AISMA and ICAEW Joint Statement

11 December 2020

Introduction

This statement has been prepared on behalf of AISMA and the ICAEW Healthcare Community to assist our members when discussing PCN statements of account issues with their clients.

Why is a PCN statement required?

- To provide a summary of transactions across the network for the relevant accounting period
- To enable the PCN member practices to reflect their share of those transactions correctly into their own practice accounts in order to meet the requirements of tax legislation for the completion of the partnership tax return

Understanding the tax treatment and application of UK GAAP: Income recognition

The general principle is that receipts which arise in the course of a trade should be recognised for tax purposes at the time that they are recognised in the trader's own accounts, so long as the accounts are drawn up in accordance with generally accepted accounting practice (GAAP), subject to any express or implied statutory rule to the contrary

Guidance on income recognition under GAAP is in section 23 of FRS102. The general approach is similar to the tax case law approach.

Section 23 of FRS102 sets out the following basic principles for revenue recognition:

- Revenue should be measured at the fair value of the consideration received or receivable.
- Revenue from the sale of goods should be recognised when the significant risks and rewards of ownership have been transferred to the buyer which in most, but not all, cases coincides with the transfer of legal title or possession.
- Revenue from the rendering of services and from construction contracts is recognised with reference to the stage of completion of the transaction at the end of the reporting period (where the outcome can be estimated reliably).

HMRC[i] states that income is generally earned when goods are provided, or services are performed. The timing of issuing bills, invoicing, or receiving payments does not determine when income should be recognised.

HMRC[ii] states that section 23 of FRS102 embodies the principle that income is recognised as it is earned, such that if the entity does not have to carry out any more actions to earn the revenue the income should be recognised.

Payments received in advance of work that is required to be done in order to have earned the income should not be recognised as receipts but should be treated as payments in advance or deferred income and matched with the costs that will be incurred when the work is done.

It is important therefore to understand when the income has been earned and whether the payment is conditional on some future event.

[i] HMRC's Business Income Manual section 31080

[ii] HMRC's Business Income Manual section 31115

For example, if the income is received under the terms of the 2019/20 NHS contract PCN Directed Enhanced Service which has no requirement for the practices/PCN to do anything beyond 31 March 2020 to ensure that the core £1.50 per patient income is earned then that income must be recognised in the year to 31 March 2020 even if it has not been spent on any specific activities at that time. The surplus falls into profit and becomes available working capital to be spent at some future date or to be distributed to the PCN members.

Understanding the tax treatment and application of UK GAAP: Expenditure provisions

[iii]A provision made in accounts will only be allowable for tax purposes if:

- It is in respect of allowable revenue expenditure and not in respect of capital expenditure
- It is in accordance with Generally Accepted Accounting Practice (GAAP).
- It does not conflict with any statutory rule governing the time at which expenditure is allowed.
- It is estimated with sufficient accuracy

Guidance on expenses provisions under GAAP in section 21 of FRS102 says that provisions must satisfy the definition of a liability: 'a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits'. Mere anticipation of future expenditure, however probable and no matter how detailed the estimate, is not enough in the absence of an obligation at the reporting date and provisions are defined as 'liabilities of uncertain timing or amount'.

Provisions should be made in the financial statements when and only when:

- the business is under a legal or constructive obligation at the reporting date as a result of a past event - a 'constructive obligation' is where as a result of 'an established pattern of past practice, published policies or a sufficiently specific current statement' the business has created a 'valid expectation' that it will meet certain responsibilities.
- it is probable that the business will be required to transfer economic benefits in settlement. Where a transfer of economic benefits is possible, but not probable, a provision should not be made but should be disclosed as a 'contingent liability' instead; and
- a reliable estimate of the amount of the obligation can be made.

FRS 102 therefore specifically prohibits provisions from being recognised in the financial statements in respect of future expenses and losses of which no obligation exists at the balance sheet date.

[iv]Unacceptable provisions

- Provisions where the only event that might require them is an unpublished decision of the partners/directors.
- In computing taxable profits no deduction may be made for the remuneration of employees unless that remuneration is paid (as defined for PAYE purposes) during the accounting period or within nine months of the end of the accounting period in relation to an obligation to make the payment that has been incurred prior to the year end.

When considering PCNs, any expenditure incurred by them after the 31 March 2020 reporting date cannot be brought into the pre- 31 March 2020 statement of account as a provision unless the PCN or its member practices had incurred a legal or constructive obligation prior to 31 March 2020 to subsequently incur that expense.

[iii] HMRC's Business Income Manual section 46510

[iv] HMRC's Business Income Manual sections 46535 and 46565

AISMA and ICAEW Joint Statement

11 December 2020

Contact details for further information:

Deborah Wood Chairman AISMA

deborah.wood@mooreandsmalley.co.uk

Mark Skellum Chairman ICAEW Healthcare Community

mark.skellum@ballardsllp.com