



Navigating the New Revenue Recognition Rules for Healthcare Providers



The Financial Accounting Standards Board has issued an Accounting Standards Update (ASU), which may have a significant impact on the recognition of revenue by healthcare providers: ASU No. 2014-09, *Revenue from Contracts with Customers*.

Overview

The ASU effectively eliminates industry-specific revenue guidance currently embedded within accounting principles generally accepted in the United States (GAAP). The intent of the ASU is to replace the current guidance with a principle-based approach for recognizing revenue. The ASU outlines five steps to be followed in recognizing revenue:

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

The ASU requires an entity to 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. This standard will be effective for non-public entities in the first annual reporting period beginning on or after December 15, 2017. Public entities are required to adopt earlier, and non-public entities have an option to early adopt as described within the ASU.

Additionally, entities have options with respect to methods used in transitioning to the new standard.

Impact on Healthcare Providers

With respect to healthcare providers, there are a number of items that will require increased focus and judgment with regard to revenue recognition.

Contract Existence

The first task is identifying whether or not a contract with a customer exists. In order for a contract to exist, the contract must be enforceable, and it must be probable that the entity will collect the consideration to which it expects to be entitled. Generally, a patient who possesses some form of commercial insurance or government-funded payment and who is admitted to, or served by, a healthcare provider would be viewed as contractually bound. That is, the terms for payment to the healthcare provider are outlined within a contract, and the healthcare provider believes it probable it will collect the consideration to which it is entitled under the contract.

However, the portion of payment (e.g., deductible) to be received from the patient directly (rather than the third party) should be considered separately, especially with regard to certain high-deductible plans where the healthcare organization may not expect, based on historical data, to collect all such amounts due. Given this situation, the provider would need to estimate the transaction price for that portion of the revenue, as discussed below, and determine if such “expected” consideration is probable of collection.

For other services provided, a patient may be self-insured. The evaluation of whether a contract exists in this case may require significant judgment. The term “enforceable” means that both parties have approved the contract and are committed to performing their respective obligations. A patient admitted through the emergency room, however, may not have explicitly entered into a contract with the healthcare provider; and, therefore, judgment will be required to make a determination as to whether revenue should be recognized, as it may not meet

the criteria for an enforceable contract. However, the healthcare provider should continue to evaluate if a contract exists. For example, a subsequent acknowledgement of a patient's responsibility may result only in delayed recognition of revenue.

Transaction Price

It is important to distinguish the gross charges of the healthcare provider from the amount that it expects to receive as payment. The healthcare provider's experience may be that it only collects a small portion of the amounts due from many self-pay patients, as well as from patients under third-party payer contracts. This concept is referred to as "variable consideration," whereby the amount of consideration to which a healthcare provider expects to be entitled varies as a result of discounts, refunds, rebates, price concessions, and similar items.

The ASU requires variable consideration be estimated based upon a weighted-average probability of outcomes or by recording the most likely outcome. With regard to estimating amounts expected to be collected, a healthcare provider may use an approach of evaluating contracts by class, rather than individually, so long as it reasonably expects that there will not be material differences from applying the guidance to individual contracts. It is likely healthcare providers will have to, at a minimum, distinguish between uninsured self-pay patients and the portions due from patients under third-party payer contracts in evaluating the amounts to which they expect to be entitled.

The portion of gross charges the healthcare provider does not expect to collect may be viewed as a "price concession." A price concession is a deduction from gross charges in arriving at net patient revenue - i.e., not a bad debt. The amount that the healthcare provider expects to collect would be considered a bad debt if it is not collected in the future. Under the guidance provided by the ASU, bad debts will be reported as an operating expense of the healthcare provider.

Additionally, revenue recognition is subject to a "constraint." Amounts should be recorded only if it is probable there will not be a significant reversal in a subsequent period. Complying with this component of the ASU will require further judgment on the part of healthcare providers.

Revenue Without a Contract

If the services provided to a patient do not qualify as a contract, then revenue recognition is allowable only if one of the following conditions is met: (1) the entity has no outstanding obligations to the customer and substantially all of the consideration promised by the customer has been received and would not have to be refunded, or (2) the contract has been terminated and any consideration received from the customer is non-refundable.

Summary

Under this ASU, it is unlikely healthcare providers will continue to recognize revenue upon the performance of services to patients without first assessing if a contract exists. In order for the contract to exist, the agreement must be enforceable and the collection of amounts to which a provider expects to be entitled must be probable. Healthcare providers must also determine the amount of consideration to which it expects to be entitled on a contract-by-contract or portfolio approach. This determination will require judgment, and healthcare providers will need to ensure appropriate information can be obtained through their information systems to allow these judgments to be supported.

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