

# report

Paper CL 07 11 18 (b)

Board	CIPFA/LASAAC
Venue	CIPFA, Mansell Street, London
Date	6 November 2018
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Subject	IFRS 16 Leases Analysis of Readiness Assessment Questionnaire

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## **Purpose**

To consider the outcomes of the readiness assessment questionnaire.

## **1 Introduction**

- 1.1 CIPFA/LASAAC consulted on the adoption of IFRS 16 *Leases* from 22 May to 7 September 2018. In total there were 80 responses (listed in Appendix A of CL 07 11-18 (a)) to the public consultation on the draft 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) for IFRS 16.
- 1.2 The consultation papers also included a readiness assessment questionnaire to assist CIPFA/LASAAC in its understanding of the practical issues facing local authorities and demonstrate to CIPFA/LASAAC their level of preparedness. As the focus of the questionnaire is based on the local authority readiness then it is significant that only 68 local authorities provided some form of response to the questionnaire. The Secretariat would note that it is not sure how effective the questionnaires are in terms of some of the statistical information but has included it for information.
- 1.3 The Secretariat would note that the confidential respondents that were local authorities that included comments in their submissions for the readiness questionnaire have not been analysed as this has the potential to impact on their desire for the response to be treated confidentially. However, the Secretariat has reviewed the comments and the spirit of the responses is included in the analysis at Appendix A.

## **2 Identification of Contracts**

- 2.1 The analysis of the consultation responses indicates that the majority (51%) of respondents can identify their lease contracts. Approximately 20 respondents indicated that there was a central lease register in place (which is a positive starting point) but a number of authorities indicated that this register may be incomplete for the reasons included in Appendix A row 1.1. More concerning was that for some authorities a central lease register was not used though some respondents did refer instead to using an asset management system. The Secretariat would note that 21 per cent of respondents were not of the view it could identify contracts.

- 2.2 The Secretariat would note that the statistical information provided by respondents is interesting - see the relevant summary in Appendix A. The Secretariat would draw the Board's attention to the statistics on operating leases where the average number of leases was 135, with one authority having over a thousand leases. This is indicative of the potential work load involved.
- 2.3 The Secretariat would note that the information available for leases with other parts of the public sector was very limited (see rows 1C and 1D) with only 6 authorities indicating they had any finance leases with other parts of the public sector. This response appears slightly at odds with some of the commentary in the impact assessment.
- 2.4 The Secretariat would note that question 1E sought information on rent reviews and only seven respondents provided direct information on the length of the period for rent reviews. These are detailed in Appendix A row 1.E1. The Secretariat would note that there is some indication that some leases do not have rent reviews but also that this could only be confirmed by direct access to the lease itself.
- 2.5 Question 2 sought views on whether local authorities could identify leases within contracts. The largest number of responses at 41% indicated that they could. The Secretariat is of the view that this is because local authorities would rely on the information, processes and systems used under current standards. The Secretariat would note, however, that some respondents indicated that the scope of this assessment is now substantially larger with differing judgements under IFRS 16.

### **3 Lease Commitments**

- 3.1 The Secretariat would comment that there was a reasonable response rate ie 50% of respondents were content with the information they reported on lease commitments. This would be expected as the information is based on the requirements under IAS 17 *Leases*. Only 13% of respondents were of the view that they were not content. The comments provided by respondents were less sure that they would be able to provide relevant information under IFRS 16 and some respondents raised the issue of schools data collection.

### **4 Systems and Processes**

- 4.1 The Secretariat is of the view that the responses to questions 4 to 7 can be considered together as they focus on the systems and processes necessary to fully adopt IFRS 16.

#### *Question 4 - Systems and Processes – Contract Contains a Lease*

- 4.2 The largest number of respondents (32%) expressing a view indicated that the authority did have the systems and processes in place to assess whether the contract contains a lease. A number of respondents indicated that this was because of the current requirements of IFRS. More detail is provided in row 4.1 of Appendix A. Some respondents indicated that they had not yet assessed the position.

#### *Question 5 Systems and Processes – Judgements and Decisions*

- 4.3 The largest number of responses (29%) were not of the view that they had systems and processes in place to make the judgements and decisions under the

standard. The respondents providing comments indicated that they didn't have the data capture processes or the systems in place to identify all the information now required by the standard ie detailed information on restoration/dilapidations, contract extension/termination options, information for the estimating the authority's incremental borrowing rate, rent reviews etc.

#### *Question 6 - Systems and Processes – Reporting Requirements and Assessments*

- 4.4 The largest number of respondents expressing a view (31%) indicated that they did not think that their current systems would be able to meet the reporting requirements and assessments under IFRS 16. The majority of respondents providing comments indicated that whilst most considered the systems would be able to provide the current information requirements a number of systems used by local authorities (which were occasionally referred to by name) could not (yet) provide complete functionality to meet all of the reporting needs of IFRS 16.

#### *Question 7 - Systems and Processes – Low Value Leases*

- 4.5 The largest number of respondents (44%) indicated that they were of the view that they had the systems and processes in place to be able to take the accounting policy choice for low value leases. For more detail see rows 7.1 to 7.4 of Appendix A.

### **5 Communications and Training**

- 5.1 A significant majority of respondents (62%) indicated that they had not developed a communications strategy to train and inform key stakeholders of the impact of the changes. For further details see rows 8.1 to 8.3 of Appendix A.

### **6 Impact on Procurement Decisions**

- 6.1 The majority of respondents (51%) indicated that they had not yet considered the impact of the introduction of the standard on their procurement decisions. A number of local authority respondents indicated that they had robust procurement procedures with one indicating that the decisions were based on value for money and that they were therefore of the view that the procurement decisions would not change. See rows 9.2 to 9.4 of Appendix A for further details.

### **7 Impact on Capital Finance**

- 7.1 The largest number of respondents (46%) expressing a view indicated that they had not considered the impact of the adoption of the standard on its capital strategies and prudential indicators. A number of authorities had undertaken some form of assessment, although not all these were fully quantified. See rows 10.1 to 10.3 of Appendix A for further details.

### **8 Current Value Measurement of the Right-of-Use Asset**

- 8.1 The largest number of respondents expressing a view (37%) indicated that the authority did not have the systems, processes and information in place to meet the current value measurement requirements for the right-of-use assets. Some respondents indicated that they could not assess this until the Code's provisions were confirmed and were particularly concerned at what point the materiality levels would be established where current value measurement was required.

## **9 Overall Readiness Assessment**

- 9.1 The statistics for the overall readiness assessment were included in Appendix B of CL 07 11-18 (a) so that CIPFA/LASAAC could consider the question in relation to the effective date in more detail. Whilst the largest number of respondents (50%) agreed that they could achieve an implementation date of 2019/20 this does give some cause for concern. The Secretariat would highlight that some respondents indicating that they could make the effective date were of the view that there were cost and resource implications to this assessment. No authorities strongly agreed that they could make this date.
- 9.2 The Secretariat would also refer CIPFA/LASAAC to some of the commentaries of the authorities in rows 12.1 to 12.6 and particularly to the authority that strongly disagreed.

**CIPFA/LASAAC is invited to consider commentaries provided by local authorities to its readiness assessment questionnaire and the detail provided in Appendix A.**

## SUMMARY OF CONSULTATION RESPONSES

### Identification of Lease Contracts

Question	Yes	No	No Comment
1 Can the authority identify all its lease contracts?	35 (51%)	14 (21%)	19 (28%)
Question	Yes	No	No Comment
2 Can the authority identify all contracts that might contain leases across its departments?	28 (41%)	19 (28%)	21 (31%)

Question	Average	Max
1A i) How many finance leases does the authority have?	Number	Number
	25	260
ii) What is the carrying value of the finance lease assets held by the authority?	Carrying Value £'000	Carrying Value £'000
	10,880	237,424
iii) What is the total of future minimum lease payments at the 31 March 2018?	Minimum lease payments £'000	Minimum lease payments £'000
	10,552	161,456
iv) What is the average lease term <sup>1</sup> of the authority's finance leases?	Lease term	Lease term
	58	900
1B i) How many operating leases does the authority have?	Number	Number
	135	1,109
ii) What is the total of future minimum lease payments at the 31 March 2018?	Minimum lease payments £'000	Minimum lease payments £'000
	26,494	665,000
	Lease term	Lease term

<sup>1</sup> Note that lease term refers to the lease term from commencement of the contract

iii)	What is the average lease term <sup>2</sup> of the authority's operating leases?		
		33	456
1C i)	How many finance leases does the authority have with other public sector entities (including other local authorities)?	Number	Number
		0.31	5
ii)	What is the carrying value of the finance lease assets held by the authority with other public sector entities (including other local authorities)?	Carrying Value £'000	Carrying Value £'000
		10,300	NA
1D i)	How many operating leases does the authority have with other public sector entities (including other local authorities)?	Number	Number
		11	150
ii)	What is the total of future minimum lease payments at the 31 March 2018 with other public sector entities (including other local authorities)?	Minimum lease payments £'000	Minimum lease payments £'000
		978	9,700

Question	Yes	No	No Comment
1E In relation to the leases outlined above are they subject to rent reviews and if so how frequently do these take place on average for your lease portfolios? Please include commentary on frequency in the comments box below.	22 (32%)	7 (10%)	39 (58%)

	<b>Question 1(i) – Identify Contracts?</b>
1.11	Approximately 20 respondents indicated that they had some form of central lease register – particularly as they considered this necessary to comply with the current reporting requirements of IAS 17 <i>Leases</i> . A number of authorities were of the view that their systems would need to be augmented to ensure that they met all the reporting requirements of IFRS 16 <i>Leases</i> . A number of authorities were of the view that their lease register was incomplete for a number of reasons:

<sup>2</sup> Note that lease term refers to the lease term from commencement of the contract

	<ul style="list-style-type: none"> <li>▪ It held the main records for property, but records for plant and equipment were held by departments (there were a number of commentaries that other departments might hold separate lease information).</li> <li>▪ The difficulties of obtaining and verifying lease information from schools.</li> <li>▪ The authorities had yet to or were planning to ensure that information was up-to-date and correct.</li> <li>▪ Responsibilities for operating leases were not with the finance department.</li> </ul>
1.12	A number of authorities indicated that they did not have one central register for leases.
1.13	A number of authorities indicated that this information was not held on central registers but appeared to be indicating that it was held on asset management systems.
2.1	<p>One council commented:</p> <p><i>'The Council has identified, and accounts for, leases embedded in several of its existing contracts. Whilst it is believed that all significant contracts that might contain a lease have been identified, it is likely that it will be necessary to undertake further work to evidence completeness.'</i></p> <p>Two councils indicated that a manual process was required to identify leases embedded in contracts.</p> <p>A third authority commented that they could identify transactions although the scope is potentially much broader now.</p> <p>It noted that:</p> <p><i>'Our assessment process has previously ignored all leases with MLP &lt;£10k or with minimum lease terms not substantially all of the useful life of asset) – this approach may not be acceptable under IFRS16 and we anticipate a significant increase in the number of on balance sheet leases and on resources needed in order to account for thee (and especially to remeasure these).'</i></p>
	<b>Question 1E – Rent Reviews</b>
1.E1	<p>Only seven respondents provided any form of confirmation of the period between rent reviews. They commented:</p> <ul style="list-style-type: none"> <li>▪ The one property asset is subject to a rent review after the initial 25 years and then every 5 years thereafter.</li> <li>▪ The standard pattern for a c.10 year lease is 3 or 5 yearly from commencement, however, each lease could be subject to an alternative pattern as agreed by the parties e.g. every 20 years.</li> <li>▪ Five years is the most common frequency/ rent reviews are normally every five years.</li> </ul>

	<ul style="list-style-type: none"> <li>▪ Most Leases have either no review, a five yearly review or ten yearly review.</li> <li>▪ On average 4 yearly rent review periods.</li> <li>▪ Property operating leases are subject to rent reviews - every 5-10 years.</li> </ul> <p>So there is some substantial difficulty in being able to establish a pattern for local authority leases.</p>
1.E2	A number of respondents indicated that the information was not readily available to establish the time period for rent reviews. Others indicated that it was not possible to establish a pattern whilst some authorities noted that some leases did not contain rent reviews.

### Information on Lease Commitments

Question	Content	Not Content	No Comment
3 Is the authority content with the information it produces for its lease commitments for its operating leases?	34 (50%)	9 (13%)	25 (37%)

<b>Question 3– Information on Lease Commitments</b>	
3.1	Approximately eleven respondents providing comments appeared to indicate that they considered the information they currently provided to be at least materially accurate and enabled them to comply with the existing requirements of IAS 17.
3.2	A number of respondents were less sure that they had sufficient information to be able to meet all of the reporting requirements of IFRS 16. A small number of authorities referred to the difficulty in obtaining information on schools.
3.3	A number of authorities indicated that they were reassessing information and/or undergoing a review or data collection process.



## Systems and Processes – Contract Contains a Lease

Question	Yes	No	No Comment
4 Does the authority have the systems and processes in place to be able to assess whether a contract is or contains a lease?	25 (37%)	17 (25%)	26 (38%)

<b>Question 4 – Systems and Processes– Contract Contains a Lease</b>	
4.1	Approximately seventeen of the respondents commenting on this issue indicated that based on their current processes to assess whether a contract is or contains a lease (and the tests in current standards) they should be able to adapt the systems to meet the new requirements. A number of the respondents indicated that these assessments were for material leases (with some giving indicative values) and it might be the case that the materiality level may have to be reviewed. There were differing comments on the processes and systems in place with some respondents referring to manual desk top reviews, the participation of other departments, the use of flow charts and contracts registers etc.
4.2	Some of the respondents indicated that they had commenced reviews of the current processes to assess readiness and the effectiveness of current systems.

## Systems and Processes – Judgements and Decisions

Question	Yes	No	No Comment
5 Does the authority have the systems, processes and information in place to make the relevant judgements and decisions under the standard?	18 (27%)	20 (29%)	30 (44%)

<b>Question 5 – Systems and Processes – Judgements and Decisions</b>	
5.1	Most of the respondents commenting on this question appeared to be of the view that they did not currently have the data capture processes or the systems in place to identify all the information now required by the standard ie detailed information on restoration/dilapidations, contract extension/termination

	options, information for the estimating the authority's incremental borrowing rate, rent reviews etc.
5.2	A number of the respondents indicated that they had working groups or processes in place to start establishing the relevant information.
5.3	A number of authorities cited the problem of gaining the relevant information from schools.
5.4	A number of authorities whilst being of the view that the data was available noted the difficulties of data collection to retrieve it.

### **Systems and Processes – Reporting Requirements and Assessments**

Question	Yes	No	No Comment
6 Are the authority's systems and processes able to meet the reporting requirements and assessments under IFRS 16 (i.e. contract reassessment and modifications and ongoing reporting requirements)?	15 (22%)	21 (31%)	32 (47%)

	<b>Question 6 – Systems and Processes – Reporting Requirements and Assessments</b>
6.1	The majority of respondents providing comments indicated that whilst most considered the systems would be able to provide the current information requirements under IFRS, a number of systems used by local authorities (which were occasionally referred to by name) could not provide complete functionality to meet all of the reporting needs of IFRS 16.
6.2	A number of respondents indicated that they were still reviewing and assessing their systems and processes.
6.3	A number of respondents indicated that they also needed to be sure of the Code's final provisions on the adoption of IFRS 16 to be able to assess this.

## Systems and Processes – Low Value Leases

Question	Yes	No	No Comment
7 Does the authority have the systems, processes and information in place to take the relevant accounting policy choice in relation to low value leases?	30 (44%)	13 (19%)	25 (37%)

<b>Question 7 – Systems and Processes – Low Value Leases</b>	
7.1	A significant number of the respondents who commented indicated that they considered they would be able to use their de minimis for the assessment.
7.2	Some respondents were of the view that this would be more easy to assess if the Code was clearer on a threshold or its specifications for low value leases.
7.3	A number of respondents appeared to indicate that they did not yet have the systems and processes in place to identify low value leases.
7.4	Commentary also indicated that new information would be required from departments/directorates.

## Communications and Training

Question	Yes	No	No Comment
8 Has the authority developed a communications strategy to train and inform key stakeholders of the impact of the changes	8 (12%)	42 (62%)	18 (26%)

<b>Question 8 – Communications and Training</b>	
8.1	Approximately fifteen respondents indicated that this was 'to be developed' or commented that it had not yet been developed or that it was being developed/considered as it was awaiting further implementation details.

8.2	A smaller number of respondents indicated that general training of key stakeholders had taken place to date.
8.3	A few respondents indicated they would update stakeholders in accordance with their normal timescales for changes in accounting policy.

## Impact on Procurement Decisions

Question	Yes	No	No Comment
9 Has the authority considered the impact of the introduction of the standard on its procurement decisions?	10 (15%)	35 (51%)	23 (34%)

<b>Question 9 - Impact on Procurement Decisions</b>	
9.1	A number of local authority respondents indicated that they had robust procurement procedures with one indicating that the decisions were based on value for money and that they were therefore of the view that the procurement decisions would not change.
9.2	A number of respondents indicated that they still had to assess this.
9.3	Some respondents indicated that some discussions had taken place with procurement teams.
9.4	Other respondents indicated that this had yet to be completed and it was a part of their readiness assessment or project plan.

## Impact on Capital Finance

Question	Yes	No	No Comment
10 Has the authority considered the impact of the adoption of the standard on its capital strategies and prudential indicators?	16 (23%)	31 (46%)	21 (31%)

	<b>Question 10– Impact on Capital Finance</b>
10.1	A number of authorities had undertaken some form of assessment, although not all these were fully quantified. One authority indicated that it may cause issues for the Housing Revenue Account debt cap (note this issue is resolved for local authorities in England on issue of the revocation of the limits indebtedness determination on 29 October 2018).
10.2	A number of authorities indicated this was yet to take place and was a future part of their impact assessment. A number of respondents indicated that this assessment could not take place until the full implications of the approach in the Code was understood.
10.3	A number of authorities considered that this would be picked up as a part of their normal processes for setting prudential indicators. A police body commented:  <i>'We are aware of the impact and will be factoring this in to the next budget setting round. We are planning to vire budget from rental expenses to MRP to cover this.'</i>

### **Systems and Processes - Current Value Measurement**

Question	Yes	No	No Comment
11 Does the authority have the systems, processes and information in place to meet the current value measurement requirements for the right-of-use assets?	16 (23%)	25 (37%)	27 (40%)

	<b>Question 11 – Systems and Processes - Current Value Measurement</b>
11.1	A small number of respondents were of the view that their current value measurement procedures for property could be extended to subsequent measurement of the right-of-use asset. Some respondents indicated that they could not assess this until the Code's provisions were confirmed and were particularly concerned at what point the materiality levels would be established where current value measurement was required. Other respondents were concerned that this was more difficult for the right-of-use asset.
11.2	A small number of authorities raised the issue of this being a further increase to the reporting burden. Other authorities were concerned about the potential for increased information requirements.

11.3	A small number of respondents were of the view that this would be very difficult for non-property leases.
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### Overall Readiness Assessment

Question						
	Strongly Agree	Agree	Possibly	Disagree	Strongly Disagree	No Comment
12	0 (0%)	33 (50%)	14 (21%)	3 (4%)	3 (4%)	14 (21%)
<p>Does the authority consider that it will be able to implement the reporting requirements of IFRS 16 for the 2019/20 financial year, please insert the following:</p> <ul style="list-style-type: none"> <li>▪ Strongly agree</li> <li>▪ Agree</li> <li>▪ Neither agree nor disagree (possibly)</li> <li>▪ Disagree</li> <li>▪ Strongly disagree</li> <li>▪ (No comment)</li> </ul>						

<b>Question 12 – Overall Readiness by Effective Date</b>	
12.1	A number of respondents even those indicating that they could implement the standard by the anticipated reporting date did raise concerns about the additional 'significant cost' of adoption by the 2019/20 financial year. For example one authority commented:

	<i>'Whilst it is anticipated that we can implement the reporting requirements of IFRS 16 for the 2019/20 financial year, significant work will be required to meet this deadline, at additional cost...'</i>
12.2	A number of respondents indicated that it was important that they understood the Code's provisions fully before being able to respond to the question. Others indicated they had not been able to make a full assessment at the time of responding to the questionnaire.
12.3	A small number of respondents indicated it would be beneficial if the timing were delayed to allow time for lessons learnt from other adopters of the standard.
12.4	A respondent indicated that the:  <i>'earlier that finalised interpretation guidance is issued the easier the introduction will be for practitioners..'</i>
12.5	An authority commented:  <i>'Whilst being broadly supportive of the changes proposed the practical implications are significant and more information is required to fully understand how this will work. For these reasons we would strongly support deferring adoption for at least a year. Any decisions to defer would need to be made promptly as local authorities will need to start commissioning the additional work required if the proposals are implemented from 1 April 2019.'</i>
12.6	Another authority who strongly disagreed commented:  <ul style="list-style-type: none"> <li>i) <i>[the authority] has a substantial Property Portfolio, part of which is serviced by assets leased in but currently recognised as Operating Leases. Our Property based Assets are valued externally. IFRS 16 means all property based assets which are leased in will now have to be included in the Valuation Commissioning Document. This will increase the number of valuations (both actual site visits and desk-top/ beacon valuations) and hence increase the cost to the Council. In addition, it potentially means the external valuer might not be able to complete their valuations within our Closedown Timescale.</i></li> <li>ii) <i>we are currently without a Head of Property Services</i></li> <li>iii) <i>as a Unitary Authority, schools come within the scope of our Accounts. Most ICT related equipment used in schools e.g. computers, copiers etc. are leased in and currently treated as Operating Lease, so this will require a huge amount of additional work.</i></li> </ul>

	<p><i>iv) we have problems with our Asset Module Accounting System – which does not process certain asset related events in accordance with the Code. Adding Right of Use Assets will necessitate significant amendments to the Asset Accounting Model – to which we are dependent on an External Organisation for Support. At this point we have low confidence over their ability to make the necessary configurational changes.</i></p> <p><i>v) we have experienced significant problems with our External Auditors surrounding asset valuations, which meant the 16-17 and 17-18 SoA were not signed off within statutory deadlines. Our opening valuations for Right of Use Assets and the supporting evidence / workings will inevitably attract significant scrutiny and challenge from our Auditors. We have no confidence in their ability to plan, manage and resource their Audit and, consequently, there is a high risk our 18-19 SoA will not be signed off by 31 July 2019 and /or we will receive a non-standard Audit opinion on them.'</i></p>
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