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Hospitals Will Record Less Debt Under Accounting Rule Change

Some hospitals and health-care service providers that have reported increased bad debt expenses because of patients' inability to pay will see a much smaller amount of debt reflected in their income statements after applying new revenue rules in January.

Rural hospitals have been particularly hard hit with bad debt—billions of combined unrecouped dollars across the sector.

''Historically we would have had quite a large bad debt number that's reflected in the income statement offset against net revenue,'' Steven Shill, assurance partner and national co-leader in the BDO Center for Healthcare Excellence and Innovation, told Bloomberg Tax.

''Under the new world order, you're frankly going to have a much smaller amount reflected as true bad debt, and it's going to be shown as an operating expense,'' he said.

Typically, hospitals have to record noncollectable debt as an income statement line item when they can't get reimbursed for the care they provide to patients who are uninsured, file for bankruptcy, or whose job status changes and they're unable to pay the bill.

Bad debt is the most significant issue health-care service providers must tackle when they apply the new revenue rules next year. Providers—including Tenet Healthcare Corp., Universal Health Services Inc., Lifepoint Health Inc.—earlier this year signaled the accounting changes are noteworthy.

''We anticipate the most significant change will be how the estimate for the allowance for doubtful accounts will be recognized under the new standards,'' United Health Services said in its most recent regulatory filing.

More Precise Figures Under today's accounting, health-care service providers record revenue using the billed amount for their services, even when they don't expect to collect it. A corresponding provision for bad debt is required to be reported on the income statement to a net revenue amount. This number can be significant for some providers because of uninsured patients or those with high deductibles or high co-pays who can't pay the bill.

That accounting treatment will change. The new Revenue from Contracts with Customers, ASC 606, requires health-care service providers to use a portfolio approach to assess whether a patient is going to pay. Revenue booked must be the amount the entity expects it will be paid. Bad debt would be shown as an operating expense.

Practitioners said the change means investors will get more precise figures about revenue hospitals can collect versus uncollected revenue that they must write off. Bad debt numbers will shrink on the income statement when they adopt new revenue rules in January, but profitability will remain relatively consistent.

''Whereas under the old system, you take your best estimates, and it would be like throwing darts at a dart board,'' Shill said. ''I think what it's going to do—not only is it going to aid comparability and one will be able to consistently assess one organization against another organization—it's also going to eliminate volatility.''

Uncompensated Care to Increase The amount owed for uncompensated care has been trending downward, but that portion related to bad debt will increase, practitioners said.

Uncompensated care totaled $35.7 billion in 2015, down 4.2 percent from the year before, according to the American Health Care Association's most recent data.

''We may have hit a high point in 2013, before the exchanges went live and Medicaid expansion, but since then uncompensated care has trended down,'' Ashley Thompson, senior vice president for policy at American Health Care Association, told Bloomberg Tax.

''On the one hand it's no surprise that if you extend coverage to the uninsured, it would result in a reduction of uncompensated care,'' Thompson said. ''But at the same time, bad debt might be increasing because individuals that are enrolled in skinny plans with high deductibles or with limited benefits create another form of uncompensated care or bad debt.''

Other practitioners said health care systems will book an increase in bad debt in the next two years, agreeing that it stems from underinsured patients and higher deductibles, but also pointing to new changes to patient benefits under the Trump administration.

Bad debt figures will surge ''probably by double digits in the next two years,'' said Lyman Sornberger, chief health-care strategy officer at Capio Partners LLC, a Sherman, Texas-based health-care asset management firm.

''In the last couple of years, patients are more insured but they're underinsured—they're covered by some payer but owe more from personal out of pocket'' expenses, Sornberger told Bloomberg Tax. ''And it is projected to increase with the revisions to the Affordable Care Act,'' he said.

More Rigor to Admissions The rules could have a trickle-down impact. The general patient admission process, for example, could become more rigorous, practitioners said.

''I think there will be a much more arduous process about understanding what their financial condition is and their ability to pay, whether through insurance or self pay or whatever,'' Venson Wallin, managing director for the BDO Center for Healthcare Excellence and Innovation, told Bloomberg Tax.

''Whether through insurance or self pay, patients will see an increased focus on their ability to pay—with some of the exchanges that are going away, the insurance issues are going to arise again and patients need to be prepared to deal with them,'' he said.

The bad debt rule changes don't apply to charity care. The challenges, however, will come to those who have elective surgery and don't meet the charity care guidelines, said Wallin. ''There may be some discussion about 'is that really something that you need at this point,' '' he said.

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