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February 14, 2011

Technical Director
File Reference No. EITF090H2
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Dear FASB Technical Director,

Quest Diagnostics Incorporated appreciates the opportunity to provide its comments to the Financial Accounting Standards Board (FASB) on the Proposed Accounting Standards Update (ASU) *Health Care Entities (Topic 954) – Presentation and Disclosure of Net Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts, a consensus of the FASB Emerging Issues Task Force*. We appreciate the efforts of the FASB and the EITF to address the concerns of constituents on how health care entities recognize and report revenues and provisions for bad debts.

Quest Diagnostics is the world's leading provider of diagnostic testing, information and services, providing insights that enable patients, physicians and others make better healthcare decisions. The company offers the broadest access to diagnostic testing services through its national network of laboratories and patient service centers, and provides interpretive consultation through its extensive medical and scientific staff. During 2010, the company generated net revenues of $7.4 billion. Over 90% of the company's revenues are derived from its clinical testing business, which is generally categorized as clinical laboratory testing and anatomic pathology services. The remainder of the company's revenues is derived from its non-clinical testing businesses consisting of testing for clinical trials; risk assessment services for the life insurance industry; its diagnostics products business that manufactures and markets diagnostic test kits and specialized point-of-care testing; and a health care information technology solutions business. Since the predominant portion of the company's business is to operate as a clinical testing laboratory, we believe that Quest Diagnostics meets the definition of a health care entity (HCE) as defined in Topic 954 of the Accounting Standards Codification (ASC) and would be affected by the proposed ASU.

The clinical testing business of Quest Diagnostics primarily recognizes revenue for services rendered upon completion of the testing process. These revenues and the corresponding receivables are recognized, net of contractual disallowances, in accordance with the guidance of ASC 605, *Revenue Recognition*. Revenues from self-pay/ uninsured patients account for less than 5% of the company's consolidated net revenues. The company's bad debt expense is impacted by factors including the quality of our billing processes, most notably those related to obtaining the correct information in order to bill effectively, and the credit and collections risk related to patient receivables. The company's bad debts related to self-pay/ uninsured patients does not represent the majority of the company's bad debt expense, nor is it material to the company's consolidated net revenues. Self-pay/ uninsured patients who meet the company's requirements for charity care services are not billed, nor is revenue recognized on these services.

While we appreciate the FASB's and EITF's desire to maintain integrity in the accounting standards for revenue recognition for HCEs, we have several concerns about the Proposed ASU on Topic 954 that primarily consist of the following:

- The implications that the Proposed ASU may have on the valuations and reporting considerations of HCEs by analysts and investors,
- The inconsistencies in application between HCEs and non-HCEs,
- The applicability of the Proposed ASU to the Quest Diagnostics' businesses other than clinical lab services.

Valuation and Reporting Considerations

Financial analysts, investors and creditors may use a variety of valuation techniques to derive an entity's fair value among which may be the multiple of revenues approach. We are concerned that the income statement reclassification of bad debts as a contra-revenue line item may have an adverse impact on the valuation of a public company such as Quest Diagnostics, its peers and other HCEs that may be potentially acquired in a business combination. We believe that there may be inconsistencies in the use of the multiple of revenues approach whereby some financial analysts and investors may exclude the adjustments for bad debts in the revenue line item while others may perform a valuation using the net revenues inclusive of the provision for bad debts. We would like to stress to you the importance of the top line revenue figure that a public company reports to analysts and investors as this is a significant factor in investor decisions and in the company's ability to compete for investors' capital. In addition, business valuation models often include assessments of R&D and SG&A expenses that are based on a percentage of revenues. We can see where the analyses using this approach to model R&D and SG&A expenses in a proposed business combination may become skewed in some cases because the frame of reference of revenues inclusive of bad debt provisions will have changed.

We are also concerned that subsequent recoveries of bad debts may result in out-of-period adjustments to revenues and may create volatility in an entity's reported revenues in a given period. In addition, Quest Diagnostics frequently reports two financial metrics referred to as the "percentage growth in revenue-per-requisition" and "days-sales-outstanding" (DSO). The information disclosed on revenue-per-requisition is a key performance indicator of the company's average reimbursement rate for services performed. Analysts and investors look to the company's historical trends of this metric in order to determine if there are signs of strength or weakness in the company's performance. We believe that the reclassification of bad debts as a reduction of revenue may cause inconsistency and confusion on how analysts and investors view this key performance indicator. Our days-sales-outstanding calculations provide a useful metric of information to users of our financial statements on the efficiency of our receivables collection process. By reducing the denominator of this equation via reporting bad debts as a reduction of revenue, this change will have a negative impact on this key performance indicator that is widely used as a measurement of financial strength of a clinical laboratory business such as ours. We believe that this may lead to further confusion and inconsistencies in the financial reporting of HCEs.

Inconsistencies among Entities

It is our belief that the EITF's original concerns over the classification of revenues and provisions for bad debts within health care entities were principally focused on hospitals due to their historical high percentage of bad debt expense related to self-pay/ uninsured patients and for the volume of indigent care. We are also aware that several hospitals provided comments on the original Exposure Draft that suggested the provision for bad debts should be shown as a reduction of revenues. We do not share this view. We believe that the hospitals that provided this comment may have arrived at their conclusion due to a greater

proportion of a hospital's self-pay/ uninsured patient care in relation to its provisions for bad debts. We certainly understand the Task Force's concern particularly when a HCE such as a hospital is trying to distinguish between self-pay/ uninsured patient care and bad debts and how an improper classification may lead to an overstatement of revenues. We are concerned that the revenue line item will become very confusing for the users of our financial statements as it will have potentially three revenue lines: gross revenues before contractual disallowances; revenues after contractual disallowances but before provisions for bad debts; and revenues after contractual disallowances and provisions for bad debts. If the primary cause for concern is the inability to distinguish between self-pay/ uninsured patient care and provisions for bad debts within a hospital, then we believe that the scope of the proposed ASU on Topic 954 should be limited to these circumstances, particularly those HCEs with significant self-pay/ uninsured patient care revenues. If an entity can clearly distinguish its bad debts as a result of credit risk on its trade receivables, then we do not see a reason to change the current model of GAAP that reports bad debts as an operating expense.

We also believe that if all HCEs were required to adopt the Proposed ASU on Topic 954 in its current form, they will effectively be required to prematurely adopt a provision of the FASB's Proposed Accounting Standards Update, *Revenue from Contracts with Customers*, which proposes a model of revenue recognition that considers an estimation of the transaction price including a measurement of a customer's credit risk at the inception of the contract. Unfortunately, this may cause inconsistencies in GAAP across industries and a temporary inequitable treatment for HCEs until all entities are required to conform to the ASU on *Revenue from Contracts with Customers* (assuming that standard is adopted as proposed). We question whether it is necessary for HCEs to essentially go through two separate adoptions of new revenue recognition accounting standards in the foreseeable future. Notwithstanding our comments above that we believe the scope of the proposed ASU could be limited to HCEs that have difficulty in discerning self-pay/ uninsured patient care from bad debts, we would not necessarily disagree with providing enhanced disclosures about the company's policies on assessing collectibility and providing a tabular reconciliation that disaggregates the allowance for doubtful accounts by payer type.

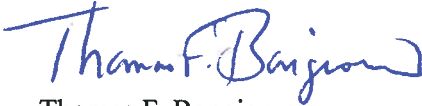
Applicability to Businesses other than Clinical Testing Business

ASC Topic 954 and the AICPA Audit and Accounting Guide, *Health Care Organizations* (May 1, 2007) define patient service revenue as "fees charged for patient care." We do not disagree that the fees Quest Diagnostics charges in its clinical testing business represent fees charged for patient care and thereby designate the company as an HCE for these services. However, we are concerned that the scope and provisions of the Proposed ASU on Topic 954 provides that it "would affect all revenue for entities within the scope of Topic 954." The revenues that Quest Diagnostics derives from its non-clinical testing businesses of clinical trials, risk assessment services, diagnostics products sold to distributors and information technology solutions are far removed from the notion of "fees charged for patient care" and do not involve a third-party payer system and a self-payer. Notwithstanding our previous comments that we believe the FASB's and EITF's concerns on Topic 954 can possibly be resolved with limiting its scope to HCEs with significant self-pay and uninsured patient care or possibly with providing enhanced disclosures, if the FASB ultimately decides to require the reclassification of bad debts as a reduction from gross revenues, then we believe that the bad debts should only pertain to fees charged for patient care from self-payers. However, this too also raises concerns that a company like Quest Diagnostics would be required to report bad debts in two locations on its income statement within revenues for its clinical testing business and in operating expenses for non-clinical testing businesses. We foresee that that this income statement presentation would lead to unnecessary confusion and would be incongruent with the accounting of other industries that perform similar services for clinical trials, sell medical instruments or provide information technology solutions yet they themselves are not HCEs. We simply do not believe that the bad debts of our other businesses should be included because these businesses do not fall under the guidance of Topic 954

or the AICPA Health Care Guidebook. We ask the EITF to reconsider if this was their original intention and whether its application to all revenue is useful to the users of financial statements.

On the following pages, we respectfully submit to you our specific comments to the questions you have raised in the Exposure Draft that was issued on December 17, 2010. If you would like to discuss any matters contained within this letter, you may contact the undersigned at (973) 520-2845, Mr. Mike Deppe, Assistant Corporate Controller at (973) 520-2847 or Mr. Jack Markey, Director of Technical Accounting Research at (973) 520-2849.

Sincerely,



Thomas F. Bongiorno
Vice President, Corporate Controller and Chief Accounting Officer
Quest Diagnostics Incorporated

We respectfully submit to you our specific comments to the questions you have raised in the Exposure Draft that was issued on December 17, 2010.

Question 1: *The amendments 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?*

Response: No. We believe that the original cause for concern on this matter was focused on hospitals that provide a significant amount of self-pay/ uninsured patient care that is difficult to distinguish from bad debts arising from credit risk and the valuation of receivables. We believe that the proposed ASU on Topic 954 may have implications on the valuations of public companies, create inconsistencies in application between HCEs and non-HCEs and should not be applied to non-HCE businesses. We certainly do agree with the basic tenets of revenue recognition including the requirement that collectibility is reasonably assured. Our process of estimating the ultimate collection of the clinical testing receivables involves significant assumptions and judgments including the historical experiences of collections and payer reimbursements. Integral to collectability is the quality of Quest Diagnostics' billing processes that focus on obtaining correct information in order to bill efficiently for the services provided and thereby reduce instances of missing or incorrect billing information. We believe that our current process of recognizing revenue upon completion of the testing services and for providing valuation allowances on receivables is well understood and is sufficient for the users of our financial statements. We believe that a requirement to reclassify bad debts as a reduction of revenues may lead to further confusion for the users of an HCE's financial statements.

We are also concerned that the reclassification of the provision for bad debts to be shown as a reduction of revenue may have an adverse impact on an entity's valuation, particularly when using the multiple of revenues approach. This, in turn may also negatively affect certain key performance indicators such as the percentage change in revenue-per-requisition and days-sales-outstanding that are used by Quest Diagnostics when communicating to analysts and investors.

In light of the FASB's proposed ASU on *Revenue from Contracts with Customers,* we believe that it is unreasonable for health care entities to undergo the adoption of two separate ASUs on revenue recognition within the foreseeable future. We further believe that the adoption of the proposed ASU on Topic 954 may create inconsistencies across industries and would effectively require HCEs to make an early adoption of a provision embedded within the proposed ASU on *Revenue from Contracts with Customers* (which is still subject to possible changes) while non-HCEs would not have to conform to such income statement presentation until and if the latter proposed ASU becomes effective for all entities. We suggest that the EITF consider limiting the scope of the proposed ASU on Topic 954 to HCEs with significant self-pay/ uninsured patient care that is difficult to distinguish from bad debts. While we believe that the limited approach is the most appropriate, in the alternative we would not necessarily object to providing enhanced disclosures about an HCE's policies on assessing collectibility and providing a tabular reconciliation that disaggregates the allowance for doubtful accounts by payer type. The enhanced disclosure approach may be a sufficient alternative and interim step that would maintain consistency until all companies are required to ultimately adopt the FASB's proposed ASU on *Revenue from Contracts with Customers,* if and when it is finalized.

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 transactions in which services provided are billed to patients 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:

1. 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)?

Response: No. We believe that the initial concerns raised by the EITF focused on the third-party payer system that includes an element of self-pay, particularly within a hospital that may have fewer distinctions between self-pay/ uninsured patient care and provisions for bad debts. More specifically, we believe that the concern related to an improper gross-up of revenues and whether or not it is proper for an HCE to recognize revenue when it provides a service that will be paid by two parties; (1) a health insurer or government agency and (2) a self-paying individual or co-payer, when collectibility may not be reasonably assured. We understand the underlying concerns about how revenues could potentially be overstated in these circumstances and about the proper timing of revenue recognition when considering that self-paying and uninsured individuals may present a greater degree of credit risk and that collectibility of the entire fee may not be reasonably assured at the time service is rendered. Quest Diagnostics' policies and procedures provide that if the company identifies an instance of a patient's inability to pay at the time services are rendered, the company does not recognize revenue associated with these services.

The composition of Quest Diagnostics' clinical testing revenues includes fees-for-services for providing diagnostics test results and does not include premium revenue or resident service revenue. The company's clinical testing revenues also include capitated payment arrangements whereby a health care insurer pays the company a predetermined monthly reimbursement based upon the number of individuals enrolled in a health plan and the predetermined rate is paid irrespective of the number or costs of services provided. We believe at this time that our credit risk associated with the third-party payers of health insurers and government agencies is minimal. If collectibility of revenues from these third-parties, whether fee-for-service or capitated arrangements, were not reasonably assured, we would defer revenues until such time that we believed they were collectible, assuming all other revenue recognition criteria are met. Quest Diagnostics currently employs a rigorous collection and allowance estimation process in connection with self-payer fees in order to help reduce the risk associated with material revisions to reserve estimates. Revisions to the allowance for doubtful accounts estimates are recorded as an adjustment to bad debt expense within operating expenses.

2. *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)?*

Response: As we have discussed earlier in this letter, we believe that the current processes and reporting employed by Quest Diagnostics is sufficient for the users of our financial statements. We would prefer to avoid the adoption of two separate accounting standards updates on revenue recognition within the next few years. We believe that the scope of this proposed ASU can be limited to HCEs that provide significant self-pay/ uninsured patient care and have difficulty in distinguishing indigent care from bad debts. Although we prefer the approach that limits the scope of the change to certain HCEs, we would not necessarily object to providing enhanced disclosures about the company's policies on assessing collectibility and providing a tabular reconciliation that disaggregates the allowance for doubtful accounts by payer type until all companies are required to ultimately adopt the FASB's Proposed ASU on *Revenue from Contracts with Customers*.

3. *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 of the entity or only apply to the health care service revenue that is accounted for under Topic 954?*

Response: We believe that the requirement to include all revenues within the scope of this proposed ASU will potentially cause inconsistencies in GAAP and financial statement presentation within and across industries. For HCE's that provide diversified services or products, the requirement to include all revenues may create an uneven playing field when analytically compared to peers and competitors that provide these same diversified services and products but are not classified as HCEs and not subject to the same reporting requirements. We believe that these inconsistencies are not limited to our company but may be present in many types of HCEs such as university hospitals that receive grants or non-profit HCEs that provide for-profit services to non-patient customers such as leasing of medical equipment or real property.

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).*

Response: We do not anticipate the need for significant changes in our accounting systems or information gathering. From the perspective of our consolidated financial statements, the information needed for a reclassification of bad debts is not overly difficult to obtain. However, the clinical testing business of Quest Diagnostics includes several business units with multiple cost centers that are comprised of regional labs and patient service centers. Our company will be required to re-map the provision for bad debts for each of these regional business units within the company's IT systems. As a public company, we will be required to modify our revenue guidance to analysts and investors so that it includes the netting of bad debt expense against revenues and educate them about the new accounting standard. We may also have to amend certain compensation plans that include revenue metrics for determining employee compensation, bonuses and commissions. Further, we will need to analyze the impact on state income tax allocations that include revenues as part of the allocation formulas. While it currently does not impact Quest Diagnostics, it is possible that some HCEs may need time to seek waivers or obtain amendments to credit agreements that contain revenue covenants. All of this of course assumes that the proposed ASU is adopted in its present form but to reiterate, we would prefer that the EITF limit the scope of the proposed ASU to HCEs with significant self-pay/ uninsured patient care where it is difficult to distinguish indigent care from bad debts. Alternatively, although we favor the limited scope approach, we would not necessarily object to providing enhanced disclosures on this subject matter which would minimize the effects on the company.

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

Response: If we are required to reclassify the provision for bad debts from operating expenses to a reduction of revenues and change the presentation of the company's income statement, we believe we could comply with the proposed standard's technical requirements given a reasonable transition period of several months. However, we believe that it will take a longer period of time and significant effort to re-educate personnel, amend compensation plans and begin the process of educating our investors and analysts. If the company was required to only provide enhanced disclosures, an implementation period of a few months should be adequate.