Accounting and Auditing Update

Greater St. Louis Chapter HFMA
August 13, 2013

Mark G. Hinsen, CPA
Jon Waitukaitis, CPA
Topics

Emerging Issues for Health Care Organizations
- Accounting for costs associated with ICD-10 implementation
- Accounting for Electronic Health Record Incentive Payments
- HFMA releases updated guidance for reporting bad debt and charity care
- OMB Circular A-133 change – HRSA release policy update on 340B program

Industry Guide Updated by the AICPA in 2012
Topics

❖ Accounting Standards Update
  • Insurance Claims and Recoveries
  • Presentation of Bad Debt
  • Advance Refundable Fees (CCRCs)
  • Impairment of Long-Lived Intangible Assets
  • Liabilities
  • Not-For-Profit Entities – Services Received from Personnel of Affiliate

❖ Proposed Accounting Standards Updates
  • Leases
  • Revenue Recognition

❖ Private Company Council
EMERGING ISSUES FOR HEALTH CARE ORGANIZATIONS
ACCOUNTING FOR COSTS ASSOCIATED WITH ICD-10 IMPLEMENTATION
Applicable guidance

- ASC 350-40 (Internal Use Software Costs)
- ASC 720-45 (Business and Technology Reengineering)
  - Section provides a helpful table that summarizes the accounting treatment for this type of project
- Technical Practice Aid issued by the AICPA in July 2012 – 6400.48, Accounting for Costs Incurred During Implementation of ICD-10
Basics

- Costs segregated among process activities (reengineering, development or modification of software, and acquisition of fixed assets)

- Generally, costs of modifying existing systems are expensed

- Costs that result in “additional functionality” can be capitalized

- Outside consultant costs are allocated among process activities based on relative fair values
  - How do we determine relative fair values?

- Training costs are expensed
## Implementation Guidance – ASC 720-45

<table>
<thead>
<tr>
<th>Steps</th>
<th>Third Party</th>
<th>Internal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Expense</td>
<td>Capitalize</td>
</tr>
<tr>
<td>Business process reengineering and information technology transformation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preparation of request for proposal</td>
<td>a</td>
<td>a</td>
</tr>
<tr>
<td>Current state assessment</td>
<td>a</td>
<td>a</td>
</tr>
<tr>
<td>Process reengineering</td>
<td>a</td>
<td>a</td>
</tr>
<tr>
<td>Restructuring work force</td>
<td>a</td>
<td>a</td>
</tr>
<tr>
<td><strong>Preliminary software project stage activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conceptual formulation of alternatives</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td>Evaluation of alternatives</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td>Determination of existence of needed technology</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td>Final selection of alternatives</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td><strong>Application development stage activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Design of chosen path, including software configuration and software interface</td>
<td>c</td>
<td>c</td>
</tr>
<tr>
<td>Coding</td>
<td>c</td>
<td>c</td>
</tr>
<tr>
<td>Installation to hardware</td>
<td>c</td>
<td>c</td>
</tr>
<tr>
<td>Testing, including parallel processing phase</td>
<td>c</td>
<td>c</td>
</tr>
<tr>
<td>Data conversion costs:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Costs to develop or obtain software that allows for access of old data by new system</td>
<td>c</td>
<td>c</td>
</tr>
<tr>
<td>b. All other data conversion processes</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td>Training</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td><strong>Post-implementation/operation stage activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Training</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td>Application maintenance</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td>Ongoing support</td>
<td>b</td>
<td>b</td>
</tr>
<tr>
<td><strong>Acquisition of fixed assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of new computer equipment, office furniture, or work stations</td>
<td>d</td>
<td>N/A</td>
</tr>
<tr>
<td>Reconfiguration of work area—architect fees and hard construction costs</td>
<td>d</td>
<td>d</td>
</tr>
</tbody>
</table>
Additional Functionality Factors

- The amount of additional software coding required and the new software processes developed.

- The extent to which billing system data will be used for new purposes, including its ability to use the additional coding capabilities beyond submitting claims to Medicare.

- Whether the changes are part of normal maintenance provided by the vendor at no additional cost.

- The entity's historical experience with clinical coding system upgrades.
Accounting for Electronic Health Record Technology Incentive Payments
HFMA Principles and Practice Board issued position paper January 2012

- Gain contingency model (favored by SEC)
  - Revenue recognized when all major gain contingencies have occurred
- IAS 20 Grant Accounting Model (favored by AICPA Health Care Expert Panel and HFMA P&P Board)
  - Cliff Method
  - Ratable Recognition Method
  - Estimated revenue when meaningful use criteria is achieved and then ratably over the EHR reporting period
Medicare Incentive Payments – Critical Access Hospitals

- No formal accounting guidance issued at this time
  - Expert panel is discussing

- In the meantime, recommend using the concepts in the HFMA position paper to determine appropriate accounting and reporting
Other Providers/Programs

► Medicaid
  • State program specific
  • Follow principles elected for Medicare generally applied to the states’ Medicaid program

► Eligible Professionals (EPs) and other qualified providers
  • Follow principles elected for Medicare revenue recognition
Presentation and Disclosure – Grant Model

Presentation:
- Should NOT be reported as part of patient service revenue
- Should be included in the performance indicator
  - Private sector entities may include as a component of “Other Operating Revenue” or as “Non-operating”
  - Consistently applied and disclosed in footnotes
- Governmental hospitals report as operating revenues (but presented separately from patient service revenue)

Disclosures:
- General description of the incentive program
- Revenue recognition model
- Statement that amounts recognized are an estimate that is subject to change, with such changes recorded in the period they occur
- Amounts recorded are subject to audit by the federal and state governments or their designee

- No guidance provided on the gain contingency model though presentation and disclosure requirements are expected to be similar
The Electronic Health Records Incentive Program, enacted as part of the American Recovery and Reinvestment Act of 2009, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals and physicians that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the Organization continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year under both programs is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Organization recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

During the year ended XX/XX/YYYY, the Organization completed the first-year requirements under the (Medicaid/Medicare) program and has recorded revenue of approximately $XXX,XXX, which is included in other revenue within operating revenues in the statement of operations.
HFMA Updates Reporting Guidance for Bad Debt, Charity Care
In December 2012, HFMA Principals and Position Board updated Statement 15, “Valuation and Financial Statement Presentation of Charity Care and Bad Debts by Institutional Healthcare Provider”

- Updated in response to AICPA audit and accounting guide changes, recently issued FASB ASU’s, and the Affordable Care Act.
- Provides useful guidance on the following:
  - Importance of properly reporting charity care and bad debt;
  - Criteria for charity care;
  - Timing of charity care eligibility requirements;
  - Charity care record keeping, valuation, and disclosure
OMB Circular A-133 Changes - HRSA Policy Release Update on 340B Program
Entities subject to OMB Circular A-133 audits:

- 2012 A-133 compliance supplement required special compliance testing for those covered entities in which it was considered a major program
- February 2013, HRSA issued a policy release update removing all references to audits under OMB Circular A-133
- 2013 A-133 compliance supplement was updated to remove all references to 340B related programs

Grantees will not be penalized for OMB Circular A-133 audits in which the special tests for 340B were not performed
Overview

- Updated issued in September 2012
  - Major update Issued in July 2011
- Very useful resource, provides guidance on transactions specifically related to health care organizations
  - Recommend that all health care organizations have access to this
- Intended as supplemental guidance, not a complete set of GAAP or GAAS
- Goal is to improve clarity and reduce variance in practice
- Expanded disclosures and commentary
- Index was added
- No illustrative financial statements
  - Although does provide external sources of example financial statements
2012 Updates

- Revised to include guidance related to clarified auditing standards
- Revised to reflect the issuance of FASB Accounting Standards Updates:
  - ASU 2011-08: Intangibles-Goodwill and Other (Topic 350) Testing Goodwill for Impairment
  - ASU 2011-04: Fair Value Measurement (Topic 820)
  - ASU 2010-28: Intangibles-Goodwill and Other (Topic 350)
- Revised to reflect the issuance of Government Auditing and Accounting Standards Updates
  - Government Auditing Standards 2011 Revision
  - Government Accounting Standards Statement No’s. 60, 63, and 64
ACCOUNTING STANDARDS UPDATES
ASU 2010-24, HEALTH CARE ENTITIES (TOPIC 954) PRESENTATION OF INSURANCE CLAIMS AND RELATED INSURANCE RECOVERIES
Background

- Previously many health care organizations only accrued for claims not covered by insurance

- ASU eliminates diversity in practice by requiring a gross estimated liability presented separately from anticipated insurance recoveries
Basics

- Insurance receivables are recorded at the same time as the liability at the same amount.

- Can net the related expense and revenue in the income statement only if the recorded amounts relate to the same claim liability and are recorded in the same period.

- Applies to all types of claims, not just malpractice.

- Potential debt covenant issue related to increased liabilities:
  - Impact on credit rating during a bond issuance?
Effective Date

- Effective for periods beginning after December 15, 2010 for nonpublic entities.
- Early adoption is permitted
- Can apply retroactively but not required
- Cumulative effect adjustment applied in initial year of adoption
ASU 2011-07, HEALTH CARE ENTITIES (TOPIC 954)
PRESENTATION & DISCLOSURE OF PATIENT SERVICE REVENUE
Basics

- Certain health care entities will now display bad debt expense as a deduction from patient service revenue, rather than as an expense.

- Applies to health care entities which recognize a “significant” amount of patient service revenue at the time services are rendered without assessing the patient’s ability to pay.
Basics

- Issue is primarily one of acute-care hospitals that operate emergency rooms

- For those health care organizations that recognize patient service revenue to the extent it expects to collect, the related bad debt is still reported as an operating expense

- Bad debts related to receivables other than patient service revenue also continue to be reported as operating expenses

- N/A for governmental entities
AICPA Technical Practice Aid

- Technical Practice Aid issued by the AICPA in February 2012 – 6400.47, Application of ASU 2011-07 in Consolidated Financial Statements
  - Should the assessment of “significance” be made at the consolidated reporting entity level or should the determination made at the separate subsidiary reporting level be retained in consolidation?
    - ASU does not address
    - TPA determined it was an accounting policy election
    - Disclosure requirements would be consistent with the policy that is elected
    - Policy should be disclosed in the notes to the financial statements
Disclosures

- Policies for recognizing revenue and determination of bad debts by major payor source

- Patient service revenue (before the provision for bad debts by major payor source)

- Qualitative and quantitative information about significant changes in the allowance for doubtful accounts:
  - Amount of write-offs by payor class
  - Significant changes in underlying assumptions or estimates
Effective Dates

- Effective for the first annual period ending after December 15, 2012 for nonpublic entities
- Effective for fiscal years beginning after December 15, 2011 for public entities
- In both cases, early adoption is permitted
- Applied retroactively in the statement of operations to prior periods presented
- Applied prospectively for financial statement disclosures
ASU 2012-01, CONTINUING CARE RETIREMENT COMMUNITIES (CCRCS) – REFUNDABLE ADVANCE FEES
Basics

- Clarifies that refundable advance fees should only be classified as deferred revenue if the refund of those fees are limited to the proceeds of reoccupancy.

- If the refundable advance fees are not limited to the proceeds of reoccupancy, they should be classified as a liability.

- Affected CCRCs would reclassify unamortized deferred revenue to a refund liability and adjust the liability to reflect the amount of refund obligation (typically by reversing revenue previously recognized).

- Consider impact on calculations of future service obligations (FSOs).
Effective Dates

- Effective for the first annual period beginning after December 15, 2013 for nonpublic entities.

- Effective for fiscal years beginning after December 15, 2012 for public entities

- In both cases, early adoption is permitted

- Applied retrospectively with a cumulative effect adjustment applied to earliest period presented
ASU 2012-02, INTANGIBLES—GOODWILL AND OTHER (TOPIC 350) TESTING INDEFINITE-LIVED INTANGIBLE ASSETS FOR IMPAIRMENT
Background and Basics

- Eliminates inconsistency with recently issued standards on testing goodwill for impairment

- Permits an entity to first assess qualitative factors to determine necessity for quantitative assessment
  - Simplifies the process

- “More likely than not” threshold defined as having a likelihood of more than 50 percent
Effective Dates

- Effective for fiscal years beginning after June 15, 2012
- Early adoption is permitted
ASU 2013-04, LIABILITIES (TOPIC 954)
Basics

- Requires a reporting entity that is jointly and severally liable to measure the obligation as the sum of the amount of the entity has agreed with co-obligors to pay and any additional amount it expects to pay on behalf of one or more co-obligors.

- Does not scope in obligations accounted for under FASB Topics:
  - ASC 410, Asset Retirement and Environmental Obligations
  - ASC 450, Contingencies
  - ASC 460, Guarantees
  - ASC 715, Compensation – Retirement Benefits
  - ASC 740, Income Taxes

- Impact on healthcare entities which participate in obligated group financing (all governmental entities, including healthcare, are excluded from the scope of this update)
Disclosures

- The nature of the arrangement, including how the liability arose, the relationship with other co-obligors, and the terms and conditions of the arrangement

- The total outstanding amount under the arrangement, not reduced by any amounts that may be recoverable from other entities

- The carrying amount, if any, of an entity’s liability and the carrying amount of a receivable, if any

- The nature of any recourse provisions that would enable recovery from other entities of the amounts paid, including any limitations on the amounts that may be recovered

- In the period the liability is initially recognized and measured or in a period the measurement changes significantly:
  - The corresponding entry
  - Where the entry was recorded in the financial statements
Effective Dates

- Effective for the fiscal years ending after December 15, 2014 for nonpublic entities.

- Effective for fiscal years beginning after December 15, 2013 for public entities

- In both cases, early adoption is permitted

- Applied retrospectively with a cumulative effect adjustment applied to earliest period presented for obligations that existed at the beginning of the entity’s fiscal year of adoption
ASU 2013-06, NOT-FOR-PROFIT ENTITIES: SERVICES RECEIVED FROM PERSONNEL OF AN AFFILIATE
Basics

- NFPs should recognize all personnel services received from all affiliates (both for profit and not-for-profit) that directly benefit the recipient not-for-profit entity and for which the affiliate does not charge the recipient NFP.

- Services would be measured at the cost of the personnel providing those services recognized by the affiliate, unless cost would not be representative of the value of the service received.
  - In these circumstances, the entity would be permitted to make an election to measure the service at fair value.

- NFP, business-oriented healthcare entities would report the increase in net assets associated with these personnel services as an equity transfer, regardless of whether those services are received from a not-for-profit or for-profit affiliate.

- Does not address transactions between affiliates for which the affiliate charges the recipient not-for-profit entity at least for the approximate amount of direct personnel costs or approximate fair value of the services rendered.
Effective Dates

- Effective for the first annual period beginning after June 15, 2014, and interim and annual periods thereafter.

- Early adoption is permitted

- May apply the amendments using a modified retrospective approach under which all prior periods presented upon the date of adoption should be adjusted, but no adjustment should be made to the beginning balance of net assets of the earliest period presented.
Proposed Accounting Standards Updates
Proposed Standards on Lease Accounting
FASB has been troubled by lease commitments not being reflected as debt on balance sheets.

This is also part of international convergence project.
The Basics

1. All leases (except immaterial and short term leases) will be on the balance sheet as assets and liabilities
   • Short term is less than 12 months

2. Transforms every company’s balance sheet and their financial ratios.
   • How will banks and others change their thinking in response?
Two Types of Leases

1. Lease of asset that “acquires or consumes more than an insignificant portion of the underlying asset over the lease term” (i.e. most equipment leases), or the present value of the lease payments accounts for substantially all the fair value of the underlying asset (Type A)

2. Lease of assets not covered in #1 (i.e. lease of a building) (Type B)
At Lease Signing – Type A and Type B

1. Record asset on your balance sheet for net present value of lease payments

2. Record liability for the same amount
Lease Payments

1. Reduces debt on balance sheet

2. Portion of payment is recorded as interest expense (accounting is similar to loan payment) – Type A leases only

3. Payment and interest amortization is reported as a single lease cost – Type B leases only
Lease Amortization

1. Each month portion of lease asset is amortized to expense to reflect passage of a portion of the lease term

2. Type B Lease requires adjustment of amortization amount to result in a straight line expense over the life of the lease
Reassessment

- If management expectations change
  - Must reassess each lease
  - i.e. Change intent on renewal option

- Very time consuming and expensive
Short Term Leases

- Leases of less than 12 months including renewal options
- Accounted for based upon current operating lease reporting if organization makes an accounting policy election to do so with additional disclosures
Difficult Concepts

- Determining lease term – They still want extensions to be considered but only if there is significant economic incentive to exercise extension.

- Determining interest rate/discount rate to utilize – Lessee’s incremental borrowing rate

- Contingent rentals, penalties and residual value guarantees
Health Care Impact

1. Could change structure of all leases due to impact on financial statements of lessors.
2. Potential for drastic increase in assets and liabilities
   - Significant impact on ratios
3. Will the banking industry and bond raters/purchasers change the way they rate bonds and view financial statements?
   - Will this increase cost of financing?
Non Public Entities

- Allows usage of a risk free discount rate to calculate PV of lease payments
- Would allow an exemption from disclosure of reconciliation of leases
Current Status

- New exposure draft issued in May, 2013
- Public comment period closes in September 13, 2013
- Recommend that organizations respond to FASB request for comment
- Earliest implementation is unknown currently. Previously this was 2015.
Proposed Revenue Recognition Standards
Contract based approach

When customer controls product, revenue is recognized.
- When is this for healthcare?

Overall, most organizations won’t see a significant change in practice.
Healthcare Impact

- Variable compensation – Must utilize probability weighted amount as estimate of revenue
  - Would health care services fall under this provision due to insurance contract adjustments?
  - If so, most entities would have to create complex allocation models.
- Must consider customer’s credit risk in the amount of revenue to recognize.
- More extensive disclosures (tabular reconciliations)
Current status

- Last exposure draft issued in November 2011 with a companion document issued in January 2012

- FASB has been negotiating minor adjustments with IASB

- Expect to issue a final standard 4th quarter, 2013

- Effective no earlier than 2016 for private entities
Private Company Council
Established May 30, 2012

Began meeting Fall, 2012

FASB has recognized issues surrounding private company financial reporting

Structure similar to proposal of Blue Ribbon Panel
Responsibilities

- Based on the criteria agreed on with FASB, PCC identifies, deliberates and votes on proposed modifications to existing U.S. GAAP for private companies
  - Recommendations are subject to FASB endorsement

- PCC is primary advisory body to FASB on private companies for active technical agenda issues
Membership and Terms

- 10 members, including chair appointed by FAF
- Initial 3 year term
- Members and chair to have considerable experience with private company issues
- Serve without compensation
Meetings and Agenda

- Agenda set by supermajority vote of PCC

- PCC to meet at least five times annually

- Identify, deliberate, and vote on GAAP exceptions
  - Two-thirds (supermajority) vote required
  - If FASB endorses, changes are issued through FASB as an Accounting Standard Update
FASB has endorsed 3 PCC proposals

- Separate identification of intangible assets in a business combination no longer required
- Allow for amortization of goodwill and a separate goodwill impairment model
- Allows a simpler approach for recognition of interest rate swaps used to swap variable rate debt to fixed rate
- FASB has issued exposure drafts on each these.
- Comments are due August 23rd
Questions?

Mark G. Hinsen, CPA
Anders CPAs + Advisors
mhinsen@anderscpa.com
314.655.5537

Jon K. Waitukaitis, CPA
jwaitukaitis@anderscpa.com
314.655.5508