New revenue standard issued
Potential challenges in the health care industry

The new revenue recognition standard will likely present challenges for many companies in the health care industry, including revenue allocation, price and contract changes, and disclosures.

Background
The Financial Accounting Standards Board (FASB) issued Accounting Standards Update, Revenue from Contracts with Customers in May 2014. The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers, and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance.
The effective date for public registrants has been deferred to 2018 for calendar year-end (annual reporting periods beginning after December 15, 2017). Early adoption as of the original effective date (2017 for calendar year-end) is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment.

The delayed effective date and transition options are intended to allow companies a reasonable timeframe to comply. However, addressing some areas of the FASB Accounting Standards Codification may require longer lead-time, particularly related to revenue or billing systems where separation and/or allocation changes may be required, so companies should perform a preliminary analysis of the new requirements on a timely basis.

**Considerations and challenges**
The requirements in the standard will present complexity for many companies in the health care industry. Examples of some of the challenges are as follows:

**Existence of a Contract** — Some health care companies currently recognize a direct reduction to patient service revenue when services are rendered and a patient is not expected to pay. Under the new revenue recognition standard, health care companies may need to consider the customer’s ability and intention to pay the amount to which the companies are entitled to in determining if a contract exists, and if revenue can be recognized.

**Transaction price calculations** — Total consideration that the entity expects to be entitled to from the customer over the contract term (i.e., transaction price) may need to be estimated at contract inception and throughout the contract term. Health care companies may need to develop methods to calculate or estimate the transaction price. For example, the new revenue standard could require companies to estimate revenue based on whether the patient is self-pay, insured, or has an arrangement with government programs (i.e., Medicare or Medicaid). Health care companies may also need a process to update these estimates each reporting period. It may be particularly important to consider data maintenance requirements relative to this determination.

**Presentation of bad debts** — The revenue recognition standard requires bad debts to be presented prominently as an operating expense. Further, the amount of bad debt expense presented in operating expenses may be affected by amounts that are determined to be a concession (i.e., an adjustment to the transaction price rather than bad debt expense) under the new model. This is a significant change for some health care companies that currently present bad debts as a deduction from patient service revenue.

**Contract combination requirements** — The standard may require a company that enters into multiple contracts at or near the same time with the same customer to be accounted for as a single contract when the pricing or economics for those contracts are interdependent. These contracts would need to be evaluated together, in terms of determining separate performance obligations and in terms of allocating the transaction price. Also, adjustments related to contract modifications may be required. These changes may require some companies to enhance their contract management systems and tools.

**Capitalization of costs to acquire customer contracts** — The standard requires certain contract costs, including costs to acquire a contract with a customer (e.g., sales commissions), be capitalized and amortized. As a result, companies may need to develop or enhance process, controls, and systems to identify and account for such capitalized costs.

**Disclosures** — The disclosure requirements under the standard are significant and may require modification to financial management reporting processes and systems. Additional disclosures include, but are not limited to, disaggregation of revenue, certain information about changes in contract asset and liability balances and contract costs, and information related to the amount of the transaction price allocated to performance obligations not yet satisfied.

**Tax** — Certain tax implications may arise as taxpayers often follow the financial reporting revenue recognition methods in the determination of taxable income and transaction tax obligations. The changes may have cash tax implications, may require federal tax accounting method changes, or give rise to new tax temporary differences that may need to be captured, calculated, and tracked through tax provision processes and systems. Taxpayers who do not follow financial reporting methods for tax may also need to consider the impact of these changes on tax reporting and may need to change their computations and procedures, as well as consider potential tax method changes. Similar implications may arise in foreign jurisdictions that impose tax based upon statutory reporting maintained under either International Financial Reporting Standards or U.S. Generally Accepted Accounting Principles, as this change may impact both standards.

**Other implications**
Organizations may need to consider other project needs, including:

- Implementation of updated or new processes, controls, and systems, where required
- Determination of new monthly closing process steps to accommodate the new requirements
- Steps to estimate the impact of the new standard, to facilitate understanding and planning by other key stakeholders
- Effective training and communication of new requirements
- Effective program and resource management related to this effort

**Getting started**

Some effective first steps to consider as you begin to evaluate the implications of the potential new standard may include:

- Evaluating significant revenue streams and key contracts to identify the specific revenue recognition changes required and the specific business units where these changes may have the greatest impact
- Addressing the longer lead-time areas where new calculation rules or revised allocation processes may be required
- Establishing a granular project plan and roadmap to manage the effort across multiple business units and countries
How Deloitte Advisory can help
We have an experienced team of professionals, both in the U.S. and globally across the member firms of Deloitte Touche Tohmatsu Limited, who can assist in developing an action plan to help you implement the new revenue recognition standard.

These capabilities includes the full breadth of services and competencies needed to help clients address these issues, and would include accounting assistance, help with process revisions, support in making system changes (including development of system business requirements), tax and other matters.

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