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Submitted via email (director@fasb.org)

Technical Director
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Financial Accounting Standards Board
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Re: Proposed Accounting Standards Update, Topic 954: Health Care Entities – Presentation of Disclosure of Net Revenues, Provision for Bad Debts, and the Allowance for Doubtful Accounts

From

Dear FASB Technical Director:

I appreciate the opportunity to comment on the Financial Accounting Standards Board (FASB) Proposed Accounting Standards Update regarding Health Care Entities<sup>1</sup>. As an emerging accounting professional, I am significantly interested in providing feedback to the Board's proposals regarding this subject. After carefully analyzing the FASB's proposed changes to the presentation and disclosure of net revenue, provision for bad debts, and the allowance for doubtful accounts under the exposure draft, I would like to answer and present related issues based on the questions posed in the exposure draft.

## Introduction

The health care industry is a complex industry composed of organizations such as hospitals, nursing homes, retirement communities, health care providers (HMO and PPO), physician practices, home health agencies, and ambulatory surgery centers <sup>2</sup>. The health care industry has simplified the intricate parts to four different categories: forprofit or non-profit, and governmental or nongovernmental. Regardless of the categorization system, the aforementioned organizations are all linked to one important concept in accounting: decision-making for both internal and external purposes. The accounting discipline is based on the conceptual framework of presenting information that includes both the primary quality of reliability, and the secondary qualities of comparability and consistency <sup>3</sup>. Over the years the financial condition of the health care industry has morphed because the reliability, comparability, and consistency qualities were absent from the industry's financial presentation of information to individuals with decision-making functions.

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The importance of presenting information that is reliable, comparable, and consistent, becomes more significant after reading FASB's 1976 discussion memorandum <sup>4</sup>:

Earnings (or profits or net income) of a business enterprise are the focal point of the information communicated in financial statements. Earnings are a major motivating force in the economic activities of business enterprises and a major motivating force in the economic activities of those who lend to business enterprises, those who invest in them, and those who manage them.

Since the "focal point of the information communicated in financial statements" are earnings, this means that for health care entities to present accurate earnings they must provide information that: (a) has faithful representation and is reasonably free of bias; and (b) is measured and reported the same way across the industry and from period to period.

Currently, the health care industry violates the abovementioned conceptual framework by recognizing revenue that is not collected at the time of the service. If payment is not made at the time a service is provided, there are two possibilities. Either the provider receives full or partial payment of the service throughout a span of time, or the provider never receives the payment. In either case, the health care entities are recognizing revenue at the time a service is provided without assuring if the payment will ultimately be collected. As a result, this action changes the appearance of the income statement by overstating revenues and profit. Moreover, since the different entities within the health care industry have no established way of judging adjustments to revenue and bad debts, the comparability and consistency within the financial statements becomes nonexistent. Consequently, to solve this problem, I have provided my responses to the questions presented in the exposure draft.

**Question 1:** The amendment in this proposed Update would require a health care entity to change the presentation of its statement of operations by reclassifying the provision for bad debts from an operating expense to a reduction from revenue (net of contractual allowances and discounts). Do you agree with this conclusion? Why or why not?

Based on the proposed update in paragraph 954-605-45-4, I agree with the conclusion that would require a health care entity to change the presentation of its statement of operations by reclassifying the provision for bad debts from an operating expense, to a reduction from revenue. The conclusion proposed by FASB not only allows a more faithful representation of earnings but also a comparable and consistent procedure that will allow entities throughout the industry to execute. By adopting this method, analysis by financial statement users is improved. By reclassifying the provision for bad debts from an operating expense to a reduction from revenue, it provides individuals with decision-making functions to assess the different sources of a health care entities' net

revenue and the changes made to its allowance for doubtful accounts. With FASB's proposed method, a superior system for the citing of disclosures is formulated. As a result, this will allow health care entities to establish the amount and collectability time period of revenue and bad-debt expense; thus resulting in greater transparency. The disclosure would hence make it mandatory for companies to estimate and reveal the amount and collectability period, by analyzing information from historical experience and interim payment rates.

The key foundation related to the question posed in this section is really about revenue recognition. Typically, revenue is recognized when a service is provided to a consumer and based on certain requirements, is adjusted to reflect any discounts based on contractual third-party agreements. A major flaw within the health care industry is its inability to reflect on whether it can collect the amount for the service provided and still record it as revenue. To improve this, a health care entity must recognize the revenue after analyzing whether the amount for the service is collectible.

In regards to arriving to the optimal solution for the industry, the Task Force has discussed three different options in determining the time and amount of revenue recognized <sup>5</sup>. The first option requires that collectability of the payment for a service, be assured before a health care entity recognizes revenue. The second option requires a health care entity to evaluate the measurement of revenue versus initial recognition in regards to collectability. Based on the second option, the consequent changes in credit would be recognized as other income/expense independently from revenue. Finally, the third option, which is a dominant characteristic in this exposure draft, requires health care entities to continue their current revenue recognition policies; however, require the entities to reflect bad debt expense as a reduction of revenue to resolve overstatement.

The primary advantage of the first option as discussed by the Task Force is that it aligns the revenue recognition guidance in the health care industry, with the general guidance that is applied throughout all the other industries. The key disadvantage of the first option however would be inconsistent with FASB's joint project with IASB in regards to revenue recognition and would result in the health care entities having to change their policies twice. The main issue according to the Task Force in regards to the second option was the fact that the industry was not ready to analyze and implement the proposal in regards to credit risk. The third option however has been modified to reflect the current proposal. Based on this proposal, the optimal solution as derived from the third option is to allow entities within the health care industry to expand disclosures and reclassify bad debts as a reduction from revenue.

**Question 2:** The Task Force consensus described in this proposed Update was reached in the context of discussing paragraph 954-605-25-3 relating to patient fee-for-service revenue (that is, revenue earned in transaction in which services provided are billed to patient or third-party payors). This was the issue that was initially raised to the Task Force for consideration. However, the final consensus was not limited to only patient service revenue. Accordingly, please answer the following questions relating to the

## scope of proposed guidance:

Unlike other industries, the health care industry is unique in the sense that most of the revenue-related transactions include more than just the consumer and the provider. There are four parties involved in a health care revenue transaction <sup>6</sup>:

- (1) the individual who receives the care;
- (2) the physician who orders the required services on behalf of the patient;
- (3) the health care entity that provides the setting or administers the treatment;
- (4) and a third-party payer that pays the health care entity, physician, or both on behalf of the patient.
  - a. Should the requirements of the proposed amendments be applicable to all revenue that is accounted for under Topic 954 (that is, patient service revenue, premium revenue, and resident service revenue)?

Based on the industry information provided above, as well as the exposure draft, I agree that the requirements should be applicable to all revenue that is accounted for under Topic 954. Due to the fact that health care entities are complex, a lot of times their revenue also comes from more than one source. The proposed amendment would contribute to comparability and consistency within the industry by being applicable to the three different sources of revenue within the industry.

b. If the answer to 2(a) is no, what types of revenue should the proposed amendments apply to (for example, should the requirements of the proposed amendments be limited only to patient and resident service revenue)?

Since the response to question 2(a) was "yes," this question does not apply to this comment letter.

c. Some diversified entities provide health care services as well as significant non-patient related products (such as pharmaceutical products) or services (such as billing and staffing, clinical information or education services). For such entities, should the requirements of the proposed amendments apply to all activities or only apply to the health care service revenue that is accounted for under Topic 954?

Regardless of whether entities provide health care services as well as non-patient related products, the requirements of the proposed amendments should apply to all activities accounted for under Topic 954. If the requirements of the proposed amendments applied

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only to the health care service revenue, then additional time and work will be spent for financial statement preparers to differentiate core activities from non-core activities. Assuming the financial statement prepares do apply the proposed amendments only to the health care service revenue, it does not generate any type of decision-useful information for individuals with decision-making functions. Instead, the goal of the proposed amendment should be to increase comparability and consistency among financial statements. By making it mandatory for health care entities to apply the proposed amendments to all activities, that objective would be achieved.

**Question 3:** Do you anticipate the need for significant changes in the accounting systems or information gathering to implement the proposed amendments? If yes, please specify the aspect(s) of the proposal that would cause the significant change (for example, a specific disclosure or part of a disclosure requirement).

Based on industry research, no significant changes in the accounting systems or information gathering to implement the proposed amendments would be needed. Most entities within the health care industry already have programs that automatically perform the reporting functions. Although the amendment proposed to reclassify the provision for bad debts from an operating expense, to a reduction from revenue, this is simply a new way to present the information. Otherwise, the information is already available and the accounting systems do not need to be changed or updated to perform the reporting that would be required.

**Question 4:** How much time do you believe would be necessary to efficiently implement the proposed amendments?

Since there will be no major changes to the accounting systems or information gathering to implement the proposed amendments, I believe that the changes should be effective at least one year from now. In the meantime, it is important for preparers and users within the health care industry to educate themselves and be aware of how these changes will affect reporting and revenue. As commented by others, although some entities may be more prepared from others to implement the change, there should be a solid effective date at least one year from now so that confusion can be avoided.

## Conclusion

To conclude my response to the FASB'S views on Health Care Entities: Presentation of Disclosure of Net Revenues, Provision for Bad Debts, and the Allowance for Doubtful Accounts, the proposed amendment in regards to reclassifying the provision for bad debts from an operating expense, to a reduction from revenue provides financial statement users figures that are reliable, comparable, and consistent while are easy to implement

and time-efficient. Once again, I appreciate the opportunity to present my views on this subject.

Respectfully,

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Talin Kontronyan

## References

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