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IFRS industry insights: Healthcare providers sector

New revenue Standard could impact profile of revenue and profit recognition

Headlines

- The **profile of revenue and profit recognition** will change for some entities as the new Standard is more detailed and more prescriptive than the existing guidance and introduces new complexities. In particular, healthcare providers will need to consider:
  - the impact of new guidance where pricing mechanisms include **variable amounts**;
  - whether payment for goods and services is considered **collectable** (receipt is probable);
  - the extent to which they supply **distinct goods or services**, which should be accounted for separately ; and
  - whether particular **costs relating to obtaining a contract** must be capitalised.
- The new Standard requires significantly more **disclosures** relating to revenue and entities will need to ensure that **appropriate processes** are in place to gather the information.

What's happened?

The International Accounting Standards Board (IASB) has published a new Standard, IFRS 15 *Revenue from Contracts with Customers* ('the new Standard'). The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, which is found currently across several Standards and Interpretations within IFRSs. The core principle is that an entity recognises revenue to reflect the transfer of goods or services, measured as the amount to which the entity expects to be entitled in exchange for those goods or services.

The new Standard is effective for reporting periods beginning on or after 1 January 2017, with earlier application permitted. Entities can choose to apply the Standard retrospectively or use a modified approach in the year of application. It is the result of a convergence project with the US Financial Accounting Standards Board (FASB) that began in 2002. Almost fully converged, the most significant differences between IFRSs and US GAAP relate to interim disclosures and timing of adoption.

Implications for the healthcare provider sector

Below, we highlight certain key impacts resulting from the new Standard that will be of particular interest to those in the healthcare provider sector. Of course many more complexities exist and, as described below, Deloitte has produced further guidance which explores these in greater detail.

How might this affect you?

The timing of revenue and profit recognition may be significantly affected by the new Standard

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the healthcare provider sector. Applying these new rules may result in significant changes to the profile of revenue and, in some cases, cost recognition.

This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics**;
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

Current accounting systems and processes may require changes to cope with the new Standard
As explained below, IFRS 15 introduces new requirements to move to a more conceptual approach. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the healthcare provider sector may require modifications to existing accounting processes and, in some cases, entities may conclude that they should develop new systems solutions.

In determining the extent to which modifications will be required, entities will wish to consider the need for sufficient flexibility to cope with future changes in the pricing and variety of product offerings made to customers. The 1 January 2017 effective date may set a challenging timeframe for developing new systems.

What are the most significant changes?

When should variable or uncertain revenues be recognised?
In certain jurisdictions, it is not uncommon for healthcare providers to render patient services, without knowing how much they will ultimately be paid. For example, a hospital may have to provide emergency services to patients prior to knowing the amount that will ultimately be paid by a private insurer, the government, or the patient themselves. It is possible for the transaction price to be different in these situations depending on who is responsible for the payment. Additionally, the amounts ultimately paid may be adjusted as a result of negotiation or dispute and entities will need to apply judgement to determine whether the adjustment should be accounted for as a concession (i.e. reducing revenue) or as a bad debt (i.e. a separate expense).

There are new specific requirements in respect of variable consideration in the new Standard such that it is only included in the transaction price if it is highly probable that the amount of revenue recognised would not be subject to significant future reversals as a result of subsequent re-estimation. This approach to variable and contingent consideration is different from that previously reflected in IFRSs and, in certain scenarios, will require a significant degree of judgement to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may change for some entities as a result.

Is it probable that payment will be received?
The new Standard requires that it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In certain jurisdictions, hospitals often provide emergency services to uninsured patients without knowing whether they will be able to collect their fees. In such cases an assessment will have to be made as to whether they meet the criteria for revenue recognition given this uncertainty.

How should revenue be allocated to the different goods and services identified?
Previously, given the lack of specific guidance in IFRSs, there was greater room for judgement when identifying the goods and services within a contract and then allocating the revenue to those goods and services. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15 and, in particular, the new rules on how revenue is allocated between different items. The new Standard requires the revenue from a contract to be allocated to each distinct good or service provided on a relative standalone selling price basis, though a 'residual' approach is permitted in limited circumstances.

This may result in practical implementation issues in the healthcare business, particularly where services are often integrated. Patients may be charged for a number of services, for example diagnostics, pathology and so on. Where it is concluded that certain elements should be accounted for separately, entities will then typically look to the standalone selling price to apportion the relevant amount of the transaction price to each distinct element in the contract.

This may change the profile of revenue recognition for some entities and, where an entity has a large volume of customer contracts, there may be some practical challenges to overcome in order to ensure systems are in place to deal with the new requirements.

Which costs relating to a contract will need to be capitalised?
In addition to more prescriptive guidance on revenue recognition, the new Standard introduces specific criteria for determining whether to capitalise certain costs, distinguishing between those costs associated with obtaining a contract (e.g. sales commissions) and those costs associated with fulfilling a contract. In the healthcare provider sector, this may be an issue where significant costs are incurred that are directly attributable to obtaining contracts with customers. At present, different entities might treat these costs differently. The new Standard will require entities to capitalise the costs of obtaining a contract which will have an impact on operating profits. In addition, the new Standard requires capitalised contract costs to be amortised on a systematic basis that is consistent with the pattern of transfer of the goods or services. Entities will need to exercise judgement to determine the appropriate basis and time period for this amortisation.

What else might change?
In addition to the key impacts discussed above, the new Standard introduces detailed guidance in many areas regarding the reporting of revenue and entities will need to ensure that they have considered all of these when assessing the extent to which their accounting policy for revenue may need to be amended.

More detailed information on the impact of IFRS 15 can be found in Deloitte's IFRS in Focus publication available from www.iasplus.com. Further industry publications are also available here.

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