Reflecting on the Impact for Hospitals Adopting the Revenue Recognition Standard and Reporting of Bad Debt - FAQs

March 5, 2020

Presented by:

Mike Shamblin, CPA
Managing Principal Audit & Assurance Services | PYA, P.C.

Holly Bizic
Senior Consultant | PYA, P.C.

Moderated by:

Matt Stuart, CPA, FACHE
Principal - Audit & Assurance Services | PYA, P.C.

Education Partners for Florida Hospitals

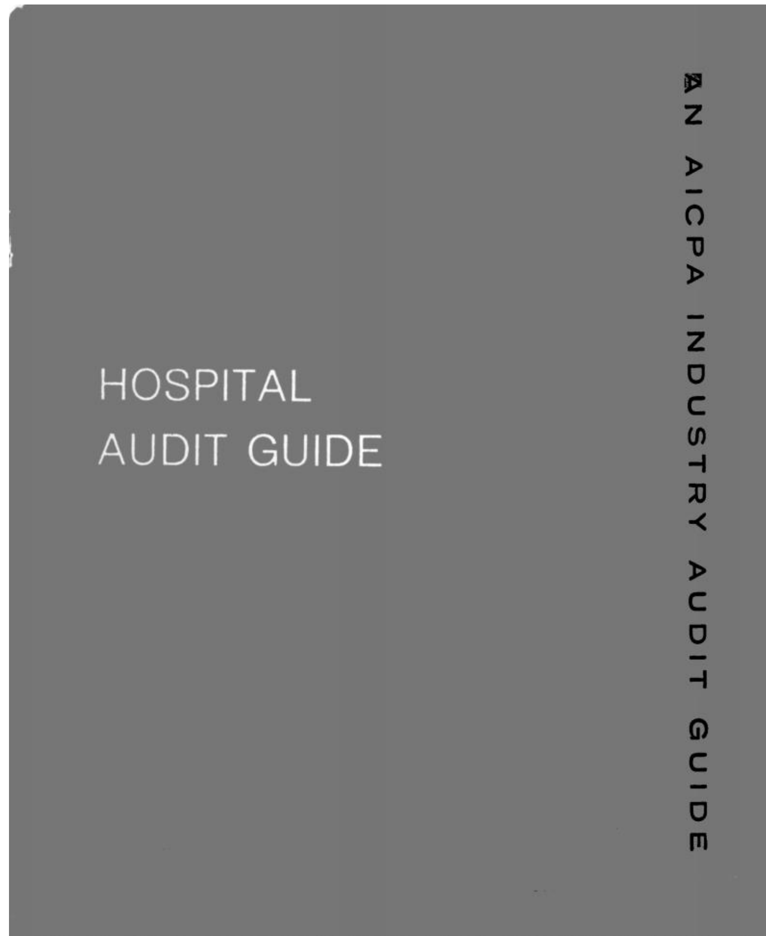
Objective

- The panel will address frequently asked questions (FAQs) regarding the impact for hospitals from adopting the new revenue recognition standard and the change in reporting of bad debt

Why did the Financial Accounting Standards Board (FASB) change the reporting of revenue for hospitals?

Where did my bad debts go?

A Brief History of Healthcare Bad Debts



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Charity allowances, other arrangements for providing service at less than established rates, and the provision for uncollectible accounts should be reported either separately from gross revenues under "deductions from gross revenues" or by some other disclosure. Allowances of this type should also be accounted for on an accrual basis.

Source: American Institute of Certified Public Accountants

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EXHIBIT B

Sample Hospital
Statement of Revenues and Expenses

Year Ended December 31, 19__
With Comparative Figures for 19__

	Current Year	*Prior Year*
Patient service revenue	$8,500,000	$8,000,000
Allowances and uncollectible accounts (after deduction of related gifts, grants, subsidies, and other income—$55,000 and $40,000) (Notes 3 and 4)	(1,777,000)	(1,700,000)
Net patient service revenue	6,723,000	6,300,000
Other operating revenue (including $100,000 and $80,000 from specific purpose funds)	184,000	173,000
Total operating revenue	6,907,000	6,473,000
Operating expenses:		
Nursing services	2,200,000	2,000,000
Other professional services	1,900,000	1,700,000
General services	2,100,000	2,000,000
Fiscal services	375,000	360,000
Administrative services (including interest expense of $50,000 and $40,000)	400,000	375,000
Provision for depreciation	300,000	250,000
Total operating expenses	7,275,000	6,685,000
Loss from operations	(368,000)	(212,000)
Nonoperating revenue:		
Unrestricted gifts and bequests	228,000	205,000
Unrestricted income from endowment funds	170,000	80,000
Income and gains from board-designated funds	54,000	41,000
Total nonoperating revenue	452,000	326,000
Excess of revenues over expenses	$ 84,000	$ 114,000

Source: American Institute of Certified Public Accountants

A Brief History of Healthcare Bad Debts

AICPA Audit and Accounting Guide

AUDITS OF PROVIDERS OF HEALTH CARE SERVICES

As of December 31, 1990

AICPA
American Institute of Certified Public Accountants

Source: American Institute of Certified Public Accountants

A Brief History of Healthcare Bad Debts

X **Health Care Services**

Investments are initially recorded at acquisition cost or, if received as a donation or a gift, at fair market value at the date of the gift. Marketable equity securities are reported at the lower of aggregate cost or market value in accordance with the requirements of FASB Statement No. 12, *Accounting for Certain Marketable Equity Securities*. Debt securities are reported at amortized cost if there is the intent and ability to hold to maturity or at the lower of cost or market value if not intended to be held to maturity. The market value method is used to equitably allocate investment income and gains and losses on pooled investments. Investments accounted for on the equity method of accounting are reported in accordance with APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

Advances from third-party payors are reported as liabilities unless the right of setoff against a related receivable applies.

Contingencies, such as those relating to pending appeals under rate-setting systems and to state waivers under Medicare, are accounted for in accordance with FASB Statement No. 5, *Accounting for Contingencies*, as amended and interpreted.

Uncollected premiums and amounts recoverable from stop-loss insurance (reinsurance) are reported as receivables, net of appropriate valuation allowances.

Bad debts are to be reported as expenses in accordance with generally accepted accounting principles.

Receivables for health care services do not include charges related to charity care and are reported net of appropriate valuation allowances.

Pledges are reported in the period in which they are made, net of an allowance for uncollectible amounts.

Depreciation and amortization of property and equipment is reported in conformity with generally accepted accounting principles.

Obligations incurred in advance refundings of debt, or for the purpose of early retirement or extinguishment of debt, are reported in accordance with FASB Statement No. 4, *Reporting Gains and Losses From Extinguishment of Debt*, as amended, and FASB Statement No. 76, *Extinguishment of Debt*.

A liability should be reported by a continuing care retirement community (CCRC) recognizing the obligation to provide future services to, and use of facilities by, current residents without additional compensation for the term of the contracts or the lives of the residents. AICPA Statement of Position 90-8, *Financial Accounting and Reporting by Continuing Care Retirement Communities*, included as Appendix C of this guide, provides guidance on applying generally accepted accounting principles in accounting and reporting for fees, for the obligation to provide future services and the use of facilities to current residents, and for costs of acquiring initial continuing-care contracts.

The ultimate cost of medical malpractice claims is reported in the period during which the incidents that give rise to the claims occur, if it is probable that liabilities have been incurred and the amounts of the losses can be reasonably estimated.

Certain information of related entities should be disclosed in the notes to the financial statements if such entities are not consolidated or combined in accordance with Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements*, as amended.

AICPA Statement of Position 89-5, *Financial Accounting and Reporting by Providers of Prepaid Health Care Services*, included as appendix B of this guide, provides guidance on applying generally accepted accounting principles for health care costs, contract losses, stop-loss insurance, and contract acquisition costs of providers of prepaid health care services.

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Source: American Institute of Certified Public Accountants

A Brief History of Healthcare Bad Debts

Sample Hospital

Statements of Revenue and Expenses of General Funds
Years Ended December 31, 19X7 and 19X6

	19X7	*19X6*
Net patient service revenue (notes 3 and 7)	$92,656,000	$88,942,000
Other revenue	6,010,000	5,380,000
Total revenue	98,666,000	94,322,000
Expenses (notes 7, 8, 12, and 13):		
Professional care of patients	53,016,000	48,342,000
Dietary services	4,407,000	4,087,000
General services	10,888,000	9,973,000
Administrative services	11,075,000	10,145,000
Employee health and welfare	10,000,000	9,335,000
Medical malpractice costs	1,125,000	200,000
Depreciation and amortization	4,782,000	4,280,000
Interest	1,752,000	1,825,000
Provision for bad debts	1,010,000	1,103,000
Total expenses	98,055,000	89,290,000
Income from operations	611,000	5,032,000
Nonoperating gains (losses):		
Unrestricted gifts and bequests (note 11)	822,000	926,000
Loss on investment in affiliated company (note 4)	(37,000)	(16,000)
Income on investments of endowment funds	750,000	650,000
Income on investments whose use is limited:		
By board for capital improvements	1,120,000	1,050,000
By agreements with third-party payors for funded depreciation	850,000	675,000
Under indenture agreement	100,000	90,000
Other investment income	284,000	226,000
Nonoperating gains, net	3,889,000	3,601,000
Revenue and gains in excess of expenses and losses	$ 4,500,000	$ 8,633,000

See accompanying notes to financial statements.

Source: American Institute of Certified Public Accountants

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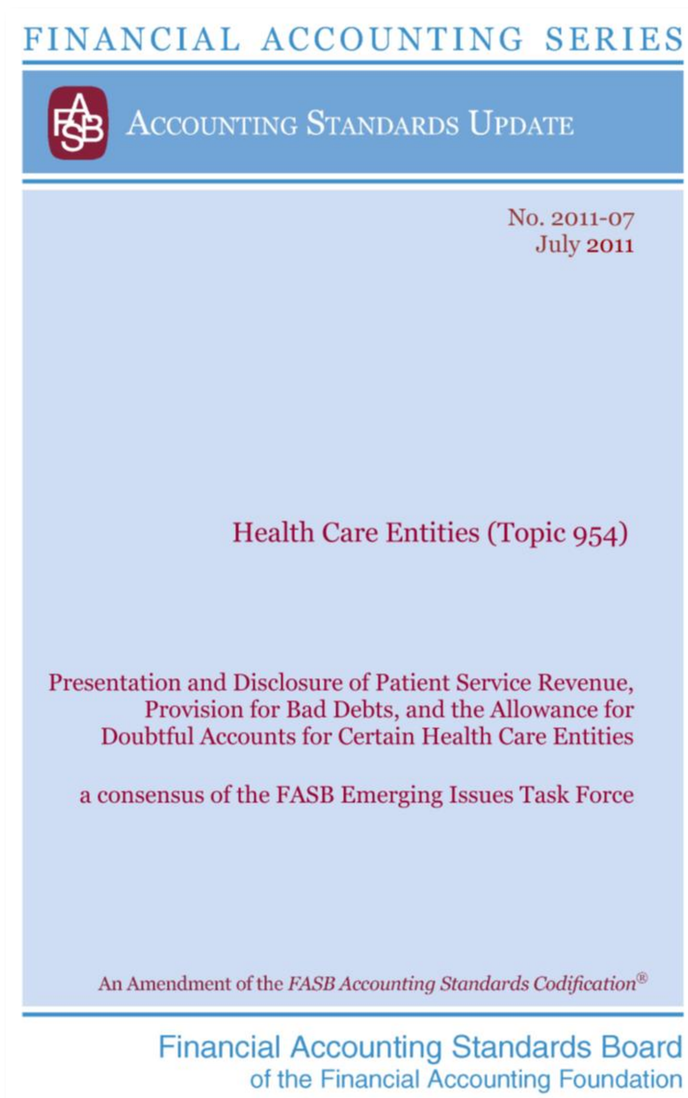
FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2011-07
July 2011

Health Care Entities (Topic 954)

Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board
of the Financial Accounting Foundation

Source: Financial Accounting Standards Board of the Financial Accounting Foundation

A Brief History of Healthcare Bad Debts

Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Some health care entities recognize patient service revenue at the time the services are rendered regardless of whether the entity expects to collect that amount. Stakeholders raised concerns that such accounting practices result in a gross-up of patient service revenue and the related provision for bad debts. Additionally, because health care entities make their own judgments regarding adjustments to revenue and bad debts, those judgments are different from one health care entity to another and comparability is impaired, making analysis difficult for financial statement users.

The objective of this Update is to provide financial statement users with greater transparency about a health care entity's net patient service revenue and the related allowance for doubtful accounts. This Update provides information to assist financial statement users in assessing an entity's sources of net patient service revenue and related changes in its allowance for doubtful accounts. The amendments require health care entities that recognize significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient's ability to pay to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on their statement of operations.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect entities within the scope of Topic 954, Health Care Entities, that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. All other entities would continue to present the provision for bad debts (including bad debts associated with patient service revenue) as an operating expense.

What Are the Main Provisions?

The amendments in this Update require certain health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing

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Source: Financial Accounting Standards Board of the Financial Accounting Foundation

A Brief History of Healthcare Bad Debts

954-605-55-1 This Example illustrates how the presentation guidance in paragraph 954-605-45-4 might be applied. Other presentations may be appropriate.

954-605-55-2 On the statement of operations:

[For ease of readability, the table is not underlined as new text.]

Patient service revenue (net of contractual allowances and discounts)	$ 60,000
Provision for bad debts	(9,600)
Net patient service revenue less provision for bad debts	50,400
Premium revenue	23,000
Other operating revenue	14,000
Total revenue	$ 87,400

> > Example 2

954-605-55-3 This Example illustrates how the disclosure guidance in paragraph 954-605-50-4 might be applied. Other presentations also may be appropriate depending on how an entity manages its business (for example, how it assesses credit risk).

954-605-55-4 Entity A recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, Entity A recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of Entity A's uninsured patients will be unable or unwilling to pay for the services provided. Thus, Entity A records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows.

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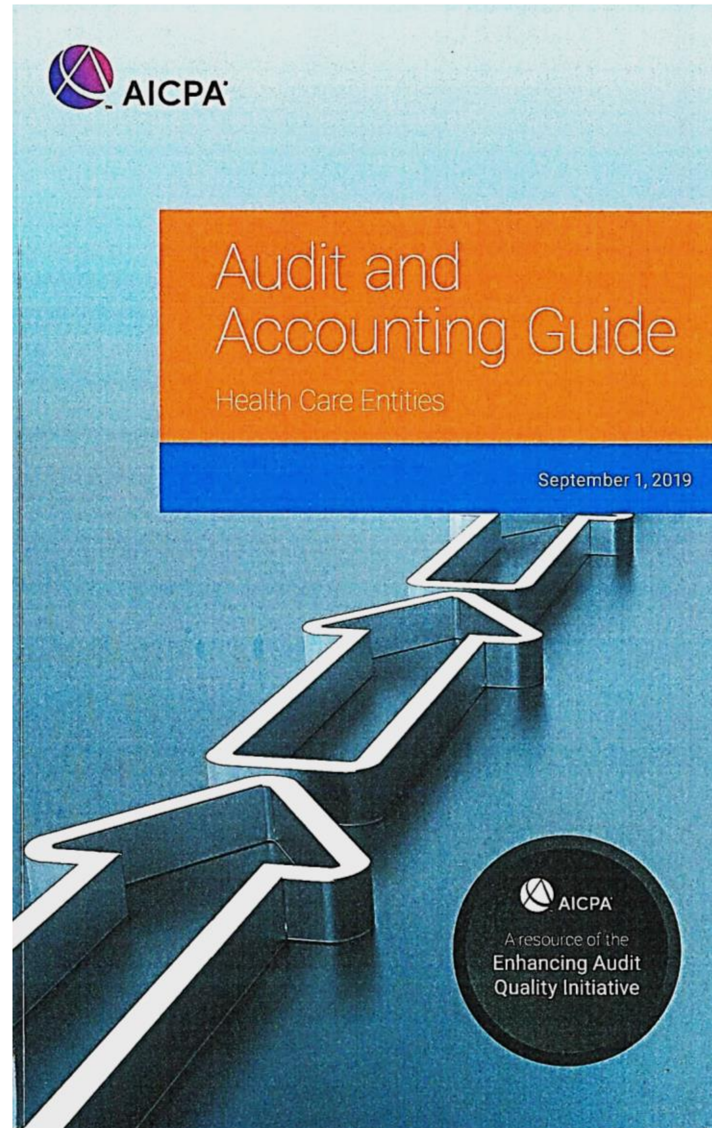
Source: Financial Accounting Standards Board of the Financial Accounting Foundation

A Brief History of Healthcare Bad Debts



Source: American Institute of Certified Public Accountants

A Brief History of Healthcare Bad Debts

Gross charges	$	15,000
Contractual adjustments:		
Discounts (EXPLICIT PRICE CONCESSION)		(5,000)
Adjusted net revenue		10,000
Third-party payment		(8,000)
Due from patient		2,000
IMPLICIT PRICE CONCESSION		(1,500)
Expected payment	$	500

A Brief History of Healthcare Bad Debts

Financial Statements

	Previous		***New***	
Net patient service revenue	$	10,000	$	8,500
			($8,000 + $500)	
Estimated provision for Bad Debts		(1,500)		
Net patient service revenue, less estimated provision for bad debts	$	8,500		

Question

Isn't healthcare unique?

Why a need to change?

Question

Is it possible that a hospital could still report some bad debt expense that does not meet the definition of an "implicit price concession?"

Question

Can you explain the difference between charity care vs. implicit price concessions vs. bad debt?

Question

With the new revenue recognition standard, hospitals no longer report as much bad debt on the GAAP-basis financial statements.

Does this make it more difficult for a hospital to demonstrate the full benefit they impart on their respective communities?

Question

Do you agree with the point of view that some in the industry have that would say an implicit price concession is an irrelevant amount because it is based on chargemaster rates, which are "artificial?"

Question

Do you think it is appropriate for hospitals to continue to record bad debt expense on their internal financial statements for tracking and internal decision-making purposes?

Question

Have you heard of any plans to update Schedule H of Form 990, which currently asks hospitals to report bad debt expense?

Question

Are there any implications from the change in reporting of bad debts in the financial statements on the cost report?

Question

Given that bad debt has been replaced with implicit price concessions for financial reporting purposes, how can hospitals track and report "bad debts" for cost reporting purposes?

Question

Do you anticipate any future changes in the reporting of bad debt in cost reports given the changes in the financial reporting of bad debt?

Thank You!

Mike Shamblin
(800) 270-9629
mshamblin@pyapc.com

Matt Stuart
(800) 270-9629
mstuart@pyapc.com

Holly Bizic
(800) 270-9629
hbizic@pyapc.com

pyapc.com