

Health Care *Alert*

Health Care Accounting alert

August 16, 2010

July 29th Emerging Issues Task Force Meeting Highlights

On July 29, 2010, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) discussed nine issues, reaching final consensuses on three issues, consensuses-for-exposure on three issues, and deferring decisions on the remaining issues. Of the nine issues discussed, four are directly related to organizations within the scope of the AICPA Accounting and Auditing Guide, *Health Care Organizations (the Health Care Guide)* and Accounting Standards Codification (ASC) Topic 954, *Health Care Entities*, two of which have reached final consensus by the EITF.

Final Consensus

Issue 09-K—Health Care Entities: Presentation of Insurance Claims and Related Insurance Recoveries

Health care organizations historically have had significant exposure to loss from medical malpractice and other types of insurance claims, such as general or workers compensation. Currently, health care organizations are limited to recognizing liabilities for claims on a net basis, in which the risk of loss has not been transferred to an insurer (a transfer of risk model). Organizations in other industries typically recognize their exposure on a gross basis, by accruing a liability based on the total amount of exposure and an offsetting receivable reflecting the estimated recovery from their insurance companies.

The EITF discussed this issue to determine whether the accounting used by health care organizations for insurance claims should be amended to be consistent with other industries.

The EITF has reached a final consensus that health care organizations should reflect their gross exposure to claims liabilities similar to the practice in other industries. To accomplish this, the total claims liability will be recognized, with the expected insurance recovery related to those claims recognized separately as a receivable. This consensus would increase transparency to the users of health care organizations financial statements related to their true exposure to medical malpractice and other insurance claims.

Transition and effective date — If ratified by the FASB, the guidance in this issue is effective for fiscal years and interim periods within those years beginning after December 15, 2010, and should be applied through a cumulative-effect adjustment to the opening balance of retained earnings (net assets) in the period of

adoption. Companies are also permitted early application or to adopt the guidance through retrospective application.

Issue 09-L—Health Care Entities: Measuring Charity Care for Disclosure

Health care organizations typically provide services to patients unable to pay for the services provided, known as charity care. Services for patients qualifying for charity care do not result in recognition of revenue or costs in the income statement (or statement of activities), but are disclosed in the notes to the financial statements. Currently, there is diversity in practice among health care organizations as U.S. GAAP permits organizations to choose among charges foregone, costs or other statistical metrics as the basis for measuring the level of charity care provided. In practice, most elect to report the amount of charges foregone, however, recent history has seen the rise of organizations reporting a community benefit, which includes some of the other methods mentioned above.

The purpose of this issue is to determine whether a single method should be required to measure the level of charity care provided and disclosed in the notes to the financial statements.

The EITF has reached a final consensus that the disclosures related to the level of charity care provided should be based on a health care organization's estimated direct and indirect costs of providing the services, resulting in improved comparability between organizations within the industry. Additionally, the EITF also concluded that health care organizations should separately disclose the amount of charity care reimbursed by third parties, typically the state. The final Accounting Standards Update (ASU) is expected to provide a variety of methods for organizations to estimate costs (e.g., cost accounting system, cost-to-charge ratios, etc.).

Transition and effective date — If ratified by the FASB, the guidance in this issue is effective for fiscal years beginning after December 15, 2010, with earlier application permitted. The guidance should be applied through retrospective application for all periods presented.

Consensus-for-Exposure

Issue 10-F—Health Care Entities: Legal Costs Associated with Insurance Claims

Currently, health care organizations follow industry-specific guidance regarding the accrual of legal fees associated with medical malpractice claims. This guidance requires organizations to accrue costs associated with litigating or settling claims when the incidents that give rise to the claim occur. Other industries historically have been given the option of an accounting policy election to either accrue for legal costs associated with an insurance claim (*allocated loss adjustment expenses or ALAE*) or recognize an expense in the period the legal costs are incurred.

The EITF discussed this issue to determine whether the industry-specific guidance should be eliminated to allow health care organizations to have the same accounting policy election as organizations historically have had in other industries, thus eliminating the diversity in practice.

The EITF has reached a consensus-for-exposure that health care organizations may make a one-time policy election to accrue for legal costs associated with an insurance claim or to recognize an expense in the period the legal costs are incurred.

Transition and effective date — The guidance in this issue would be effective for fiscal years beginning after December 15, 2010, with earlier application permitted. The guidance should be applied through retrospective application for all periods presented.

Further Discussion Expected

Issue 09-H—Health Care Entities: Revenue Recognition

Revenues from patient services are reported on a net basis in the financial statements, based on the organization's established rates less any contractual allowances, with an exception related to some uninsured patients. Services to uninsured patients qualifying for charity care do not result in the recognition of revenues or costs associated with those patients, and are recorded on a net basis. Health care organizations are required to disclose information, in the notes to the financial statements, related to the impact of these services. However, many uninsured patients do not qualify for charity care. Current practice in the health care industry has been to recognize revenues and receivables for services provided to patients not qualifying for charity care based on the established rates, even when an entity expects to receive little or no cash for these services. Typically, a separate allowance for bad debt and corresponding bad debt expense will be recorded to offset the exposure to these patients' gross reporting. This practice is inconsistent with general revenue recognition guidance which states that revenues should not be recognized for amounts not deemed to be collectible.

The purpose of this issue is to determine whether revenue recognition related to charity care services should be modified to consider collectability in the initial measurement of revenue from services provided to uninsured patients, which would be consistent with organizations in other industries.

The EITF has discussed, through several meetings, the current practice in the industry related to charity care and tentatively agreed that collectability should be considered in the initial assessment of revenue, consistent with other industries. The EITF discussed various methodologies to accomplish this, including determining whether a "netting" of the revenue and related bad debt expense could be a viable interim approach in advance of finalization of the FASB and International Accounting Standards Board (IASB) joint revenue recognition project. However, concern was expressed about proposing changes in advance of the completion of such a large-scale project. Instead, the EITF tentatively decided to consider, at a future

meeting, disclosure alternatives as an interim solution until the FASB and IASB conclude their joint revenue recognition project.

Transition and effective date — The transition method and effective date will be discussed at a future meeting to the extent the EITF reaches a consensus-for-exposure.

For more information, please contact your local Grant Thornton Health Care Executive, including [Michael Sorelle](#), Partner, or [Mike DiFranco](#), Senior Manager.

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