Revenue Recognition, Gross/Net Accounting and Hosted Services

NHS England

The overarching principle is that transactions should be accounted for in accordance with accounting standards, with all treatments having been agreed by all parties.

Before considering whether gross or net accounting is appropriate bodies must first consider **IAS 18 Revenue**. The standard describes revenue as:

*"the **gross inflow of economic benefits** during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions*
from equity participants.

This Standard shall be applied in accounting for revenue arising from the following transactions and events:

- *(a) the sale of goods;*
- *(b) the rendering of services; and*
- *(c) the use by others of entity assets yielding interest, royalties and dividends.*

*"IAS 18 states that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an **AGENCY** relationship, the gross inflows of economic benefits include amounts collected on behalf of the **PRINCIPAL** and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission."*

Once revenue recognition has been considered, organisations should then consider the appropriateness of gross or net accounting.

Organisations are reminded that the DHSC Group Accounting Manual 2018-19 states that: "The overarching principle is that transactions must be accounted for in accordance with accounting standards, with all treatments having been agreed by both parties. Generally, this means revenue income and expenditure must be recorded gross unless one party is acting solely as an agent". (Section 4.17)

An organisation is acting as an agent if it has transferred the risk and rewards and it does not have exposure to significant risks and rewards associated with the sale of goods or rendering of services. For example, in the case of a staff recharge, if the member of staff concerned is off sick for a period of time, if the employing organisation would need to supply someone else to the receiving organisation, then the risks of employment have not been transferred. The employing organisation should use gross accounting. Alternatively, for example, if no substitute employee would be provided and the receiving organisation would continue to pay, this may indicate that

the employing organisations has transferred the risks and should use net accounting. This is one factor amongst many and each circumstance should be assessed individually and agreed between both parties but, in line with the principles of IFRS.

IAS 18 further sets out the following criteria that, individually or in a combination, indicate that an entity is acting as a principal. They are as follows:

- *"The entity has the primary responsibility for providing the goods or services to customer or for fulfilling the order.*
- *The entity has the inventory risk before or after the customer order, during shipping or on return.*
- *The entity has latitude in establishing prices, either directly or indirectly.*
- *The entity bears the customer's credit risk on the receivable due from the customer of the service."*

If **ALL** parties involved in the arrangement agree net accounting is appropriate, and is in accordance with accounting standards, then net accounting may be used.

With regards to the sending of statements where net accounting is appropriate, in the case of staff recharges, the receivable organisation will send a receivables statement (where applicable) to the payable organisation but not an income statement as this is classed as a non-income item (see example 2 in attachment below). The "substance" of the transaction in example 2 is payroll which wouldn't ordinarily form part of Agreement of balances or attract an analysis 2 code. In the case of hosted services (example 3 in attachment below), the receivable organisations will send a receivable statement (where applicable) to the payable organisations but not an income statement as this is classed as a non income item. However, in the case of example 3, the "substance" of the transaction is expenditure with Foundation Trusts (FTs). FT income and expenditure does form part of Agreement of balances and attracts an analysis 2 code. The FT will send income statements but, **as it is also a party to the hosted service arrangement;** the FT will send income statements correctly to all principals included in the agreement (for their share of the agreement) rather than to the agent alone.

It is recognised that, within NHS England, there are instances where net accounting is appropriate and is agreed. Annex 5 of the Agreement of Balances guidance (included on FinMan) sets out where NHS England has hosted services which are being accounted for on a net basis. This list is updated prior to each Agreement of Balances exercise.

At all times it is vital that the parties involved assess each individual situation in line with the principles of IFRS and determine whether gross or net accounting is appropriate. Once the accounting treatment has been determined, and all parties agree (including any Foundation Trust/NHS Trust), the agreement should be documented and auditable. All parties should follow the appropriate coding conventions *(see examples on Excel document attached)* to enable consolidation to take place and minimise the level of gross mismatches in the Agreement of Balances Income and Expenditure exercise.