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CPAs & Advisors

Lessons Learned on Revenue Recognition Adoption and Consideration on Other Standards

Presenters

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Revenue Recognition

› ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606)

› 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

  • Five-step model

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Grants & Contributions

› ASU 2018-08, *Not-for-Profit Entities* (Topic 958): *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

  • Applicable to all not-for-profit organizations

› Distinguishes between exchange transactions and contributions

› Differentiates conditional contributions from contributions with donor restrictions

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Today's Goals

Lessons learned from early adopters

- Lessons Learned #1 & #10 : Overall
- Lessons Learned #2 - #7: Revenue Recognition
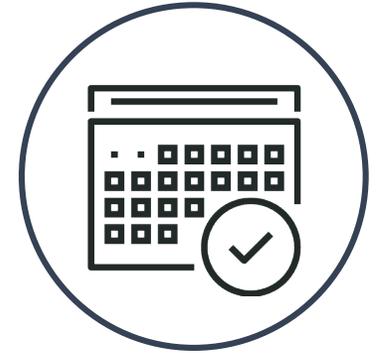- Lessons Learned #8 - #9: Grants & Contributions

Action items to develop your implementation plan

Resources available

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1 **Effective Date**

› Public entities – Past year of adoption

  • "Conduit debt obligor" entities

› Nonpublic entities – As of December 3, 2019, current fiscal year

› Implementation starts at the beginning of the fiscal year

  • Are financial statements issued to any third parties? Should not imply in accordance with GAAP if not implemented Topic 606 and ASU 2018-08

  • See Lesson #10 for hours commitment you should expect

2 Valuation Methodology

› Step 3 of Five-Step Model: Determine the transaction price

- • The amount of consideration to which the entity expects to be entitled

Gross Charges **—** Explicit Price Concessions **—** Implicit Price Concessions **=** Transaction Price
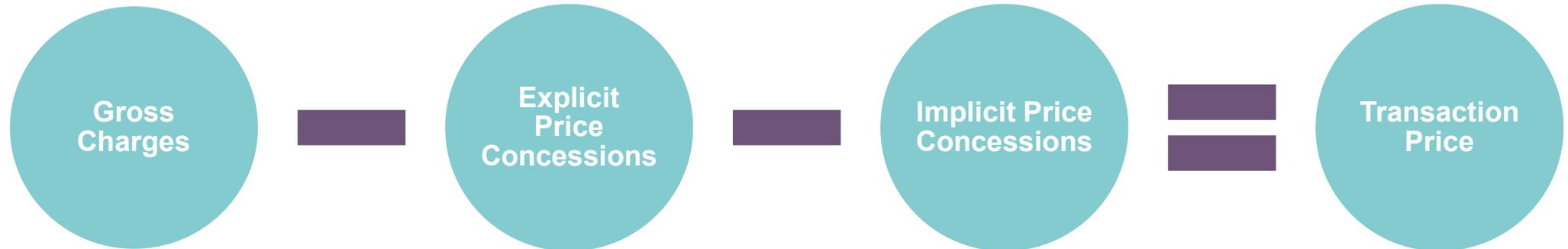
› If current valuation methodology is accurate, net amounts reported on statements of operations not expected to change

3 **Data Extraction**

› **Action Item:** Identify practice management system report capturing all data needed

- To ensure completeness of data, reconcile to monthly journal entries capturing charges, adjustments and payments
- To validate reliability of data, test specific patients with secondary insurance and patient payments for consistency in payer (in other words, make sure adjustments and payments are applying to payer of charges)
- **Tip:** Set up report to auto-run with other month-end reports

3 **Data Extraction**

Practice Management System "Wish List"

› Unique encounter identifier

› Date of service

› Payer

› Charges

› Adjustments

› Payments

› Date of entry

› Service delivery site

› Service delivery department

› Procedure code

› Adjustment type

› Billable encounter count

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④ Portfolio Development

› Revenue recognition when applying portfolio approach should not differ materially from an individual contract approach

- Common characteristics of contracts

- Materiality of contracts with similar characteristics

› **Action Item:** Build key to portfolios

- Start with payer (see previous slide about reliability of payer)

- Consider impact of site, department, procedure type, etc.

- **Tip:** Get revenue cycle/billing manager or team member with deep understanding of reimbursement involved

5 Data Analysis

Ideal approach: payment $ per patient

- Easier to understand
- More likely to add value, especially in PPS rate reimbursement environments
- Encounter count may be unreliable

Practical approach: payment as % of gross charges

- Reliable through validation of gross charges with financial statements
- Less likely to know what % of gross charges should be paid
- Possibly requires additional portfolios

5 Data Analysis

› **Tip:** Match up adjustments and payments to charges based on date of service (rather than date posted)

› **Tip:** Consider collections trends when selecting time period of data for analysis

› **Tip:** Calculate an average transaction price on 12 months of data EXCEPT when payment rate or charges (when using payment as % of charges approach) change

› **Tip:** Monitor and update transaction price based on rolling average to smooth outliers (rolling 12-month average, when possible)

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6 Reconciliation of Revenue and Journal Entries

› If old methodology produced materially accurate valuation, implementation should not result in material impact

  • Run old methodology alongside new analysis as initial monitoring

› Common reconciling items between transaction price per new methodology and general ledger:

  • Change in estimate of PY patient accounts receivable

  • Estimated amounts due to/from third-party payers for CY activity

  • Change in PY estimated amounts due to/from third-party payers

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6 Reconciliation of Revenue and Journal Entries

› Recommended GL accounts (split explicit & implicit price concessions if would like to disclose now or in future)

- Gross receivables (to reconcile to aging)

- Allowance for estimated price concessions – explicit & implicit (repurpose existing allowances for contractual adjustments & uncollectible accounts)

- Gross revenue (to reconcile to gross charges posted)

- Price concessions (to reconcile to contractual adjustments, other adjustments & write-off's posted; repurpose existing contractual adjustments & other adjustment accounts)

- Estimated price concessions – explicit & implicit (repurpose existing changes in allowances for contractual adjustments & uncollectible accounts)

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6 Reconciliation of Revenue and Journal Entries

› Two-step journal entry:

- Record activity posted in practice management system (charges, adjustments, & payments)

- Based on estimated revenue or receivables (transaction price), record change in estimated price concessions and allowance for estimated price concessions

› If current valuation methodology is accurate, same journal entry under new methodology with different supporting documentation

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6 Reconciliation of Revenue and Journal Entries

› Example reconciliation and entries for first month under Rev Rec:

- Patient receivables, net of $306,000 allowance, per 12/31/2018 audit – $2,356,000

- Activity posted in practice management system in January:

  › Gross charges – $4,834,000

  › Contractual adjustments, other adjustments, and write-off's – $2,299,000

  › Cash collections – $2,127,000

- Gross receivables at 1/31/2019 per aging – $3,070,000

- Estimated transaction price for January 2019 based on Rev Rec analysis:

  › Patient service revenue – $2,397,000

  › Receivables – $2,626,000

6 Reconciliation of Revenue and Journal Entries

1. Record activity posted in practice management system:

   - Cr. Gross revenue $4,834,000

   - Dr. Price concessions $2,299,000

   - Dr. Cash $2,127,000

   - Dr. Gross receivables $408,000

2. Record estimated transaction price:

   - Dr. Estimated price concessions $138,000

   - Cr. Allowance for estimated price concessions $138,000

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7 Method of Adoption and Disclosures

Full retrospective method

- Prove out valuation by payer for all periods presented
- Rework on comparative disclosures

Modified retrospective

- Additional disclosures required when not comparative

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7 **Method of Adoption and Disclosures**

› Significant changes in estimates, including results of lookback on PY patient A/R versus collections

› Credit balances in patient A/R – Separate liability on balance sheet if material; disclosed in notes if not material

› Potential revision to statement of operations due to grouping of incentive revenue or other revenue streams relating to services to patient from other revenue to patient service revenue

8 It's Not an Exchange Transaction

DISCLAIMER: It's a lot less likely than historically that it is an exchange transaction, but it may still be an exchange transaction.

› Meaningful Use revenue – Conditional contribution

› Federal grant funds restricted for purchase of property and equipment – Conditional contribution with donor restriction

› Local government grant to subsidize care of eligible population, without correlation of barrier (i.e. volume of services) to funding – unconditional contribution with donor restriction

- Net assets with donor restrictions recognized upon receipt of agreement

- Net assets released from restriction as qualifying expenditures are incurred or on pro rata basis, whichever applies

9 Conditional Contribution Disclosures

› Anticipated funding versus authorized funding (below is specific to those who receive 330 grants, but there may be other examples)

› **Action Item:** Reconcile 330 grant funding authorized at year-end per NOA to anticipated funding established in SAC and supplemental funding allocations

10 Time Investment

60-120 hours

Additional management (accounting & billing) and/or consulting hours

30-50 hours

Additional audit hours in year of implementation

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Action Items

Topic 606

1. Designate someone to oversee implementation

2. Educate accounting, billing and other stakeholders

   - Accountant responsible for preparing revenue and receivable entries
   - Revenue cycle/billing manager (deep understanding of reimbursement)
   - If not listed above, expert of EHR reporting
   - Users of financial statements (management and Board)

3. Identify revenue streams subject to ASC 606

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Action Items

Topic 606

4. Determine adoption method

5. Extract, validate and analyze data for portfolio development and transaction price estimation

6. Adopt compliant policies and procedures, including updates to internal control

7. Monitor estimated transaction price compared to collections

8. Draft financial statement disclosures

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Action Items

ASU 2018-08

1. Designate someone to oversee implementation

2. Educate accounting, development and other stakeholders

   - Accountant responsible for preparing grant and contribution revenue, receivable, and net assets with donor restrictions entries

   - Development department or individuals responsible for soliciting and monitoring of grants and contributions

   - Users of financial statements (management and Board)

3. Identify funding in scope of ASU 2018-08

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Action Items

ASU 2018-08

4. Determine adoption method

5. Analyze each grant and contribution agreement

6. Adopt compliant policies and procedures, including updates to internal control

7. Draft financial statement disclosures

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IMPLEMENTATION MATTERS

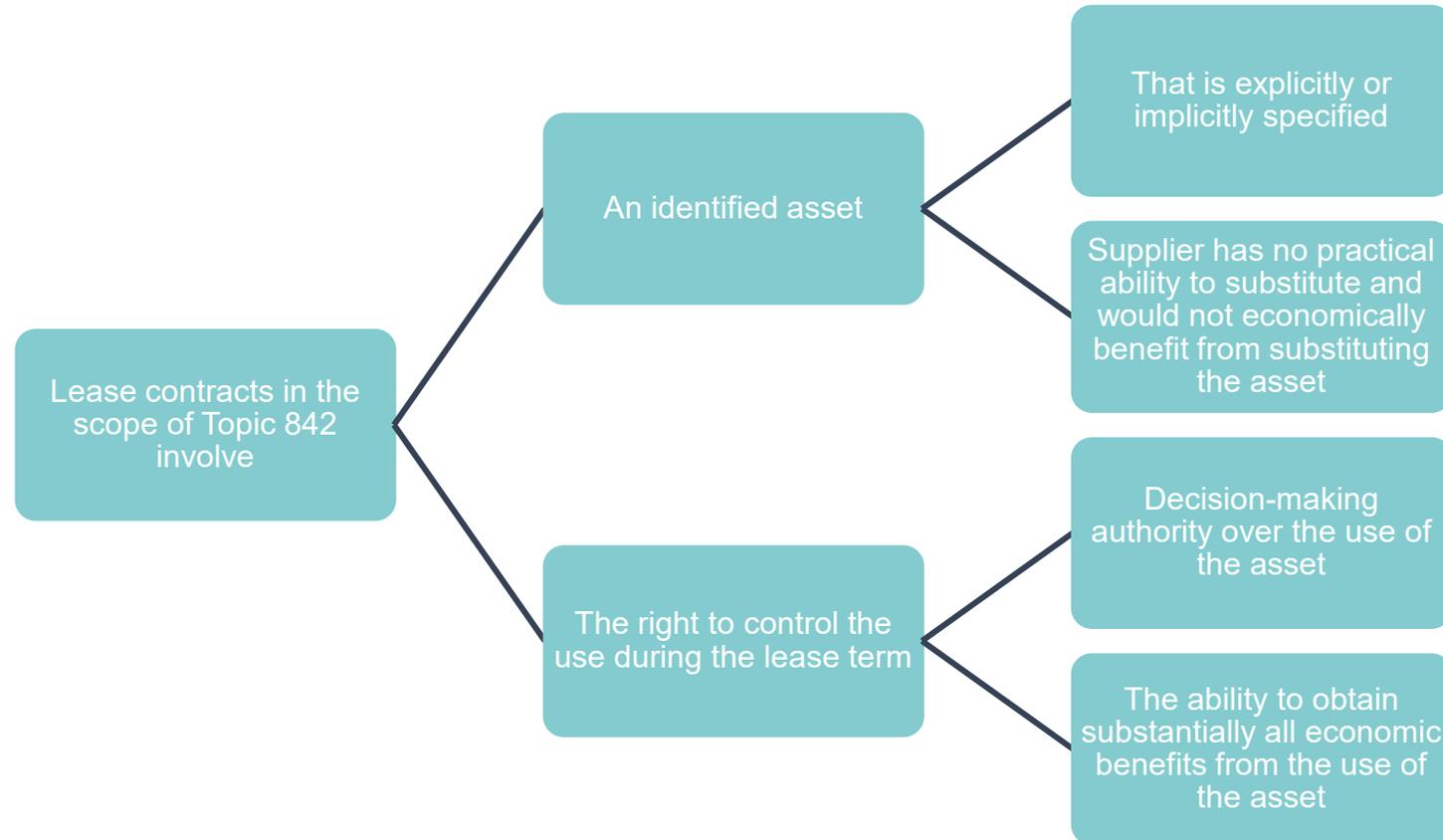Leases

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Leases (ASU 2016-02; TOPIC 842

A lease contract conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration
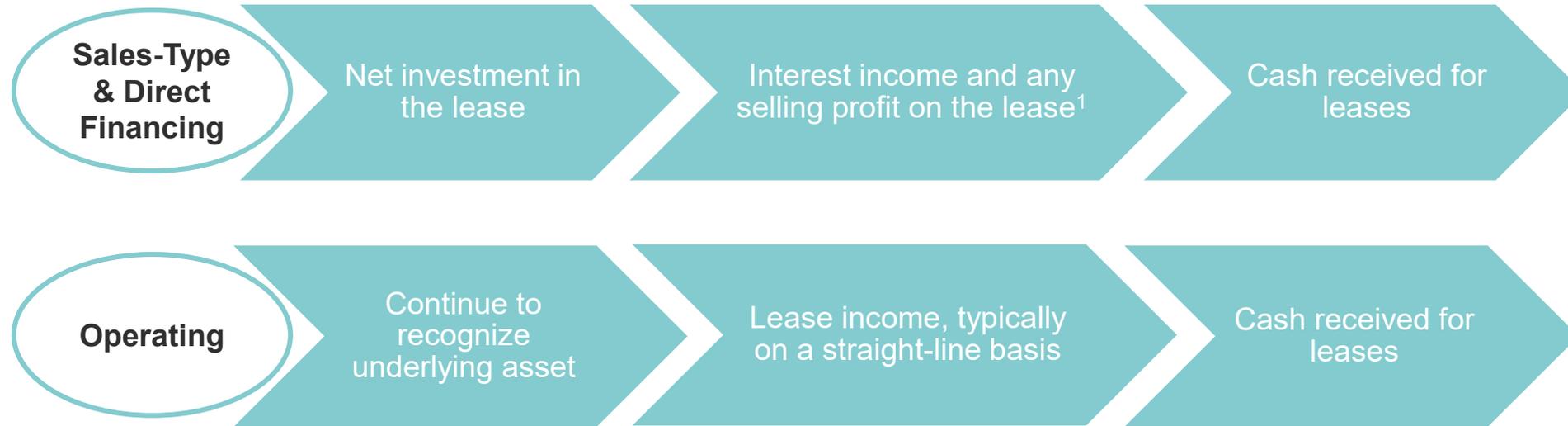
LESSOR → Right-of-use Asset → **LESSEE**

LESSEE → Lease Payments → **LESSOR**

Identifying A Lease
The new primary determinant for on/off balance sheet treatment)

Lease contracts in the scope of Topic 842 involve

- 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

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LESSOR ACCOUNTING OVERVIEW

Sales-Type & Direct Financing → Net investment in the lease → Interest income and any selling profit on the lease[1] → Cash received for leases

Operating → Continue to recognize underlying asset → Lease income, typically on a straight-line basis → Cash received for leases

Classification is similar to the classification in Topic 840

[1] Selling profit is recognized at lease commencement for sales-type leases and over the lease term for direct financing leases (note: selling profit is rare for direct financing leases)

LEASES…Additional Transition Method Available

Lease Accounting	2019 (comparative period)	2020 (year of initial adoption)
Original Transition method provided in Update **2016-02**	842	842
Additional Transition method provided in Update **2018-11**	840	842

Cumulative-Effect Adj. 7/1/18

Cumulative-Effect Adj. 7/1/19

Leases – Getting Ready

Inventory of leases – *What's out there? Know your leases.*

Materiality – *How modern is your capitalization policy?*

Debt covenants – *To what extent will capitalizing your operating leases affect covenants based on leverage ratios?*

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Questions?

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Thank You!

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