



Revenue Reporting

It's Not as Simple as It Might Seem

By Dexter Braff

REVENUE. Perhaps the most basic performance measure of a company, it can also be one of the most confusing. The next time you start comparing your organization to another, consider that although people might be talking about revenue, rarely are they speaking the same language.

In fact, there are many ways to report revenue. Each has distinct strengths and weaknesses that must be understood to properly evaluate an income statement and, in turn, understand a company's performance.

Revenue as Cash Collections

PERHAPS THE EASIEST—and most easily understood—way of reporting revenue is as cash collections. When this method is used, each dollar of cash collected generates a dollar of revenue. The primary advantages to reporting revenue as cash collections are that not only is it simple, but it also conforms to cash-basis accounting, which is often used in preparing simple income tax returns. As an added bonus,

reporting revenue as cash collections appeals to many entrepreneurs who live and breathe daily cash flow.

Matching revenue and expenses is critical to understanding a company's performance.

The main disadvantage to reporting revenue as cash collections is that, due to the time differences between when bills are collected and expenses are incurred, cash-based revenue does not “match” expenses well. As such, income statements can be extremely misleading.

Consider what happened when billing and collections were first transitioned to the regional DMERCs. For those companies using cash-based revenue reporting, the interruption in bill processing caused a temporary yet substantial reduction in cash flow—and, hence, revenue. With expenses remaining constant, reported income during this time fell dramatically, even though there might have been no fundamental change in business.

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Revenue as Cash Plus Change in Accounts Receivable

MATCHING REVENUE AND EXPENSES is critical to understanding a company's performance. The primary advantage to reporting revenue as cash plus change in accounts receivable (AR) is that it is a more effective way of matching revenue and expenses than reporting revenue as cash collections. Using this method, col-

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lection patterns are largely factored out of the revenue calculation. In addition, it is an indirect way to estimate revenue when billed.

Consider a new home care company that opened January 1. As a new company, it would have no AR when it opened. During the entire month of January, however, the firm billed \$10,000 and collected \$0. While cash collected is \$0, change in receivables equals \$10,000. The company's reported revenue would therefore be \$10,000—a more accurate and meaningful figure than the \$0 that would reflect cash collected.

Now let's say that during the month of February, the same company collected \$7,000 and billed an additional \$12,000. The ending AR is now \$15,000 (\$10,000 beginning AR minus \$7,000 collected plus \$12,000 billed). Using this reporting method, revenue is accounted for as cash collected—\$7,000, plus a \$5,000 change in receivables (\$15,000 minus \$10,000 AR at the end of January), or \$12,000. Notice how this is an indirect method of arriving at the billed revenue figure for February.

The obvious question, then, is why companies would use this method of reporting revenue at all. Why not just use billed revenue? Basically, since the basis of this method is cash collections, many people find it easier to use and more easily understood than other methods. In addition, reporting revenue as cash plus change in AR does not require significant adjustments for contractual allowances or bad debt, since they are factored in through reduced cash and reduced AR. But therein lies its greatest weakness. As an indirect method, it masks this critical information. When AR is reduced for these types of adjustments, the negative change in AR properly reduces revenue. However, these adjustments are not reported separately and are essentially lost in all of the activity that affects cash and AR.

Revenue as Billings

RATHER THAN TAKE AN INDIRECT ROUTE to billings through cash plus change in receivables, revenue can be reported directly as billings. By getting closer to reporting revenue when services are performed, this method substantially closes the gap

between reported revenue and expenses, thereby improving matching and performance evaluation.

There are, however, several potential problems in reporting revenue in this manner. For example, if billings are posted at submitted rather than allowable rates, a corresponding contractual allowance should also be reported at the time of billing. If not, revenue will be overstated. Similarly, even when billings are booked at allowable rates, companies should account for bad debt to recognize that not all revenue will ultimately be collected. Bad debt can either be estimated, or accrued, at the time of billing or recognized directly when an account is written off. Regardless of the method, consistent assessment and recording of bad debt are essential to avoid overstating revenue and distorting performance analysis.

Finally, in such a complex payer environment, companies must remember that changes in billings—and, hence, revenue—can often be a function of processing issues and not fundamental changes in service.

Revenue as Billings Plus Change in Billings on Hold

BILLINGS ON HOLD is the aggregate billing potential of services rendered that have not yet been billed, usually due to missing information. Similar to the cash plus change in receivables approach, by using this method, bill-processing issues are factored out of the revenue calculation. This method provides for the best matching of revenue and expenses—and is frequently used by auditors—because revenue is essentially recognized when services are delivered.

The obvious disadvantage to this method of reporting revenue is that companies that do not track billings on hold cannot use this approach. Additionally, similar to the problems incurred with reporting revenue as billings, companies using this method must provide for additional allowances or adjustments to account for the fact that not all held billings will ultimately be released.

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Depending, in part, on the accounting, billing and computer resources available to them, all companies must choose the most appropriate way of reporting revenue. At the same time, these companies must be keenly aware of how revenue is derived to best interpret its meaning and impact on their business financial statements. **HC**