FASB Healthcare Accounting Update

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FINANCIAL ACCOUNTING STANDARDS BOARD

Agenda

- Revenue Recognition
- Leases
- NFP Financial Statements
- Other Recent ASUs/ Projects in the Pipeline
- Q&A

Revenue Recognition

FINANCIAL
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STANDARDS BOARD

New Revenue Standard - 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

* Public entities include NFPs with publicly-traded conduit (or direct) debt

Revenue Recognition (ASU 2014-09; Topic 606)

Objective: To develop a single, principle-based revenue standard for US GAAP and IFRS

- The revenue standard aims to improve accounting for contracts with customers by:
  - Providing a robust framework for addressing revenue issues as they arise
  - Increasing comparability across industries and capital markets
  - Requiring better disclosure

Substantially converged with IFRS on major provisions

Scope

- All contracts with customers, <u>except</u>
  - Lease contracts
  - Insurance contracts
  - Financial instruments
  - Guarantees
  - Non-monetary exchanges in the same line of business to facilitate sales to customers
- Contracts not with customers are <u>excluded</u>:
  - Contributions
  - Collaborative arrangements

Final U.S. GAAP Model – Recognition

- Core Principle:

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

- Steps to apply the core principle:

1. Identify the contract(s) with the customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when (or as) a performance obligation is satisfied

Final U.S. GAAP Model – Disclosure

Topic	Requirements
Disaggregation of revenue	• Qualitative and quantitative* disaggregation of revenue into categories that depict how revenue and cash flows are affected by economic factors
Information about contract balances	• Opening and closing balances * • Amount of revenue recognized from contract liabilities * • Explanation of significant changes in contract balances *
Remaining performance obligations	• Transaction price allocated to remaining performance obligations * • Quantitative or qualitative explanation of when amounts will be recognized as revenue *
Interim requirements	• Quantitative disclosures *

* for public entities only

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Revenue Recognition—
FASB Post-Issuance Activities

- Transition Resource Group (TRG): Specialists (auditors, preparers, regulators, others) and FASB members who discuss interpretations of the principles

- FASB has issued clarifications on Topic 606 in 2016
  - Licenses and Performance Obligations – ASU 2016-10
  - Narrow Scope Improvements and Practical Expedients (including contract modifications, noncash consideration, collectability, and presentation of sales taxes) – ASU 2016-12
  - Principal versus Agent (reporting revenue gross versus net) – ASU 2016-08

<u>Other Projects:</u>

- FASB has recently added a project to clarify and improve the guidance around revenue recognition of grants and contracts by NFPs

Some Areas of Focus for AICPA Healthcare Revenue Recognition Task Force

- Self-pay patients
  - Implicit price concessions
  - Application of a portfolio approach
  - Medicaid pending
- Third-party payors
  - Third-party settlement estimates
- CCRCs
  - Various issues involving entrance and other fees, contract costs, etc.
- Disclosures

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

Self-Pay: Implementation Issues

- 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 is 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
- What constitutes an impairment loss or bad debt

Self-Pay Example

Hospital provides services to uninsured patient in ER

Hospital does not determine whether patient is committed to perform his/her obligations

Criteria in Step 1 are not met

Continue to reassess

Hospital assesses patient's intent and ability to pay as probable and classifies patient as self-pay

Hospital charges standard rate of $10,000 but estimates transaction price to be $1,000 in Step 3

Criteria in Step 1 are met

Self-Pay – Change in Transaction Price

Contract price:	$10,000
Implicit price concession:	$9,000
Transaction price:	$1,000

Entity now expects to collect $1,100 → + $100 → Change in transaction price

Entity now expects to collect $900 → - $100 → Change in transaction price (or bad debt)

Portfolio Approach

- ASC 606 provides that as a practical expedient, the revenue recognition guidance may be applied to a portfolio of contracts with similar characteristics if the impact of applying the guidance to the portfolio would not differ materially from applying the guidance to individual contracts or performance obligations within the portfolio
  - Portfolios could be
    - True Self-pay
    - High Deductible Plans
    - Co-pays and deductibles
- Use of historical experience to determine collectability %
- Entities that evaluate credit risk (i.e. elective surgery center) would recognize change in transaction price as bad debt expense

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

Third-Party Estimates

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

- The standard indicates, "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 – CCRCs

- Identifying and satisfying the performance obligation(s) and recognizing the monthly/periodic fees and nonrefundable entrance fees under Type A or “life care” contracts for continuing care retirement communities
  - Allocating the transaction price to the performance obligation(s) in the contract(s)
  - Recognizing revenue when (or as) the CCRC satisfies a performance obligation
    (i.e. pattern of transfer through stages of care/multiple performance obligations) vs. straight line
- Accounting for contract costs and financing component considerations
- Recognition of a CCRC’s performance obligation(s) to provide future services and use of facilities to residents is impacted by decision related to entrance fees

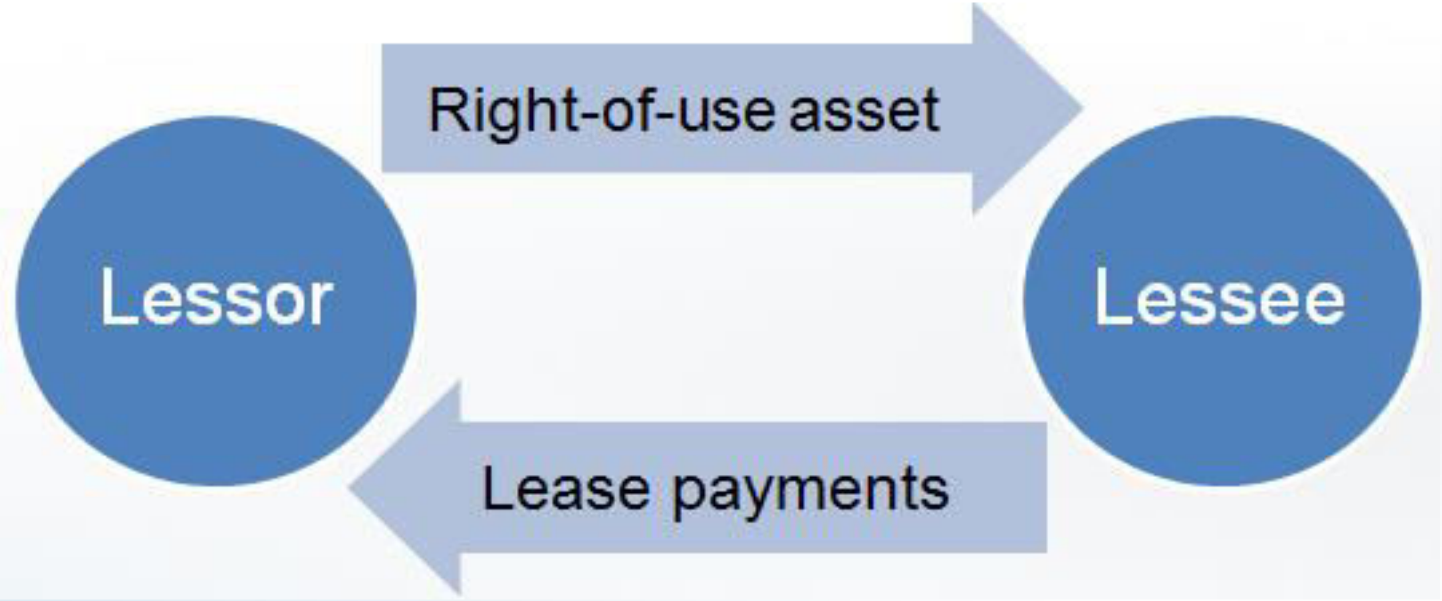
Healthcare – Disclosures

- 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
- A healthcare entity should also 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

Leases

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



Lessee Model

All leases (more than 12 months) are recognized on the lessee's balance sheet

Current U.S. GAAP (IFRS)	IASB	FASB
Capital (Finance) Leases	Type A	Type A
Operating Leases	Type A	Type B

All leases are accounted for the same.

Classification is based on existing U.S. GAAP/IFRS

Lessee Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
Finance ("Type A")	Right-of-use (ROU) asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payments
Operating ("Type B")	Right-of-use (ROU) asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payments

Classification is similar to the classification in Topic 840

Recognition and measurement exemption for short-term leases

Other than public business entities may use risk-free rates for measurement of all lease liabilities

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

Lessor Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
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 – Effective Date

Public Companies*

- Fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (CY 2019; FY 2019-20)

All Other Organizations

- Fiscal years beginning after December 15, 2019 and interim periods beginning after December 15, 2020 (CY 2020; FY 2020-21)

Early Application

- Permitted for all organizations

* "Public Companies" refers to the following: (1) public business entities, (2) a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an-over-the-counter market, and (3) an employee benefit plan that files or furnishes statements with or to the SEC **(Same Here as Revenue Recognition Standard)**

NFP Financial Statements

NFP Financial Statements Project—Key Objectives (recommended by FASB's NFP Advisory Committee (NAC))

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about:
  - Financial performance
  - Cash flows
  - Liquidity
- Better enable NFPs to "tell their financial story"

Redeliberations Plan

Phase I **Aim: Final ASU by mid-2016, effective for calendar year 2018 (fiscal year 2018-19)**	**Phase II**
Net Asset Classes: • Classification scheme • Disclosure of board designated net assets • Underwater endowments • Expirations of capital restrictions	**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
Expenses/Investment Return: • Expenses by nature; analysis of expenses by function and nature • Netting of investment expenses against investment return • Disclosure of netted investment expenses • Enhanced disclosures about cost allocations	**Statement of Cash Flows:** • Realignment of certain items
Operating Measures: • Modest improvements to disclosures for those that use an operating measure, especially about board appropriations, designations, and similar transfers	**Phase 2**: need to decide whether to wait to deliberate at same time as the **Financial Performance Reporting** project for business entities
Liquidity/Availability: • Quantitative disclosures about availability • Qualitative disclosures about liquidity • Consideration of alternatives suggested by stakeholders (e.g., classified balance sheet)	
Statement of Cash Flows: • Methods of presenting operating cash flows (direct/indirect)	

Key Phase I Changes (Amendments to Current GAAP)

- Allowing free choice between direct method and indirect method in presenting operating cash flows
- Improving presentation and disclosures for net asset classes
- Enhancing information about the liquidity and availability of financial resources
- Providing better information about expenses and expense allocation
- Improving reporting of investment return

Cash Flow Statement

- Continue to allow choice between the **Direct Method** and the **Indirect Method**
  - HOWEVER: Indirect reconciliation no longer also required if choose to present Direct Method

Net Assets

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

*** NFPs may choose to disaggregate further**
**** 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 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.

Liquidity and Availability of Resources

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

Quantitative Disclosure for Financial Assets Availability Example

Financial assets, at year-end*	$ 234,410
Less those available unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with time or purpose restrictions	(11,940)
Subject to appropriation and satisfaction of donor restrictions**	(144,500)
Investments held in annuity trust	(4,500)
Amounts held by bond trustees	(30,200)
Board designations:	
Quasi-endowment fund, primarily for long-term investing**	(36,600)
Amounts set aside for liquidity reserve	(1,300)
Financial assets available to meet cash needs for general expenditures within one year	$ 5,370

*Total assets, less nonfinancial assets (e.g., PP&E, inventory, prepaids)

**Excludes amounts that have been appropriated for next 12 months that do not have purpose restrictions

Expense Reporting

- Report expenses, either on the face of financial statements or in the notes, by:
  - Function *
  - Natural classification
  - Analysis (disaggregate function by nature)**

    *** currently required in GAAP**

    **** Board may explore segment reporting instead for HC in Phase II**

- NFPs required to provide qualitative disclosures about methods used to allocate costs among program and support functions

Reporting of Investment Return

How to present?

- **Net presentation** of investment expenses against investment 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)

What to disclose?

- Disclosure of investment expenses **no longer required**
  - If reported, carefully label and don't include in expense analysis
- No longer require disclosure of investment return **components**

Operating Measure: Improved Disclosures

- Reinforcing current GAAP requirement about transparency of components of any operating measures presented:
  - *NFPs utilizing an operating measure that reflects governing board designations, appropriations, and similar actions (internal transfers) must report these types of internal transfers appropriately disaggregated and described by type (either on the face of the statement of activities or in the notes)*

Effective Date, Early Adoption, and Transition

- Effective Date: For fiscal years beginning after 12/15/2017 (e.g., CY 2018, FY 2018-19)
  - Interim financials the following year
- Early Adoption: Permitted, but must apply the regular transition provisions.
- Transition:
  - For year of adoption: apply all provisions.
  - For comparative years presented: apply all provisions, except can choose not to present:
    (1) Analysis of expenses by nature and function, and/or
    (2) Disclosures around liquidity and availability of resources

Example of Early Adoption

- Choose to early adopt in CY 2016
- Apply <u>all</u> provisions to CY 2016
- If choose to present comparative financials for CY 2016, apply all provisions to CY 2015, except can choose not to present:
    (1) Analysis of expenses by nature and function, and/or
    (2) Disclosures around liquidity and availability of resources

Important Notes

- NFPs are *already permitted* to incorporate many of the changes in the ASU
- The only changes that cannot be done without formally adopting the ASU are:
  (1) Presenting one class of restricted net assets (consolidating temporarily and permanently restricted)
  (2) Underwater endowment accounting
  (3) Eliminated disclosures of investment return components and netted expenses
  (4) Eliminated requirement to provide indirect reconciliation if using direct method for operating cash flows

Other Recent ASUs

(see Appendix for complete list of ASUs issued since last year's Fall meeting)

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Accounting for Financial Instruments – Recognition and Measurement (ASU 2016-01; Topic 825)

Disclosures: FV of Financial Instruments not recognized at FV in Balance Sheet

- ASU 2016-01 extends to **all** entities other than Public Business Entities the exemption from having to disclose this information
- Thus, no NFPs or private companies would have to provide these disclosures
  - *Currently, NFPs with more than $100 million in assets or with any derivatives (e.g., interest rate swaps) provide these disclosures*
- ASU is effective for NFPs and private companies for CY 2019 (FY 2019-20), one year after PBEs. This provision may be early adopted for all financial statements not yet issued.

ASU 2016-01: Other Noteworthy Change

- All equity investments (under than consolidated or equity method) at FV through net income
  - Cost-based practical expedient for nonmarketable equity securities
  - AFS (Other-than-Trading) classification thus now limited to debt securities
  - This provision may not be early adopted.

Accounting for Financial Instruments – Credit Losses (ASU 2016-13; Topic 326)

- At core of ASU 2016-13 is new Current Expected Credit Loss (CECL) Model
  - Focuses on what a reporting entity expects to collect, rather than on whether the loan/ other asset has "gone bad" (incurred loss model)
    - *Considers past history, current conditions, reasonable expectations about foreseeable future*
- CECL Model not expected to result in significant impact on most entities other than financial institutions.
  - Would apply to trade receivables (such as patient receivables), loans receivable, and lease receivables, but not to pledges receivable
    - *Likely already taking CECL considerations into account for such assets*

Accounting for Financial Instruments – Credit Losses (cont’d)

- More noteworthy is the change to impairment (credit loss) guidance for available-for-sale debt securities. (next slide)
- Effective for CY 2020 (FY 2020-21) for SEC registrants, CY 2021 (FY 2021-22) for private companies, NFPs.

ASU 2016-13: Available-for-Sale Debt Securities

Excluded from the CECL model

Should apply modified impairment guidance in Topic 320

- An allowance approach would be used for recognizing impairment losses, which would allow for credit loss reversals
- Requirement to consider the length of time that fair value of the security has been below amortized cost would be eliminated
- Other-than-temporary concept has been eliminated

Simplification Initiative Objective

- Reduce cost & complexity while maintaining or improving the usefulness of the information
- Projects include narrow-scope items that the FASB can complete in the short term

Not always so SIMPLE!!

FASB Simplification Initiative – Some Final Guidance

Measurement-Period Adjustments (ASU 2015-16)

- No longer have to retrospectively adjust comparative prior year information for adjustments identified in the current year to provisional amounts recognized in a business combination (including acquisition of another NFP)
- Effective for private companies and NFPs for CY 2017 (FY 2017-18); can early adopt

FASB Simplification Initiative – Some Final Guidance

Equity Method of Accounting (ASU 2016-07)

- No longer have to retroactively adjust equity interest when cross significant influence threshold (typically 20% ownership; lower for partnership interests) as if had such interest all along

- Effective for private companies and NFPs for CY 2017 (FY 2017-18); can early adopt

Other Noteworthy Recent ASUs

- Balance Sheet Classification of Deferred Taxes (ASU 2015-17)
- Effective Date and Transition for PCC Alternatives (ASU 2016-03)
- Improvements to Employee Share Based Payment Accounting (ASU 2016-09)
- Classification of Certain Cash Receipts and Cash Payments (EITF) (ASU 2016-15)

Other Projects in the Pipeline

(see FASB website, Technical Agenda page, for complete list)

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Some Noteworthy Projects in the Pipeline

- **Accounting for Financial Instruments – Hedging**
- **Accounting for Goodwill Impairment**
- **Improving the Presentation of Net Periodic Pension/ Postretirement Benefit Cost**
- **Simplifying the Balance Sheet Classification of Debt**
- **Disclosure Framework (various projects)**

Staying Current

Best ways to stay current:

- **Sign up for electronic *Action Alert***
- **FASB on Twitter**
- **www.fasb.org**
  - **Pages on FASB website for NFPs**
  - **Project summaries**
  - ***FASB in Focus* executive summaries**
  - **Podcasts**
  - **Webcasts**

Questions?

Appendix –
ASUs Issued Since September 2015

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ASUs Issued Since September 2015

ASU & Cod. Topic/Subtopic	Title
ASU 2015-16, Business Combinations (Topic 805)	Simplifying the Accounting for Measurement-Period Adjustments
ASU 2015-17, Income Taxes (Topic 740)	Balance Sheet Classification of Deferred Taxes
ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10)	Recognition and Measurement of Financial Assets and Financial Liabilities
ASU 2016-02, Leases (Topic 842)	Leases

ASUs Issued Since September 2015

ASU & Cod. Topic/Subtopic	Title
ASU 2016-03, Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815)	Effective Date and Transition Guidance (PCC)
ASU 2016-04, Liabilities—Extinguishments of Liabilities (Subtopic 405-20)	Recognition of Breakage for Certain Prepaid Stored-Value Products (EITF)
ASU 2016-05, Derivatives and Hedging (Topic 815)	Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (EITF)
ASU 2016-06, Derivatives and Hedging (Topic 815)	Contingent Put and Call Options in Debt Instruments (EITF)

ASUs Issued Since September 2015

ASU & Cod. Topic/Subtopic	Title
ASU 2016-07, Investments—Equity Method and Joint Ventures (Topic 323)	Simplifying the Transition to the Equity Method of Accounting
ASU 2016-08, Revenue from Contracts with Customers (Topic 606)	Principal versus Agent Considerations (Reporting Revenue Gross versus Net)
ASU 2016-09, Compensation—Stock Compensation (Topic 718)	Improvements to Employee Share-Based Payment Accounting
ASU 2016-10, Revenue from Contracts with Customers (Topic 606)	Identifying Performance Obligations and Licensing

ASUs Issued Since September 2015

ASU & Cod. Topic/Subtopic	Title
ASU 2016-11, Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815)	Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)
ASU 2016-12, Revenue from Contracts with Customers (Topic 606)	Narrow-Scope Improvements and Practical Expedients
ASU 2016-13, Financial Instruments—Credit Losses (Topic 326)	Measurement of Credit Losses on Financial Instruments
ASU 2016-14, Not-for-Profit Entities (Topic 958)	Presentation of Financial Statements of Not-for-Profit Entities
ASU 2016-15, Statement of Cash Flows (Topic 230)	Classification of Certain Cash Receipts and Cash Payments (EITF)