Q&A Section 6400

Health Care Entities

.53 Accounting for Costs Incurred in Connection With the Implementation of Electronic Health Record Systems

Inquiry — The widespread implementation and use of electronic health record (EHR) systems are primary agenda items for a number of health care entities. EHR technology has shown to be effective in transforming the quality, safety, and efficiency of care within health care entities that have implemented the technology successfully. However, successful implementation can be time-consuming and expensive as health care entities struggle to adopt these systems in a manner that meets regulatory mandates and clinicians' expectations. Integration of EHR technology into clinical workflow, the adoption strategies used when implementing EHR technology, and technological upgrades and continuous quality improvement are all issues that health care entities confront when seeking to implement and use EHR systems to store and manage clinical information.

How should health care entities account for costs incurred in connection with the implementation of EHR systems for internal use?

Reply — EHR system conversions would follow guidance similar to other information system conversions and may require changes to both business processes and information systems. When a project involves both process engineering and software development or modification, the guidance in FASB *Accounting Standards Codification* (ASC) 720-45 should be considered. FASB ASC 720-45 requires that project costs be segregated among process reengineering activities, activities that develop or modify software, and costs associated with acquisition of fixed assets. The costs associated with process reengineering (for example, assessing the current state of business processes, process redesign or reengineering, or work force restructuring) are expensed as incurred. The costs associated with developing or modifying internal-use software are capitalized or expensed based on FASB's internal-use software guidance in FASB ASC 350-40. Costs associated with acquisition of fixed assets are accounted for in accordance with an entity's policy for capitalizing long-lived productive assets. If an outside consultant is engaged to conduct the project, the total consulting contract price should be allocated among these activities based on the relative fair values of each component (which are not necessarily the separate prices stated within the contract for each element). FASB ASC 720-45-55-1 provides a helpful table that summarizes the accounting for typical components of a business process reengineering and IT transformation project, and the guidance that applies to each component.

Significant expenses also are likely to be incurred in connection with training coders, clinicians, and other end users. According to paragraphs 4 and 6 of FASB ASC 350-40-25, all training costs should be expensed as incurred, even those that are incurred during the application development stage.

The guidance set forth in FASB ASC 350-40 should be followed when accounting for the implementation costs associated with cloud computing EHR agreements or outside licensing arrangements, the acquisition of a new EHR system, or the modification of existing software within an EHR system.

Health care entities should determine the extent to which modifications of existing software result in "additional functionality"— that is, whether the modifications enable the software to perform tasks that it was previously incapable of performing. The following summarizes the financial reporting requirements for each type of cost:

- In accordance with FASB ASC 350-40-25-7, "*Upgrades and enhancements* are defined as modifications to existing internal-use software that result in additional functionality — that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications."

- Associated qualifying costs of application development stage activities that result in new tasks that the software could not previously perform should be capitalized. Conversely, if the changes do not result in the capability to perform additional tasks, the associated costs should be expensed as incurred.

- *Maintenance costs* should be expensed as incurred. Training costs and data conversion costs, except for costs to develop or obtain software that allows for access or conversion of old data by new systems, should also be expensed as incurred.

The specific facts and circumstances of each entity should be considered in evaluating whether any of the modifications result in additional functionality, and professional judgment should be applied in assessing whether modifications to an entity's system result in additional functionality beyond the original software's capabilities and, therefore, qualify as an upgrade or enhancement. Factors to consider in the assessment might include the following:

- The extent and types of changes being made to the software design. A significant amount of changes may be indicative of additional functionality.

- The amount of additional software coding required and new software processes developed. Less software coding or fewer additional software processes may point toward maintenance, rather than additional functionality.

- The extent to which EHR system data will be used for new purposes, including its ability to use the additional coding capabilities beyond submitting claims to Medicare (for example, to track data in order to improve disease management programs and

clinical outcomes or to enhance the quality of patient care or pay-for-performance contracts), may be indicative of additional functionality.

- The entity's historical experience with EHR system upgrades (for example, the number of years since the last upgrade, the amount of changes made, and whether that upgrade qualified for capitalization). An entity should consider the criteria applied to previous upgrades, including its experience to determine whether those upgrades resulted in additional functionality, and compare those criteria to the facts and circumstances associated with the proposed or planned upgrade.

- Increase in the number and complexity of the interfaces between the central EHR system and downstream departmental systems. The greater the complexity of the system, the more likely that significant changes will be required, resulting in additional functionality.

Software modifications that do not result in additional functionality are expensed as maintenance costs. Modifications that result in additional functionality are considered upgrades or enhancements to the existing system and are expensed or capitalized in accordance with the criteria set forth in paragraphs 1–6 of FASB ASC 350-40-25.

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.54 Financial Presentation Considerations Related to Transactions Involving Provider Taxation Programs and Similar Arrangements

Inquiry — The Medicaid program is set up on a state-by-state basis to provide medical assistance to the indigent. Although state-administered, the program is a joint federal and state program for which the federal government finances a portion of the cost. Under this arrangement, the federal government "matches" a percentage of the total amount paid by the state to health care providers. This matching is referred to as *federal financial participation*.

States have attempted to increase the amount of federal matching funds for which they are eligible by increasing the amount of medical assistance they provide. In order to pay for the increased medical assistance, some states have imposed provider taxes on health care entities and used those funds to make additional provider payments. As a result, these states have been able to generate additional federal matching funds without expending additional state funds. How should a health care entity present provider taxes paid within their financial statements?

Reply — The accounting for these types of programs is dependent on the individual facts and circumstances. Provider tax regulation prohibits state provider tax programs from directly or indirectly guaranteeing the return or offset of a portion or all the provider tax payments. This means there is no legal right of offset, and provider tax payments are not directly correlated with the amount of supplemental revenues that are generated or earned in the year the tax payment is due. The facts and circumstances of the provider tax payments are more similar to revenue-raising activities of the states than to the negotiation by the states of the price paid for the goods and services that it purchases or pays for through its programs. Therefore, the provider tax

assessments should be separately accrued as a liability (until paid) and recognized as an expense. FASB Concepts Statement No. 6, *Elements of Financial Statements—a replacement of FASB Concepts Statement No. 3 (incorporating an amendment of FASB Concepts Statement No. 2)*, identifies *revenues* and *expenses* as transactions associated with an entity's ongoing major or central operations (as opposed to gains and losses, which are peripheral or incidental) and states that those amounts should be presented gross. Because supplemental payments to providers under provider tax programs represent additional payment for services provided to Medicaid beneficiaries, gross presentation of supplemental revenues and associated provider tax expenses would be appropriate.

Accrual of revenue and related receivables should be reported separately from fee expenses and related liabilities. Providers should follow guidance for revenue recognition of Medicaid supplemental payments under FASB ASC 606, *Revenue from Contracts with Customers*.

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