation)
- Effective for fiscal years beginning after December 15, 2015 (public), or December 15, 2016 (nonpublic)
- Retrospective application is required and early adoption is permitted for financial statements that have not previously been issued

Example

On December 31, 201X, an entity issues a noninterest-bearing debt security due in three years with a face amount of $10,000,000, to an investor for $9,000,000. On the same date, the entity incurs and pays $50,000 worth of issuance costs to parties other than the investor.

	Existing Standard	New Standard
Debt issuance costs (asset)	$ 50,000	
Noninterest-bearing note	$ 10,000,000	$ 10,000,000
Less unamortized discount based on imputed interest rate of approximately 3.5%	$ 1,000,000	$ 1,000,000
Less issuance costs		$ 50,000
Note payable note	$ 9,000,000	$ 8,950,000

ASU 2015-05 | Intangibles – Goodwill and Other Internal Use Software

- This guidance will help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (CCA)
- Under the new standard, fees paid by a customer in a CCA will be within the scope of the internal-use software guidance if both of the following criteria are met:
  - The customer has the contractual right to take possession of the software at any time during the CCA period without significant penalty
  - It is feasible for the customer to run the software on its own hardware (or to contract with another party to host the software)
- Effective for annual periods beginning after December 15, 2015
- Prospective or retrospective application are both permitted

ASU 2015-07 | Fair Value Hierarchy (Topic 820)

- Objective: Creating uniformity of how certain investments measured at net asset value (NAV) with redemption dates in the future (including periodic redemption dates) are categorized within the fair value hierarchy
- Current: Investments valued using the NAV (or equivalent) are categorized within the fair value (FV) hierarchy on the basis of when the investment is **redeemable as of the measurement date**
- Change: Removes the requirement to categorize with the FV hierarchy all investments for which FV is measured using the **NAV per share practical expedient**
- Effective for fiscal years beginning after December 15, 2015 (public), or December 15, 2016 (nonpublic)
- Retrospective to all period presented, early adoption permitted

Example

	Assets at Fair Value as of December 31, 201X			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$4,437,500	$ -	$ -	$4,437,500
Self-directed brokerage account	25,000	-	-	25,000
Common stocks	960,000	-	-	960,000
U.S. government securities	-	225,000	-	225,000
Corporate bonds (Aaa credit rating & non-investment grade)	-	307,500	20,000	327,500
Total assets in the fair value hierarchy	5,422,500	532,500	20,000	5,975,000
Investments measured at net asset value	-	-	-	1,422,000
Investments at fair value	$5,422,500	$532,500	$20,000	$7,397,000

ASU 2015-16 | Simplifying the Accounting for Measurement – Period Adjustments

- Recognize adjustment to provisional amounts in the period in which the adjustments are determined
- Either indicate they are provisional in the disclosures, or live with them as an error
- This eliminates what was a 12-month window to essentially true-up a business combination

ASU 2015-17 | Income Taxes (Topic 740)

- Requires entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet
- Simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet
- The amendments may be applied prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented
- Effective for fiscal years beginning after December 15, 2016 (public), or December 15, 2017 (nonpublic)

ASU 2016-01 | Financial Instruments (Topic 825)

- For those with equity securities as investments the ASU supersedes current guidance and no longer requires equity securities with a readily determinable fair value to be classified into categories
- Those categories were trading or available for sale
- With this change, **all equity securities must now be measured at fair value, with changes in the fair value recognized through net income (or excess, or revenue over expenses for NFPs)**
- This means that there is no more recognizing the changes in value of available for sale securities flow through "unrealized gain/loss in other comprehensive income", which is located in stockholders' equity, or, for NFPs, through changes in net assets
- This only applies to equity securities – i.e., ownership interests or the rights to buy them, not debt interests

ASU 2016-01 | Financial Instruments (Topic 825) (Continued)

- Generally, an entity will record a cumulative effect adjustment to beginning equity as of the beginning of the first reporting period in which the guidance is adopted
- Equity investments without readily determinable fair values will require a qualitative assessment for impairment at each reporting period, similar to qualitative assessments for goodwill and other intangible assets
- Enhanced disclosures regarding equity securities will also be required
- Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes
- Effective for fiscal years beginning after December 15, 2017 (public), or December 15, 2018 (nonpublic)

ASU 2016-01 | Financial Instruments (Topic 825) (Continued)

- Consider the implications
- Debt covenants
- Budgets
- Investment policy/strategy

ASU 2016-13 | Measurement of Credit Losses on Financial Instruments

- Affects assets held at amortized cost basis or available for sale
  - Recall from ASU 2016-01 that these are not equity securities anymore – ownership interests
- Removes how you account for credit losses on those securities
- In current GAAP you only record a loss if it is probable that it has already been incurred
- Requires that you look over the extended life of the debt securities and record the loss when it is probable that it has occurred
- Requires that instead of writing the asset down you are recording a valuation account. The losses are recorded to the income statement, as are changes in the allowance account.

ASU 2016-13 | Measurement of Credit Losses on Financial Instruments (Continued)

- Practitioners are encouraged to pool various types of assets
- The guidance says that they don't believe that it should change how they are looking at debt securities, so it could change the timing of the loss recognition
- Estimated total loss could be based on discounted cash flows, historical loss rate
- Effective for fiscal years beginning after December 15, 2020, for NFPs and Employee Benefit Plans, and one year earlier for nonpublic business entities. Early adoption is permitted for years after December 15, 2018.

ASU 2016-02 | Leases

- Requires lessees to recognize the assets and liabilities arising from all leases on the balance sheet
- A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term
- Effective for NFP's that issue conduit debt, public business, SEC registrants and entities for fiscal years beginning after December 15, 2018
- Effective for other entities after December 15, 2019 (calendar 2020)
- Moss Adams issued some fairly easy to use guidance with illustrations – see our web site or our handouts in the room

ASU 2016-02 | Leases – Practical Considerations

- Debt covenants and the impacts on them
  - More debt being recorded on the balance sheet, which will impact debt-to-equity or other debt ratios
  - Recording the current portion of an operating lease liability as a current liability may impact liquidity ratios
  - Additional interest expense may be recorded compared with interest expense under the old lease guidance which may impact interest coverage or other ratios that include interest expense as a component
  - Restrictions on capital purchases

ASU 2016-02 | Leases – Practical Considerations (Continued)

- Identification of capital leases:
  - Expenses
  - Contract management
- Operating lease commitment schedules before ASU 2016-02 implementation
- Budgeting considerations

ASU 2016-14 | Not-for-Profit Entities (Topic 958)

- Phase 1 – *Issued August 2016*
  - Unrestricted and Restricted Net Assets
  - Underwater Endowments
  - Placed-in-Service Assets
  - Expenses – Statement of Functional Expenses
  - Liquidity – Quantitative & Qualitative Disclosures
  - Investment Returns
  - Statement of Cash Flows
  - Effective for annual financial statements issued for fiscal years beginning after December 15, 2017
- Phase 2 – *In Discussion*
  - Operating Measures
  - Statement of Cash Flows

Net Assets

Current GAAP	Unrestricted	Temp. Restricted	Perm. Restricted
GAAP	**Without Donor Restrictions**	**With Donor Restrictions**	
+ Disclosures	**Amount, purpose, and type of board designations ***	**Nature and amount of donor restrictions**	

*** New disclosure requirement**

Underwater endowments

- Revised net asset classification
  - To be reflected in net assets with donor restrictions rather than in net assets without donor restrictions
- Enhanced disclosures
  - In addition to aggregate amounts by which funds are underwater (current GAAP), also need to disclose aggregate of original gift amounts (or level required by donor or law) for such funds, fair value and any governing board policy, or actions taken, concerning appropriation from such funds.

Expiration of capital restrictions

- Gifts of cash restricted for acquisition or construction of property, plant and equipment
  - In absence of explicit donor restrictions, NFPs would be required to use the placed-in-service approach (no more implied time restrictions)
    - Healthcare NFPs are already required to do so

Expense reporting

- Report expenses, either on the face of the financial statements or in the notes, by:
  - Function (currently required by GAAP)
  - Natural classification
  - Analysis (disaggregate function by nature)
- NFPs are required to provide qualitative disclosures about methods used to allocate costs among program and support functions
- ASU also provides enhanced guidance on allocations from M&G expenses

Expense Reporting Matrix Example

Analysis of operating expenses by nature *and* function → one place in the F/S (statement of activities, separate statement, or schedule in notes), with additional qualitative information about cost allocations

FUNCTION

Functionalization is optional

NATURE

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

*Either nature or function (or both) on face of Statement of Activities

Liquidity and availability of resources

- NFPs required to provide:
  - Qualitative information on how a NFP manages its liquid available resources and its liquidity risk (in the notes)
  - Quantitative information that communicates the availability of a NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year (on the face and/or in the notes)

Reporting of investment return

- Net presentation of investment expenses against return on the face of the statement of activities
  - Netting limited to external and direct internal expenses
  - May report net return in multiple, appropriately labeled lines (e.g. from different portfolios, in different net asset classes, or in operating versus nonoperating)

- No longer required to disclose:
  - Investment expenses
  - Investment return components

Cash flow statement

- In presenting operating cash flows, NFP entities are able to choose between two options:
  - Direct method
  - Indirect method
- Indirect method reconciliation no longer required for direct method

NFP FS project – Phase II

- Phase II
  - Operating measures: all other elements of the proposal, including:
    - Whether to require intermediate measure(s)
    - Whether and how to define such measure(s), and what items should or should not be included in the measure(s)
    - Alternative disaggregation approaches suggested by stakeholders
  - Statement of cash flows: realignment of certain line items

ASU 2016-15 | Statement of Cash Flows (Topic 320)

- Released fall of 2016
- This gives guidance on seven different cash flow issues, and the idea was to slow down the number of questions coming to the FASB
- Predominance principle: What does this relate to with respect to what is already in GAAP, and apply the classification that relates to what is already in GAAP.
- Effective December 15, 2018, early adoption is permitted

ASU 2016-15 | Statement of Cash Flows (Topic 320) (Continued)

There has been diversity in practice as to how certain items are reported on the statement of cash flows; this provides specific guidance for certain items

- Contingent consideration payments made after a business consideration – classified as investing if they are soon after the business combination. If it is some time after, part is financing and part is operating. So if not soon after the combination, there could be a bifurcation.
- Cash payments for debt prepayment or extinguishment costs should be classified as financing.

ASU 2016-15 | Statement of Cash Flows (Topic 320) (Continued)

- Cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage (that is, the nature of the loss). For insurance proceeds that are received in a lump-sum settlement, an entity should determine the classification on the basis of the nature of each loss included in the settlement.
- Cash proceeds received from the settlement of corporate-owned life insurance policies should be classified as cash inflows from investing activities.

Questions?

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