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Central Ohio HFMA

Healthcare Accounting Update

November 21, 2019

Agenda

New Accounting Standards

- ASU 2016-12 Leases
- ASU 2018-08 Revenue Recognition
- ASU 2019-06 Intangibles and Goodwill
- ASU 2018-15 Cloud Computing
- ASU 2016-01 Recognition and Measurement of Financial Instruments
- ASU 2016-18 Restricted Cash
- ASU 2017-01 Definition of a Business

Pending Accounting Standards

- Simplifying the Classification of Debt
- Interest Rate Reform

Leases

ASU 2016-12

- Objective of the lease accounting standard was to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet
- Include virtually all leases on balance sheet for lessees
- Must be applied to all leases in place upon implementation (nothing is “grandfathered”)
- Leases less than 12 months may be scoped out
- Leases between related parties should be classified in accordance with the lease classification criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease

Effective dates

- Public business entities and not-for-profit entities that are conduit debt obligors – Periods beginning after December 15, 2018
- All others – Periods beginning after December 15, 2020 (Delayed 1 year)
- Early adoption is permitted

Accounting Alternatives Under ASC 842

Topic	Description
Modified retrospective transition option (ASU 2016-02)	- An entity may elect to measure, present, and disclose its leasing activities as of the beginning of the earliest period in the financial statements with any required cumulative effect adjustment being recognized retained earnings as of that date.
Comparatives under ASC 840 option (ASU 2018-11)	- An entity may elect not to present 2 years of consistently prepared financial statements, but rather measure, present, and disclose its leases as of the effective date of the new lease accounting standard with any required cumulative effect adjustment being recognized as of the effective date
Package of three (Transition practical expedient)	An entity may elect not to reassess: - Whether expired or existing contracts contain leases under the new definition of a lease; - Lease classification for expired or existing leases; and - Whether previously capitalized initial direct costs would qualify for capitalization under Topic 842.
Use of hindsight (Transition practical expedient)	- Hindsight is allowed when considering the likelihood that lessee options to extend or terminate a lease or purchase the underlying asset will be exercised, and in assessing the impairment of ROU assets. - Elect on its own or with the package of practical expedients.

Accounting Alternatives Under ASC 842

Topic	Description
Short-term lease exemption	- As an accounting policy, a lessee may elect not to apply the recognition requirements in ASC 842-20 to short-term leases. Instead, a lessee may recognize the lease payments in profit or loss on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred.
Lessee nonlease component separation practical expedient	- As a practical expedient, a lessee may elect not to separate nonlease components from the lease components to which they relate. A lessee applies this practical expedient as an accounting policy election by class of underlying asset – e.g. equipment, fleet, real estate, etc.
Lessor nonlease component separation practical expedient	- As a practical expedient, a lessor may elect not to separate nonlease components from the lease components in the arrangement provided certain criteria are met. - Subsequent accounting of the combined components depends on significance of the lease and nonlease components.
Discount rate	-Nonpublic business entities are permitted to make an accounting policy election to use the risk-free rate when measuring their lease obligations vs. incremental borrowing rate - As of implementation of ASU 842, may opt to elect to apply the discount rate as of implementation or initial lease date

Revenue Recognition-Industry Guidance

- AICPA Revenue Recognition Guide- Chapter 7 Healthcare
- HFMA Issue Analysis: Revenue Recognition Under Topic 606 for Provider Tax Programs and Similar Arrangements
- HFMA Issue Analysis: Revenue Recognition Implications Under Topic 606 for Capitation and Risk Sharing Arrangements

Revenue Recognition – Grants and Contributions

ASU 2018-08

- The amendments apply to all entities that make or receive grants or contributions; typically, grant makers are government agencies, nonprofits, such as charitable foundations, and businesses; recipients include both NFPs and business entities
- Clarified guidance on how entities determined whether to account for a transfer of assets as an exchange transaction under other guidance (i.e. ASC 606) or a contribution
- These amendments are expected to shift many grants from an exchange transaction to a nonexchange transaction, which will impact the accounting
- For nonexchange transactions, the new guidance clarifies the contribution accounting model's guidance regarding whether arrangements are conditional (and thus, revenue or expense recognition must be deferred) or unconditional (in which case revenue or expense is immediately recognized)
- FASB included decision-making framework, which assists entities in distinguishing whether grants are exchange or nonexchange transactions and, if they are nonexchange, whether they are conditional or unconditional

Revenue Recognition – Grants and Contributions

Effective dates

- Public business entities or NFPs as conduit bond obligors – Periods beginning after June 15, 2018 (resource recipients) and periods beginning after December 15, 2018 (resource providers)
- All others – Periods beginning after December 15, 2018 (resource recipients) and periods beginning after December 15, 2019 (resource providers)
- Early adoption is permitted

Transition options

- Modified prospective – Amendments will apply to new grant and gift agreements entered into after the effective date, as well as the remaining portions of any agreements from prior years that are incomplete as of the effective date; prior period results are not restated
- Full retrospective

Revenue Recognition – Grants and Contributions

Step 1 – Consider whether the transaction is exchange (reciprocal transaction) or nonexchange (nonreciprocal transaction):

The ASU clarifies that an exchange transaction is a reciprocal transfer in which each party receives and sacrifices approximately commensurate value; in an exchange of commensurate value, a reciprocal flow of benefits occurs between the parties

Indicative of exchange	Indicative of nonexchange
• The expressed intent by both parties is to exchange resources for goods and services that are of commensurate value	• Recipient solicits assets from the resource provider without the intent of exchanging goods or services of commensurate value
• Both parties agree on the amount of assets transferred in exchange for goods and services that are of commensurate value	• Resource provider has full discretion in determining the amount of the transferred assets
• Contractual provisions provide for the assessment of penalties beyond the amount of assets transferred if the recipient fails to perform	• Penalties assessed for failure to comply with the terms of the agreement are limited to the delivery of assets/services already provided and the return of unspent funds

Revenue Recognition – Grants and Contributions

Step 2 – Consider whether the transaction is conditional or unconditional:

The ASU clarifies that a contribution is conditional if the agreement includes both of the following:

- The recipient overcome a barrier or hurdle to be entitled to the resources
- The grantor is released from its obligation to transfer resources (or if resources were advanced, has the right to demand their return) if the recipient fails to overcome the barrier
- If either is absent, the grant / contribution is unconditional, and revenue and expense are recognized immediately by both the resource recipient and the resource provider, respectively

Revenue Recognition – Grants and Contributions

Example

- Hospital A is awarded a grant from the federal government; the agreement requires Hospital A to:
  - Follow the rules and regulations established by the Office of Management and Budget (OMB)
  - Incur certain expenses (or costs) in compliance with rules and regulations established by the OMB and the federal awarding agency
  - Obtain an annual audit in accordance with OMB guidelines
  - Submit a summary of research findings to the federal government
- Any unused assets are forfeited, and any unallowed costs that have been drawn down by Hospital A are required to be refunded
- Hospital A retains the rights to the findings

Is this transaction exchange or nonexchange?

Revenue Recognition – Grants and Contributions

Hospital A concludes this is a nonexchange transaction (nonreciprocal)

- Commensurate value is not being exchanged between the two parties
- Hospital A retains all the rights to the research and findings and receives the primary benefit of the findings
- The federal government's benefit is considered indirect because the research and findings serve the general public

Is this nonexchange transaction conditional or unconditional?

Revenue Recognition – Grants and Contributions

Hospital A determines that it should account for this grant as conditional

- The grant agreement limits Hospital A's discretion on the conduct of the research as a result of the specific requirements on how the assets may be spent (qualifying expenses)
- There is a right of return and release
- The audit requirement alone is not a barrier to entitlement because it is not related to the purpose of the agreement

Intangibles – Goodwill and Other

ASU 2019-06

- Extends the **optional** accounting alternatives for goodwill and intangible assets acquired in a business combination that were previously only available to private companies to all not-for-profit entities (including NFP conduit bond obligors with publicly-traded debt)
- Not-for-profit entity is permitted to amortize goodwill on a straight-line basis over 10 years, or less than 10 years if it demonstrates that another useful life is more appropriate
- NFPs, like private companies, have an open-ended effective date; if elected, the goodwill alternative would be applied prospectively to both existing goodwill and goodwill generated in future business combinations; the intangible alternative would apply prospectively to future business combinations; existing intangible assets are not impacted

Intangibles – Goodwill and Other

Goodwill accounting alternative

- Amortize goodwill on a straight-line basis over 10 years (or a period less than 10 years if able to demonstrate that another useful life is more appropriate)
- Upon adoption of the accounting alternative, must make an accounting policy election to test goodwill for impairment at either the entity level or the reporting-unit level; Goodwill of the entity (or the reporting unit) is tested for impairment if an event occurs or circumstances change indicating that the fair value of the entity (or the reporting unit) may be below its carrying amount
- Annual testing of goodwill for impairment is not required

Intangible asset accounting alternative

- For transactions occurring after adoption of the alternative, a not-for-profit entity should subsume into goodwill and amortize customer-related intangible assets that are not capable of being sold or licensed independently from the other assets of a business and all noncompetition agreements acquired
- A not-for-profit entity that elects the intangible asset accounting alternative is required to adopt the alternative to amortize goodwill

Goodwill Impairment

ASU 2017-04

- The ASU will simplify how an entity is required to test goodwill for impairment by removing Step 2 from the current GAAP goodwill impairment test
- An entity will perform its annual (or any interim) goodwill impairment test by comparing the fair value of a reporting unit with its carrying value; an entity should recognize a goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value

Effective dates and transition options

- Public business entities – Periods beginning after December 15, 2019 (SEC filer) or December 31, 2020 (non-SEC)
- All others – Periods beginning after December 15, 2021
- Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017; amendments should be applied prospectively

Cloud Computing

ASU 2018-15

- Evaluate the accounting for fees paid by a customer in a cloud computing arrangement (CCA)
- Amends the definition of a hosting arrangement and requires a customer in a hosting arrangement that is a service contract to capitalize certain implementation costs as if the arrangement was an internal-use software project
  - The FASB broadened the definition of the term “hosting arrangement” in the master glossary to include hosted CCA services
  - Effectively, the definition now includes any arrangement in which the customer accesses or uses software but does not take possession of the software
- Entities that enter into hosted CCA service arrangements will apply the existing internal-use software guidance to determine which implementation costs are eligible for capitalization

Cloud Computing

The general guidelines included within the internal-use software guidance should be considered, and include the following:

- Activities to develop or obtain software that allow for access to or conversion of old data by new systems are capitalizable
- Activities related to coding and testing during the application development stage are capitalizable
- Training activities are not development activities and, if incurred during the development stage, are expensed as incurred
- Data conversion activities are expensed as incurred; the process of data conversion from an old system to a new one may include purging or cleansing existing data, reconciling the data in the old and new systems, creating new or additional data, and converting old data to the new system

Cloud Computing

Examples of qualifying costs incurred during the application development stage:

- External direct costs of materials and services consumed including fees paid to third parties / service provider for services provided to customize and / or configure the service
- Travel expenses incurred by third parties or the service provider in their duties directly associated with implementing the hosted CCA service
- Internal payroll and payroll-related costs (i.e. costs of employee benefits or stock-based compensation) for employees who are directly associated with and who devote time to implementation during the development phase
- Interest costs incurred while implementing the hosting arrangement

Deferred implementation costs are expensed over the term of the hosting arrangement, which is the fixed, non-cancelable term of the arrangement, plus any reasonably certain renewal periods

Cloud Computing

Presentation

- The amortization of the capitalized costs would be recorded in the same line item on the income statement as the hosting fees
- The capitalized implementation costs would be presented on the balance sheet in the same line item as a prepayment of the hosting fees
- Cash flow classification would be the same as the hosting fees

Disclosure

- Nature of the entity's hosting arrangements that are service contracts
- Amortization expense for the period, including description of the method or methods used in computing amortization
- Balances of major classes of capitalized implementation costs, by nature or function
- Accumulated amortization, either by major classes of capitalized implementation costs or in total

Cloud Computing

Effective dates

- Public business entities – Periods beginning after December 15, 2019
- All others – Periods beginning after December 15, 2020
- Early adoption is permitted

Transition options

- Prospectively – All implementation costs incurred after the date of adoption
- Retrospectively – In accordance with ASC 250-10-45

ASU 2016-01 Recognition and Measurement of Financial Instruments

ASU 2016-01

- Requires entities to measure equity investments at fair value and recognize any changes in fair value in net income (except for investments accounted for under the equity method, investments that result in consolidation of the investee, and certain other investments)
- There is no change for classifying and measuring investments in debt securities or loans
- Entities that are not public business are no longer required to disclose the fair value of financial instruments measured at amortized cost and they can early adopt this provision for any financial statements they have not yet issued or made available for issuance

Effective dates and transition options

- Public business entities – Periods beginning after December 15, 2017
- All others – Periods beginning after December 15, 2018
- Applied using a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption

ASC Reorganization After ASU 2016-01

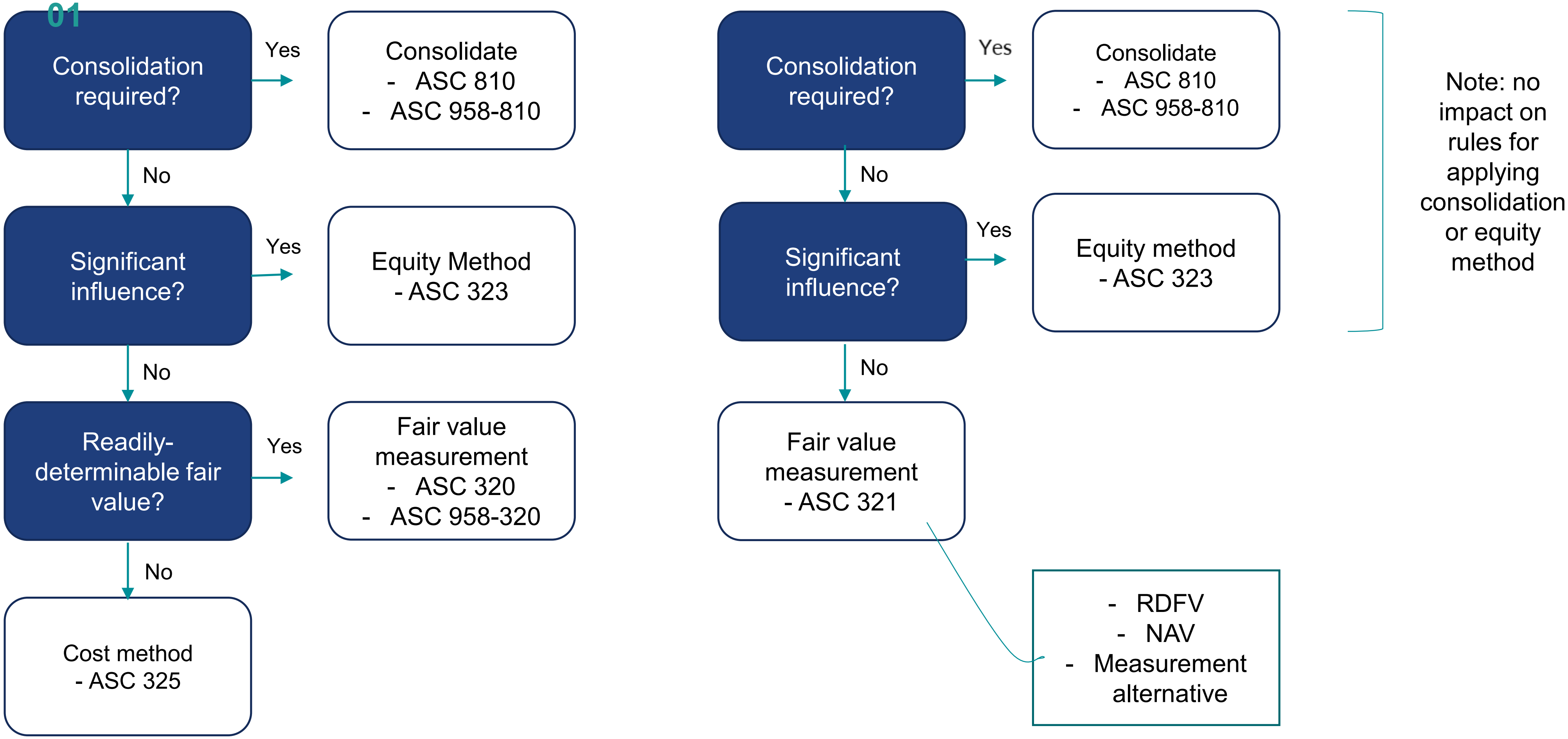
Scope

ASC section	Prior to 2016-01	After 2016-01	Impact
ASC 320 ASC 958-320	- Debt securities - Marketable equity securities	- Debt securities	Will still classify debt securities as trading/AFS
ASC 325-20	- Cost method investments	Superseded	
ASC 321	N/A – new	- All equity investments (including marketable equity securities)	Equity securities with readily-determinable FC are no longer classified as trading/AFS All fair value changes run through net income/performance indicator

Impact on Equity Investment Accounting

Prior to adoption of ASU 2016-01

After adoption of ASU 2016-01



ASC 321 “Measurement Alternative”

- An election to remeasure fair value on a nonrecurring basis
- Can be elected if investment has neither a readily-determinable fair value nor a NAV
- Measure at cost minus impairment (if any), plus or minus changes resulting from observable price changes in orderly transactions for identical or similar investments of same issuer
- Adjustment to carrying amount are included in net income/performance indicator

ASU 2016-18 Restricted Cash

Overview:

- Requires cash flow statement include changes in “restricted cash and cash equivalents”
- “Restricted cash and cash equivalents” to be included when reconciling beginning of period and end of period cash and equivalents; includes restricted cash that may be included in assets whose is limited

Effective dates:

- Effective for years beginning after December 15, 2017 for public business entities
- Effective for years beginning after December 15, 2018 for all other entities
- Early adoption is permitted
- Retrospective application

ASU 2016-18 Restricted Cash

Balance Sheet		
	2018	2017
Current assets		
Cash and cash equivalents	$ 5,000	$ 8,000
Noncurrent asset		
Assets whose use is limited:		
Held by bond trustee	22,000	2,000
Board-designated for PPE	15,000	10,000
Total	$42,000	$20,000
Liabilities and Net Assets		
Bonds payable	$22,000	
Net assets	20,000	20,000
Total	$42,000	$20,000

ASU 2016-18 Restricted Cash

Statement of Cash Flows	
Operating Activities	
Investing Activities	
Financing Activities	
Proceeds from issuance of bonds	22,000
Net cash provided by financing	22,000
Net increase in cash, cash equivalents and restricted cash	$22,000
Cash, cash equivalents, and restricted cash, beginning	$20,000
Cash, cash equivalents, and restricted cash, ending	42, 000

ASU 2016-18 Restricted Cash Reconciliation and Nature of Restrictions

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the balance sheet that sums to amounts shown in the statement of cash flows.

	2018	2017
Cash and cash equivalents	$ 5,000	$ 8,000
Restricted cash include in assets whose use is limited	37,000	$12,000
Total cash, cash equivalents & restricted cash sown in the cash flows	$42,000	$20,000

Significant Accounting Policy Sample Disclosure:

Amounts included in restricted cash represent $22,000 in tax-exempt bond proceeds deposited with a trustee that will be used to pay for construction along with $15,000 of other funds that have been board-designated for future property and equipment purchases.

Clarifying the Definition of a Business

ASU 2017-01

- Changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business
- Provides a framework that gives entities a basis for making reasonable judgements about whether a transaction involves an asset acquisition or business combination
- This clarification will reduce the number of transactions that an entity must further evaluate to determine whether they are business combinations or asset acquisitions

Effective dates and transition options

- Public business entities – Periods beginning after December 15, 2017
- All others – Periods beginning after December 15, 2018
- Early adoption is permitted and amendments should be applied prospectively

Clarifying the Definition of Business - Key Changes

	Old guidance	**New guidance**
Missing inputs or processes	A set is a business if a market participant could replace the missing elements	A set must include at a minimum an input and a substantive process to be a business
Single/similar asset threshold	None	If substantially all the fair value is concentrated in a single asset (or group of similar assets) the set is not a business
Definition of outputs	…have the ability to *provide a return*	…have the ability to *provide goods or services*
Presence of goodwill	Presumption that the set is a business	Indicator of a substantive process

Clarifying the Definition of a Business

Step 1

Evaluate whether substantially all of the fair value is concentrated in a single asset (or group of similar assets).

Step 2

Evaluate whether an input and substantive process exist.

Clarifying the Definition of a Business

	Asset Acquisition	Business Combination
Acquirer's transaction costs	Capitalized	Expensed
Purchase of assets	Assets acquired are recognized at price	Assets acquired are recognized at fair value
Potential for goodwill be recognized	No	Yes

Simplifying the Classification of Debt (pending)

Proposed ASU

- Intended to improve financial reporting by simplifying guidance used to determine whether debt should be classified as current or noncurrent in a classified balance sheet
- The proposed amendments would replace current fragmented and fact-specific guidance with an overarching, cohesive principle for debt classification that focuses on a borrower's contractual rights and obligations that exist as of the reporting date

Effective dates and transition options

- Issued September 12, 2019; comment period through October 28, 2019
- Effective date will be determined after the Board considers feedback
- Early adoption is permitted and amendments should be applied prospectively

Simplifying the Classification of Debt (pending)

Classification of principle

- Debt would be classified as noncurrent if either of the following criteria are met as of the balance sheet date: (1) Liability is contractually due to be settled more than one year after the balance sheet date or (2) entity has contractual right to defer settlement of liability for at least one year after the balance sheet date

Waivers of debt covenant violations

- The amendments would continue to require an entity to classify debt as noncurrent when there has been a debt covenant violation if the entity receives waiver of or a forbearance that meets certain conditions before the financial statements are issued

Refinancing after the balance sheet date

- The amendments would prohibit an entity from considering a subsequent refinancing when determining the classification of debt as of the balance sheet date

Simplifying the Classification of Debt (pending)

Short-term debt that has an associated long-term financing arrangement

- The amendments would preclude an entity from considering other financing arrangements (such as letters or lines of credit) in determining the classification of debt

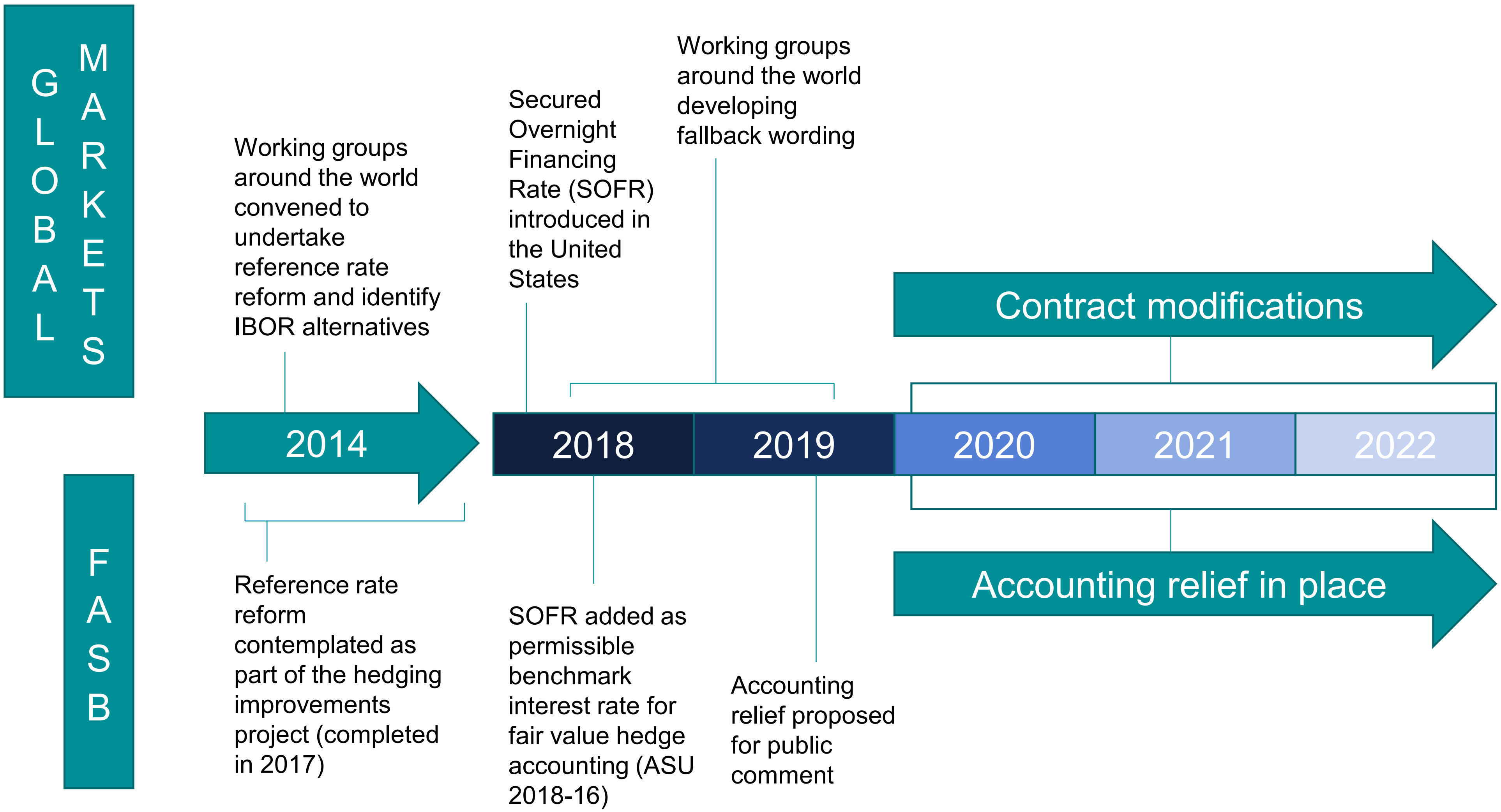
Acceleration clauses

- The amendments would remove the probability assessment of the acceleration of the due date and instead the subjective acceleration clause would affect the classification of debt when it is triggered

Separate line item presentation

- The amendments would require separate presentation in a classified balance sheet for debt that is classified as noncurrent because of a waiver of a debt covenant violation obtained after the balance sheet date

FASB Moving in Tandem with Global Markets on Interest Rate Reform



Interest Rate Reform Proposed ASU: Two Areas of Focus

Contract Modifications	High volume of modifications results in burdensome accounting evaluations →	Simplified accounting evaluations scaled for high volume of modifications
Hedge Accounting	Hedge accounting discontinued when contracts are modified →	Hedge accounting preserved when contracts are modified
	Hedge accounting discontinued if hedging relationships are not highly effective during the temporary transition period →	Hedge accounting preserved during the temporary transition period, with any hedge breakage/ineffectiveness visible in the financial statements

Thank you

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