IFRS 15: Revenue from Contracts with Customers

Frequently Asked Questions

Introduction

This document, issued in April 2019, answers frequently asked questions on the application of IFRS 15 by NHS providers. It does not form part of any accounts direction to providers. If there is any doubt, a reading of IFRS 15 and the Department of Health and Social Care (DHSC) Group Accounting Manual (GAM) should take precedence.

Other sources of guidance

As well as the DHSC GAM, providers can also refer to:

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| TAC Completion Instructions     | Here, 22 March entry | • Explains how IFRS 15 has been reflected in disclosure requirements of TAC schedules  
                                  |                                                                                   | • Gives examples of revenue streams that do not fall under IFRS 15, and of receivables that are not contract balances under IFRS 15  
                                  |                                                                                   | • Annex summarises all disclosure requirements in IFRS 15 and raises considerations for local accounts. |

Interaction between IFRS 9 and IFRS 15

Q1: How should we deal with contract challenges from commissioners?

In previous years under IAS 18, where the provider has accrued income at the year end which has not been agreed and/or paid by commissioners, the provider would need to supply evidence to its auditors to show the recoverability of its receivable, and thus also support its revenue position. This principle has not changed. If the provider has evidence that it is entitled to the revenue, it should continue to recognise the revenue. It should then make separate considerations about whether any required impairment of the receivable is required under IFRS 9.

Paragraph 51 of IFRS 15 defines when an amount of consideration is variable. Paragraph 52 adds that consideration is variable if the customer has a valid expectation from the entity’s [provider’s] customary business practices, published policies or specific statements that the entity [provider] will accept an amount of consideration that is less than the price stated in the contract.
A logical application of this is that if the commissioner’s contract challenges are valid, then the provider should apply the accounting requirements for variable consideration. Paragraph 53 says that the entity shall estimate the amount of variable consideration using either the expected value of the consideration, or the most likely amount. (This is a brief summarisation of the paragraph.) Therefore if the commissioner’s challenges are considered valid by the provider and it no longer expects to be entitled to that portion of the revenue, the provider would de-recognise the revenue under IFRS 15.

Q2: We are recognising revenue from a contract but we have concerns that the customer may not be able to afford what we expect to bill. Does this mean we should not recognise the revenue?

Paragraph 47 of IFRS 15 defines that the transaction price for revenue recognition as being the amount of consideration (cash or other assets) to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. This says ‘expects to be entitled’ rather than ‘expects to collect’. If the provider is entitled to the revenue, it should recognise the revenue. Any concerns about the customer’s ability to pay fall within the impairment provisions of IFRS 9, as adapted by the DHSC GAM.

Determining whether an income stream falls under IFRS 15

Q3: We have income stream x that feels like it should be IFRS 15, but we don’t have a formal contract and it is not clear how we apply the five steps of IFRS 15.

A revenue stream will fall under IFRS 15 if it does not fall under a different standard. The five-step model in IFRS 15 ultimately defines how revenue is accounted for. They are not a set of criteria to determine whether IFRS 15 applies. Also remember that the DHSC GAM (paragraph 4.48) explains that the definition of a contract is expanded to include legislation and regulations which enables an entity to obtain revenue that is not classified as a tax.

Paragraph 9 of IFRS 15 sets out the criteria to be met in defining a contract that falls under IFRS 15. Where a revenue stream does not fall under another standard but there is not a contract meeting the definition of such under IFRS 15, paragraph 15 of the standard is then important. It states:

15 When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

(a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

(b) the contract has been terminated and the consideration received from the customer is non-refundable.

This means that income can be recognised as revenue when all, or substantially all, of the promised funding has been received by the Trust. If, for example, the funding for
the current financial year is received in monthly instalments and the twelfth payment is received after the year end, we believe it would be appropriate to accrue the associated revenue into the current reporting period by application of this paragraph.

It should also be remembered that as specified in the December update to the GAM, where entities receive revenue through taxation, fines and penalties which is wholly non-refundable and leads to no obligations, entities are not required to wait until all, or substantially all, of the promised revenue has been received to recognise the revenue. In these instances, entities should recognise revenue when an equivalent to a taxable event has occurred, the revenue can be measured reliably, and it is probable that the assisted economic benefits from the taxable event will flow to the collecting entity. All these elements are required to be satisfied.

Other income sources: timing of income recognition

Q4: We were awarded income from an education body at the end of the financial year telling us that the monies are to be used by the end of June in the subsequent financial year for delivering specific courses. There is no condition saying the money is repayable if not delivered by 31 March given the courses are to be delivered by 30 June. The paying body expects us to recognise the income in the current financial year as they will be recognising the expenditure and we will need to do this otherwise we will have an agreement of balances mismatch. However, under IFRS 15 we have assessed that the performance obligation is the delivery of the courses. If we do not deliver the courses before the end of this financial year we believe this is a contract liability under IFRS 15 and we would need to defer the income at the year end. Which approach takes precedence?

DHSC group counterparties are asked to work together to avoid agreement of balances mismatches and the same should apply in this case. However where disagreement remains, following accounting standards for the preparation of the entity’s own accounts takes precedence over avoiding an agreement of balances mismatch. That being said, it is not expected to be the case that both parties to a transaction accurately apply accounting standards and come to a different treatment, even though IFRS 15 is a revenue standard without an equivalent standard for expenditure recognition.

In this example, the entity is correct to identify the performance obligation and should defer the revenue. The entity must take steps to communicate this position to the paying body so that they can adopt equivalent treatment: they might not know about the entity’s planned timing for this without being told. If following this the paying body continues to recognise expenditure in the current year, the entity will accurately have an agreement of balances mismatch.

Other income sources: reviewing research and development contracts

Q5: Does research income fall under the scope of IFRS 15?

Under many research contracts, the Trust has obligations to deliver to the funder in exchange for the consideration provided. We expect that these will fall under IFRS 15.
This might be less clear for some research grants, and where these are from government IAS 20 considerations apply. IAS 20 includes ‘grants related to income’ (i.e. revenue grants) in its scope and it defines government grants as “transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity”.

Our work during the year has identified some research contracts that fall under IFRS 15 and some that do not (i.e. IAS 20). The TAC schedules at month 12 include revenue lines for research and development income for both IFRS 15 and non-IFRS 15. While providers will need to consider the standards and the contract in detail, it may be helpful to consider whether the Trust feels it is ‘transferring a promised good or service’ to the grant-paying body (customer), in the language of IFRS 15.

Q6: What considerations should be made for research contracts that do fall under IFRS 15?

As ever with applying IFRS 15, the key steps are identifying the performance obligations (the promises to transfer goods/services to the customer) and then whether those performance obligations are settled at a point in time or over time.

For example: A provider shared an example of a research contract where it was considered the only performance obligation was the delivery of completed research at the end of three years. Upon review of the contract we felt that paragraph 35c was met, being a condition meaning the performance obligation is considered satisfied over time: “the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).” The contract including a schedule of the types of activity that would be reimbursable and the research was overall specific to the contract. The contract required annual reports of work completed and expenditure incurred – in this case these were not judged as performance obligations in their own right. But the contract did say that provided the activity undertaken was in line with the schedule, then upon receipt of these reports the Trust would be paid annually. The Trust therefore recognised revenue each year as part of satisfying the ultimate performance obligation over the three years.

Other income sources: overseas patients with no reciprocal arrangement

Q7: Under current regulations, where we invoice overseas patients where there is no reciprocal arrangement, there is a risk-share with the CCG. How much of this falls under IFRS 15?

All of it. As explained in the DHSC GAM, the definition of a contract under IFRS 15 is extended to incorporate legislation and regulations which enables an entity to obtain revenue that is not classified as a tax. The risk-share arrangements for overseas visitors income are set out in regulations, and therefore fall under IFRS 15. More guidance on the applicable regulations is available here and here (including specific guidance on accounting entries). In applying IFRS 15 to overseas visitor charging, the visitor is the customer.
Disclosure requirements / definitions

Q8: What is the difference between a contract receivable and a contract asset?

A contract receivable relates to where the entity has recognised the revenue but has not yet received the cash and has an unconditional right to receive the cash (or other consideration). In plain English this means it simply reflects that the customer hasn’t paid the entity yet: and it is in receivables rather than cash at the year end. A contract receivable only relates to contract income that falls under IFRS 15. A contract receivable could be invoiced or un-invoiced: accrued income can fall within the definition of contract receivables if the entity has an unconditional right to receive the cash.

Paragraph 116 of IFRS 15 requires separate disclosure of contract receivables. This is incorporated into the receivables note in the TAC forms, with specific rows for contract receivables.

A contract asset relates to where the entity has recognised the revenue but is not yet entitled to receive the cash (or other consideration). This means that the entity’s right to receive cash (or other consideration) for the goods or services transferred to the customer is conditional on something other than the passage of time, e.g. the entity’s future performance. For example consider a case where an entity has a contract which says it will provide two separate goods to a customer, delivered two months apart, and the contract says the customer only pays following successful delivery of the second good, and at the end of the financial year the entity has supplied only the first to the customer. The entity can assess the two distinct goods as two separate performance obligations and so recognise revenue for the first good (allocating the transaction price as appropriate), but its entitlement to the cash is dependent on it fulfilling the rest of the contract. It therefore holds a contract asset on the balance sheet.

We do not expect contract assets to be material in the NHS. For standard NHS work, even where distinct performance obligations are identified, the entity’s entitlement to be paid for each performance obligation is not usually dependent upon the subsequent ones. This is regardless of when billing actually happens: the definition of a contract asset is about not being entitled to the cash at the reporting date, not about when it is actually billed or received.

Q9: Should the accrual for partially completed spells be considered a contract receivable or a contract asset?

While consideration will normally flow after the patient is discharged, the provider is entitled to revenue in exchange for the work already done which is the purpose of the partially completed spell accrual. It should normally therefore be a contract receivable.