



HORNE HEALTHCARE

**REVENUE  
RECOGNITION**



# ACCOUNTING STANDARD UPDATE 2014-09

## *Revenue from Contracts with Customers*

The new revenue recognition standard is a fundamental change in how healthcare providers recognize patient revenue. This standard poses complex challenges that requires healthcare financial leaders to assess current revenue streams and the financial impact on the organization.

### 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.

### TAKE THESE FIVE STEPS

to achieve the core principle and understand how ASU 2014-09 affects your financial performance metrics, finance and tax planning, and debt covenant compliance:

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

### ASU 2014-09 Effective Dates

#### NONPUBLIC ENTITIES

- Annual reporting periods beginning after December 15, 2018

#### PUBLIC ENTITIES

- Annual reporting periods beginning after December 15, 2017

In transitioning to the new standard, amendments may apply and are recognized

at the date of initial application:

- a. Retrospectively to each prior reporting period presented
- b. Retrospectively with the cumulative

### THE STEPS WITH THE MOST IMPACT

While the five steps of ASU 2014-09 have unique implications for healthcare entities, **STEPS 1 AND 3** have the most impact on the industry and require increased focus and judgment to revenue recognition.

#### **STEP 1 IDENTIFY THE CONTRACT**

- Does a contract exist?
- Is it enforceable?
- Is it probable that the entity collects substantially all of the consideration to which it is entitled for services performed?



In evaluating whether collectability is probable, consider the patient's ability and intention to pay based on past experience with either a specific patient or a class of similar patients.

Patients possessing commercial insurance are generally considered to be bound by a contract because the healthcare provider believes it is probable it will collect the consideration to which it is entitled.

Under the new standard, the patient portion of the payment (i.e., co-pay and deductible) is considered separately, especially high-deductible plans where the healthcare organization may not expect to collect all such amounts due.

In this situation, estimate the transaction price for that portion of the revenue, and determine if collectability is probable.

### CASE EXAMPLE

A patient is admitted to the emergency room and is required by law to be provided emergency services regardless of the ability to pay.

In this case, evaluating if contract exists requires significant judgment by the healthcare provider. A patient admitted to the emergency room may not always have the capacity to explicitly enter into such agreement, likely resulting in no contract.

### OPTIONS

- Obtain subsequent acknowledgement from the patient of their responsibility for the services
- Determine if a contract exists
- Recognize revenue

## **STEP 3** DETERMINE THE TRANSACTION PRICE

*Definition of transaction price: the amount of consideration to which a healthcare provider expects to be entitled in exchange for providing services to a patient.*

Under the new guidance, review all historical, current, and forecasted information that is reasonably available, including historical cash collections from the individual or the payer class the patient is associated with, to determine the amount of consideration it can reasonably expect to collect.

The concept that the amount collected for different payer classes is subject to change based on patient characteristics is known as “variable consideration.”

### CASE EXAMPLE

Assume the standard rate for the services provided in the emergency room is \$10,000 (which may be the amount invoiced to the patient). After a review of the patient's information, the entity designates the patient to a patient class that historically has the ability and intent to pay \$1,000.

This \$1,000 is the variable consideration and is the amount of revenue to be recognized.

Variable consideration is included in the transaction price only to the extent that it is probable that a significant reversal will not occur.

### PORTFOLIO APPROACH

A healthcare provider may use an approach of evaluating patient contracts by the individual or payer class. The portfolio approach may be utilized as long as the entity expects there to be no material differences from applying the guidance to individual contracts.

ASU 2014-09 states that entities should determine the amount to include as the transaction price by estimating either the expected value (that is, the probability-weighted amount) or the most likely amount, depending on which method is thought to be the most accurate.

### PRICE CONCESSIONS

In the case example, the \$9,000 of the gross charges that the entity does not expect to collect is known as a “price concession.” Price concessions are either explicit or implicit.

- **Explicit Price Concession**

A healthcare provider giving a self-pay discount of 50% off charges up front

- **Implicit concession**

The difference between the gross charges, the explicit price concession, and the transaction price (based on historical cash collection data).

# REVENUE RECOGNITION DIFFERENCES

Under ASU 2014-09 (Topic 606)

Revenue Recognized Under Existing Guidance		
Gross Charges	\$	10,000
Contractual		(5,000)
NPSR Before Bad Debt		5,000
Bad Debt		(4,000)
Net Patient Service Revenue	\$	1,000

Bad debts are considered to be the difference between the gross charges, the discount, and the amount received from the patient.

This example shows the healthcare entity should recognize \$4,000 in bad debt expense to offset net patient service revenue.

Revenue Recognized Under ASU 2014-09		
Gross Charges	\$	10,000
Explicit Price Concession		(5,000)
Implicit Price Concession		(4,000)
Net Patient Service Revenue	\$	1,000
Bad Debt		-

The net patient service revenue is calculated based on the historical cash collections, so it should be reasonably known what percent of gross charges an entity expects to receive.

This example shows the entity expects to collect \$1,000; there is conceptually no change in the net patient service revenue after bad debt.

Because the collection amount is probable, the \$4,000 is considered a bad debt expense under the existing guidance will be classified as an implicit price concession under the new guidance.

If there are future impairments of the \$1,000 net patient service revenue (i.e. collecting \$500 rather than \$1,000), the entity can recognize bad debt expense as a component of operating expenses.

This new standard and the way providers recognize revenue could impact your financial performance metrics, finance and tax planning, and debt covenant compliance. Now is the time to get ahead of the challenges to understand how ASU2014-09 will impact your financial statements and determine possible tax implications.



For more information on the new standards and how HORNE Healthcare can help you prepare, **Leigh Ellen Madden at 601.326.1137 or [leighellen.madden@hornellp.com](mailto:leighellen.madden@hornellp.com)**.