

The 2019/20 Code of Practice on Local Authority Accounting in the United Kingdom

Consultation on IFRS 16 Leases

Invitation to Comment

Invitation to Comment

Introduction

1. Local authorities in the United Kingdom are required to keep their accounts in accordance with 'proper practices'. This includes, for the purposes of local government legislation, compliance with the terms of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code), prepared by the CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC). The Code is reviewed continuously and is issued annually.
2. Under the oversight of the Financial Reporting Advisory Board, CIPFA/LASAAC is in a position to issue mid-year updates to the Code. However, this will only be done in exceptional circumstances.
3. The edition of the Code that is applicable for a financial year is based on accounting standards in effect on 1 January prior to the start of the financial year. For the 2019/20 Code, this means that European Union (EU) adopted accounting standards with an effective date of 1 January 2019 or earlier will need to be taken into account.
4. This Invitation to Comment (ITC) sets out CIPFA/LASAAC's proposals for developing the new edition of the Code (the 2019/20 Code) to apply to accounting periods commencing on or after 1 April 2019 (Section B of this ITC) for IFRS 16 Leases as a single issue consultation. As there are a number of complex issues covered in this ITC it also contains an Executive Summary (Section A) which highlights the most significant issues which interested parties will need to consider. It is anticipated that the remaining changes to the 2019/20 Code will be included in the annual consultation in July 2018.

The Consultation Process

5. Where CIPFA/LASAAC is interested in specific issues, consultation questions have been included in the ITC. However, CIPFA/LASAAC also welcomes responses to individual questions or areas if these are of specific interest to an interested party and welcomes comments on any aspect of the draft 2019/20 Code in relation to leases or service concession arrangements. In order to assess comments properly CIPFA/LASAAC would prefer respondents to support comments with clear accounting reasons and, where applicable, preferred alternatives.
6. Responses to this Invitation to Comment will be regarded as on the public record and are required to be published on the CIPFA website unless confidentiality is specifically requested on the response form. If you require your response to be treated as confidential please indicate this clearly on the response itself. Copies of all correspondence and an analysis of responses will be provided to the Financial Reporting Advisory Board.
7. A copy of the Exposure Draft of the 2019/20 Code for the amendments resulting from the adoption of IFRS 16 in PDF format can be downloaded from the CIPFA website.
8. To assist interested parties in responding to the consultation, a response form (in Word format) is attached. We would be grateful if respondents to the consultation could use this form as this will speed up the analysis.
9. Responses are required by **7 September 2018** and may be sent to:

The Secretary

CIPFA/LASAAC Local Authority Accounting Code Board

Policy and Technical Directorate

CIPFA

77 Mansell Street

London

E1 8AN

Email: code.responses@cipfa.org

(For ease of handling, emailed responses using the Word document form provided are preferred.)

SECTION A – EXECUTIVE SUMMARY

IFRS 16 Leases

10. The International Accounting Standards Board (IASB) issued IFRS 16 *Leases* in January 2016. It supersedes IAS 17 *Leases* and its associated interpretations¹. The effective date of IFRS 16 is for reporting periods commencing on or after 1 January 2019. Subject to CIPFA/LASAAC's decisions on adoption, the standard will apply to the 2019/20 Code.
11. IFRS 16 has been developed with the aim of improving the financial reporting of leasing activities in light of criticisms that the previous accounting model for leases failed to meet the needs of users of financial statements. In particular it was felt that information reported around operating leases lacked transparency. Furthermore the existence of two different accounting models for leases, whereby assets and liabilities associated with leases were not recognised for operating leases but were recognised for finance leases, meant that transactions that were economically similar could be accounted for very differently.
12. A notable feature of IFRS 16 is that the lessee and lessor accounting models are asymmetrical. IFRS 16 removes the previous lease classifications of operating and finance leases for lessees and it requires that a right-of-use asset be recognised for all leases (there are exemptions for short-term and low value leases). However, for lessors the finance and operating lease classifications have been retained and the provisions in the standard for lessors are substantially unchanged.
13. IFRS 16 will have a substantial practical impact on local authority accounts preparers. It is likely that local authorities will need to consider both new or amended processes and systems and data collection processes to manage the information requirements on the adoption of the standard. Management will also need to make new judgements and decide on the most effective accounting policies for the production of the financial statements. The new standard will have impacts across the authority and it will be important that the changes are communicated to the authority's key stakeholders. It is likely to be the case that it will not just impact on financial reporting but also on local authority operational models.
14. IFRS 16 will mean that current value depreciation and interest is charged to the Surplus or Deficit on the Provision of Services. It will also impact on the statutory reporting and capital financing requirements for leased assets which currently refer to finance leases.
15. The recognition of the right-of-use asset will bring leases into the scope of the Prudential Framework. The cost (on initial recognition) of the right-of-use asset will meet the definition of capital expenditure in contrast to the current revenue treatment of operating leases.
16. This does not introduce any issues which need to be resolved by amendment to the Code. However, CIPFA/LASAAC is interested in any practical impacts that the new accounting arrangements might have in relation to:

¹ IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, SIC 15 *Operating Leases Incentives* and SIC 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

- whether operating leases in existence at the transition date meet the definition of capital expenditure
 - the impact on the Capital Financing Requirement (CFR) of recognising the right-of-use assets for all leases (particularly for the HRA in England)
 - the making of the Minimum Revenue Provision and the Statutory Repayment on Loans Fund Advances for the capital cost of the right-to-use asset.
17. Some of the impact on local authorities in relation to the capital financing implications has been clarified for English authorities in the new [Minimum Revenue Provision Guidance](#). Paragraph 43 extends the recommended treatment of finance leases to leases where the right of use asset is recognised on the balance sheet (when that accounting policy becomes applicable to local authorities) to extend the current approach for finance leases. The effect of the statutory guidance is such that the recommended approach for the MRP for leases where a right of use asset is recognised will be a top-up so that the aggregate charge to revenue for the lease will effectively be the annual lease payment. CIPFA and CIPFA/LASAAC are committed to working with both local authorities and the devolved administrations to ensure the effective adoption of IFRS 16 for local authorities.
18. CIPFA/LASAAC has created a sub group to consider the issues for the adoption of IFRS 16.

Scope

19. IFRS 16 applies to all leases except for contracts which are service concession arrangements specified in section 4.3 of the Code, licenses for intellectual property and rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets*.

Portfolio Application

20. The requirements for IFRS 16 are applied to individual leases. However, the Exposure Draft confirms that portfolio application may be applied in accordance with the application guidance in the standard.

Separation of Lease Components in a Contract

21. IFRS 16 includes a practical expedient by class of underlying assets that permits lessees to ignore the requirement to separate non-lease and lease components of a contract and account for the entire contract as a single lease component. The Exposure Draft includes this practical expedient and CIPFA/LASAAC is interested in determining whether there are any practical issues that arise from this approach.

Recognition Exemptions

22. IFRS 16 includes two recognition exemptions permitting entities not to apply the recognition, measurement and presentation requirements of the standard for lessees. The exemptions are for short-term leases and leases for which the underlying asset is of low value (the IASB provides an indicative value of

\$5,000²). CIPFA/LASAAC proposes adapting the Code to require local authorities to mandate the use of the short-term exemption.

Identifying a Lease

23. IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. Under the standard accounts preparers will need to assess whether a contract conveys the right to use the asset or is instead a contract for a service that is provided using the asset. The following issues will need to be considered:
- whether an identified asset is explicitly or implicitly specified in the contract
 - if an asset is specified in a contract, whether the supplier has a substantive right to substitute that asset
 - whether the asset specified in a contract is physically distinct
 - whether the customer has the right to obtain substantially all of the economic benefits and for service potential from use of the asset throughout the period of use
 - whether the customer has the right to direct the use of the asset throughout the period of use.

Lease Term

24. In order to determine the period over which the lease is accounted for the lease term needs to be assessed. The lease term is defined as the non-cancellable period of the lease together with both periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option and periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

Lessees Initial Recognition and Measurement

Initial Recognition

25. At the commencement date of the lease a lessee is required to recognise a right-of-use asset and a lease liability.

Initial Measurement of the Right-of-Use Asset

26. At initial recognition the right-of-use asset is measured at cost. The measurement of the right-of-use asset is initially directly related to the initial measurement of the lease liability with a number of potential adjustments.

Initial Measurement of the Lease Liability

27. At the commencement date the lease liability is initially measured at the present value of the lease payments payable over the lease term. This is discounted at the rate implicit in the lease. If the rate implicit in the lease cannot be readily determined, the lessee is required to use their incremental borrowing rate.

Lessees - Subsequent Measurement

² Note that this comment by the IASB is not a formal part of IFRS 16.

Subsequent Measurement of the Right-of-Use Asset

28. IFRS 16 permits a choice in measurement approach for items of property, plant and equipment (where an entity uses the revaluation model under IAS 16 *Property, Plant and Equipment*) to measure the right-of-use asset under the cost model or to apply the revaluation model under IAS 16. The Code's current approach for finance leases and CIPFA/LASAAC's view, generally held in the Code, is that subsequent measurement of assets for local authorities should be at current value, subject to cost/benefit considerations. The Exposure Draft of section 4.2 includes CIPFA/LASAAC's proposal to adapt the provisions of IFRS 16 and require that the subsequent measurement of the right-of-use asset for property, plant and equipment follows the measurement requirements in section 4.1 of the Code. CIPFA/LASAAC is seeking interested parties' views on this proposed adaptation, particularly in relation to cost/benefit considerations. It is also proposing to include either a materiality based approach to current value measurement (and is requesting information from local authorities on lease terms to facilitate this) or an approach based on information which is available without undue cost or effort.
29. HM Treasury in its consultation³ on IFRS 16 is also considering adapting the approach to measurement of the right-of-use asset and is focussing on similar issues to the proposed approach by CIPFA/LASAAC. HM Treasury recognises the difficulties inherent in the revaluation of the right-of-use asset and that the cost model in IFRS 16 is not the same as a depreciated historical cost measurement. It has proposed that as a practical expedient the cost model is used as a proxy for all items of property, plant and equipment. HM Treasury also recognises that some discussions have highlighted concerns over consistency of applying such a proxy, especially where assets may be held for their entire lease term and is seeking views on the approach to subsequent measurement in its consultation papers.
30. CIPFA/LASAAC is also seeking views from interested parties on which of the two options below best meet the needs of local government circumstances and provide an appropriate cost/benefit balance for the users of local authority financial statements:
- Option 1 – Subsequent measurement at current value with practical expedients applying to the lower value property, plant and equipment which allow the IFRS 16 cost model to be used as a proxy for current value for those lower value items (including an option related to undue cost or effort)
 - Option 2 –The approach proposed by HM Treasury ie that as a practical expedient the cost model is used as a proxy for all items of property, plant and equipment.

CIPFA/LASAAC would seek interested parties' views on the technical and practical merits of both options.

Subsequent Measurement of Investment Properties

31. The subsequent valuation of investment properties in the Exposure Draft follows the requirements of IFRS 16 ie if an entity applies the fair value model in IAS 40 *Investment Property* it is required to apply that fair value model to right-of-use assets that meet the definition of investment property in IAS 40. As local

³ [HM Treasury, IFRS 16 Leases: Exposure Draft](#)

authorities are required to follow the fair value model except in exceptional circumstances subsequent measurement of any leased assets which are investment properties will (normally) be at fair value.

Subsequent Measurement of the Lease Liability

32. After the commencement date subsequent measurement of the lease liability requires that a lessee:
- increases the carrying amount to reflect interest on the lease liability
 - reduces the carrying amount to reflect the lease payments made, and
 - remeasures the carrying amount to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease payments.

The Exposure Draft of the Code includes the subsequent measurement of the lease liability under IFRS 16 without adaptation.

Presentation

33. IFRS 16 requires that the right-of-use asset and the lease liability are presented separately in the Balance Sheet or in the notes. If the right-of-use asset or the lease liability is not presented separately in the Balance Sheet then IFRS 16 requires that the carrying amount of those items and the line items that they are reported in are disclosed in the notes. The Exposure Draft specifies that depreciation on the right-of-use asset should be recognised in the same way as for other assets in the relevant service lines and the interest expense on the lease liability is recognised with other financing costs in the financing and investment income and expenditure line in the Comprehensive Income and Expenditure Statement. The Cash Flow Statement also includes presentational changes to reflect the new reporting requirements in the standard.

Concessionary Leases – Lessees Only

34. CIPFA/LASAAC has followed the approach in the Exposure Draft issued by IPSASB⁴ in relation to concessionary leases as these provisions are based on accounting principles and treatments already included in the Code for 'soft' loans and non-exchange transactions.
35. CIPFA/LASAAC therefore proposes that the right-of-use asset for concessionary leases should be measured at fair value by discounting the market based lease payments using the market rates. It also proposes recognising a subsidy in accordance with IPSAS 23⁵ as income on the initial entry into the transaction; except that where a present obligation exists it is recognised as a liability. As an authority satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognised.
36. This is different to the approach proposed by HM Treasury in relation to leases provided at a peppercorn rent which focuses on measurement of the right-of-use asset in accordance with the Government's Financial Reporting Manual (FRM's) adoption of IAS 16. However it is not clear that this would mean that the reporting of such transactions would produce materially different outcomes.

⁴ [Exposure Draft 64, Leases](#)

⁵ IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*

Lessor Accounting

37. The lessor accounting model and classification tests remain substantially unchanged from those in IAS 17. Lessors are still required to split leases between finance and operating leases. Leases that transfer substantially all of the risks and rewards incidental to ownership of the underlying asset are finance leases; all other leases are operating leases.
38. There are two areas where there are changes from the approach under IAS 17:
- The structure of a sub-lease - under IAS 17 a sub-lease was classified with reference to the underlying asset. However, IFRS 16 requires the lessor to assess the sub-lease with reference to the right-of-use asset.
 - Sale and leaseback accounting – IAS 17 accounting requirements depended on whether the leaseback was an operating lease. For IFRS 16 the determining issue is whether the transfer of the asset qualifies as a sale in accordance with the requirements of IFRS 15 *Revenue from Contracts with Customers*.

The Use of the Lessor Accounting Model in IFRS 16

39. A small number of respondents to the early consultation on the Code did not agree with the approach to the lessor accounting model approach in IFRS 16.
40. The IPSASB in its consultation on leases⁶ is of the view that this could give rise to a number of practical issues that it considers are more prevalent in the public sector ie:
- consolidation issues - ie where the lessor and lessee are part of the Group Accounts and separate records need to be maintained for the underlying asset and lease receivable
 - understandability issues – ie due to different accounting models for the same transaction - it may be difficult for users of the financial statements to distinguish between a lease and the sale of an asset in lessor’s financial statements, and
 - asymmetrical information in the public sector – different recognition criteria for the same transaction distorts the analysis of the financial position of public sector entities.
41. CIPFA/LASAAC has raised the issue in this ITC to highlight the IPSASB proposals. However, at this juncture these proposals are not included in the Exposure Draft of the Code as the IPSASB does not intend to issue its final standard on leases until June 2019.

Disclosure Requirements

42. Overall the disclosure requirements have increased under IFRS 16. The Standard has introduced a disclosure objective which gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee and lessor. This includes additional disclosures for the right-of-use asset, depreciation charges and interest expense on the lease liabilities and disclosures on the exemptions for recognition

⁶ [Exposure Draft 64, Leases](#)

(ie low value and short-term leases). IFRS 16 also requires a lessor to provide some additional disclosures to enable users of financial statements to better evaluate the uncertainty of cash flows associated with the lessor's leasing activities.

Transition

Definition of a Lease

43. IFRS 16 offers entities the option of applying a practical expedient for the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:
- to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and IFRIC 4
 - not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

CIPFA/LASAAC has mandated this transition approach and would seek the views of interested parties on this issue.

Approach to Transition

44. IFRS 16 provides for two approaches to transition ie to apply the Standard:
- retrospectively with full retrospective restatement (following the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*)
 - retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application (for local authorities - 1 April 2019) as an adjustment to reserves (retained earnings) – preceding year information is not restated.
45. CIPFA/LASAAC proposes mandating the second option in the Exposure Draft of the Code as this option will reduce the reporting burden for local authorities on transition.
46. For leases previously classified as operating leases the standard provides options for measuring the right-of-use asset. The option proposed by CIPFA/LASAAC in the Exposure Draft of the Code is to use an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet before the date of initial application. CIPFA/LASAAC has made this choice for cost/benefit reasons.
47. IFRS 16 also includes a number of practical expedients for measurement under the cumulative catch-up retrospective approach to transition. CIPFA/LASAAC proposes mandating two of those practical expedients and again is seeking views on this issue.

Consequential Amendments - Service Concession Arrangements (PFI/PPP Arrangements)

48. Section 4.3 of the Code (Service Concession Arrangements: Local Authority as Grantor) requires the measurement of a service concession arrangement liability

to follow the provisions for a finance leases in section 4.2 of the Code and IAS 17. As IAS 17 will no longer be an extant standard CIPFA/LASAAC proposes changing the service concession arrangement liability measurement to that of IFRS 16. This is a similar measurement approach ie the liability is measured on an amortised cost basis. However, CIPFA/LASAAC would note that IFRS 16 requires that where there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review, the lessee is required to remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (ie when the adjustment to the lease payments takes effect). This would mean where PFI contract payments are increased (annually), for example, by RPI that the liability would need to be remeasured.

49. CIPFA/LASAAC considers an alternative might be to retain the current IAS 17 provisions in section 4.3. This would retain the economic effect of the current measurement provisions for service concession arrangements (PFI/PPP). CIPFA/LASAAC would seek interested parties' views on the approach to the measurement of service concession arrangement liabilities under the standard.

Impact on the Group Accounts

50. IFRS 16 has implications for the Group Accounts of local authorities. UK GAAP does not yet use the IFRS 16 approach for accounting for lessees. Local authority Group Accounts will therefore need to align their accounting policies and recognise and measure the right-of-use asset for leases held by the Group in accordance with the requirements of the Code. This may have practical issues for local authority accounts preparers.
51. As IFRS 16 accounting requirements are not symmetrical, there is a single classification model for lessees whilst for lessors the dual model retains the finance and operating lease split. Therefore for intra-group leasing arrangements the right-of-use assets will need to be eliminated on consolidation.

Effective Date

52. IFRS 16 was adopted by the European Union in December 2017. The Code applies EU adopted IFRS. This means that CIPFA/LASAAC currently expects to follow the process for application of the new Standard consistent with the rest of the public sector and therefore the new standard will be applied in local government in the 2019/20 Code and have an effective date of 1 April 2019.

Full List of Questions Included in the Consultation

IFRS 16 Leases

Recognition Exemptions

- Q1 Do you agree with CIPFA/LASAAC's proposal to mandate the recognition exemption for short-term assets? If not, why not? What alternatives do you suggest?
- Q2 Do you agree with CIPFA/LASAAC's approach to low value assets in the Exposure Draft? If not, why not? What alternatives do you suggest?

Identifying a Lease

Q3 Do you agree with the approach in the Exposure Draft to identifying a lease? If not, why not? What alternatives do you suggest?

Q4 Are there any practical issues that arise under IFRS 16 on identifying a lease? If so, what are they?

Initial Recognition and Measurement

Q5 Do you agree with the approach in the Exposure Draft to the initial measurement of the right-of-use asset and the lease liability? If not, why not? What alternatives do you suggest?

Q6 Do you have any commentary on the approach to determining the interest rate implicit in the lease or the authority's incremental borrowing rate?

Subsequent Measurement

Q7 a) Which approach to the subsequent measurement of the right-of-use asset summarised in paragraph 106 do you consider best reflects local government's measurement of the right-of-use asset ie:

- option 1 - current value measurement with materiality based practical expedients or
- option 2 - HM Treasury proposal as a practical expedient, to adopt the IFRS 16 cost model for lessees as a proxy for the revaluation model?

Please set out the technical financial reporting and the practical issues relating to your response.

Q7 b) If you consider option 1 to be a viable option, which approach do you prefer ie the materiality based approach to current value measurement (see paragraphs 98 to 99) or the approach which relies on information which is available without undue cost or effort (see paragraph 100)? Please provide the reasoning for your response.

Q8 Do you agree with CIPFA/LASAAC's approach to the subsequent measurement of the lease liability? If not, why not? What alternatives do you suggest?

Concessionary Leases – Lessees Only

Q9 Do you agree with CIPFA/LASAAC's approach for accounting for concessionary leases for lessees? If not, why not? What alternatives do you suggest?

Lessor Accounting

Q10 Do you agree with CIPFA/LASAAC's approach for accounting for lessors? If not why not? What alternatives do you suggest?

The Use of the Lessor Accounting Model in IFRS 16

Q11 Do you agree that CIPFA/LASAAC should retain the dual lessor accounting model (ie which maintains the operating and finance lease split) in the Code? If yes, why? If not why not? What alternatives do you suggest?

Sale and Leaseback Transactions

Q12 Do you agree with CIPFA/LASAAC's approach for sale and leaseback transactions? If not why not? What alternatives do you suggest?

Transition

Q13 Do you agree with CIPFA/LASAAC's approach to the definition of a lease on transition? If not, why not? What alternatives do you suggest?

Q14 Do you agree with CIPFA/LASAAC's approach to retrospective transition? If not why not? What alternatives do you suggest?

Q15 Do you agree with CIPFA/LASAAC's proposal in relation to the transitional approach to measuring the right-of-use asset for those assets previously classified as operating leases? If not why not? What alternatives do you suggest?

Q16 Do you agree with CIPFA/LASAAC's approach to the practical expedients on transition? If not, why not? What alternatives do you suggest?

Consequential Amendments – Service Concession Arrangements (PFI/PPP Arrangements)

Q17 Do you agree with CIPFA/LASAAC's proposals for the consequential amendments to the measurement of service concession arrangement (PFI/PPP) liabilities or do you consider that the current approach to measurement (ie the IAS 17 measurement as a finance lease) should be retained? If you agree, why do you agree? If not, why not? What alternatives do you suggest?

Effective Date

Q18 Do you agree with the proposed effective date for public sector implementation of IFRS 16? If yes, why? If not, why not? What alternatives do you suggest?

Further Guidance

Q19 Are there any areas within the Code in relation to IFRS 16 where additional guidance would be helpful?

SECTION B – 2019/20 CODE RELATING TO THE ADOPTION OF IFRS 16 LEASES – DETAILED DISCUSSION

IFRS 16 Leases

Introduction and Background

53. The International Accounting Standards Board (IASB) issued IFRS 16 *Leases* in January 2016. It supersedes IAS 17 *Leases* and its associated interpretations⁷. The effective date of IFRS 16 is for reporting periods commencing on or after 1 January 2019. Subject to CIPFA/LASAAC's decisions on adoption, the Standard will apply to the 2019/20 Code.
54. The introduction of the new Standard arose out of concerns raised by investors about the lack of transparency of leasing obligations. Under IAS 17 leased assets were recognised when a lease is economically similar to purchasing the asset being leased; such leases were classified as finance leases. All other leases were classified as operating leases and were not recognised in the balance sheet. The lack of information on operating leases meant that investors and analysts did not have a complete picture of the financial position of the company. IFRS 16 addresses this issue.
55. IFRS 16 removes the previous classifications of operating and finance leases under IAS 17 for lessees. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing the lessee's obligation to make lease payments for the asset.
56. The provisions in IFRS 16 relating to lessors remain substantially unchanged from IAS 17. Lessors continue to account for leases as either operating or finance leases depending on whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset. This distinction is no longer relevant to lessees and means that the approach to the two models in the standard is asymmetrical. This will also have implications for the Group Accounts of local authorities.
57. IFRS 16 will have a substantial practical impact on local authority accounts preparers. It will change reports of both financial position and financial performance in the financial statements of local authorities. Local authorities need to ensure that they make effective preparations for the implementation of the standard and will need to ensure that they have adequate governance arrangements in place. It is likely that local authorities will need to consider both new or amended processes and systems and data collection processes to manage the information requirements. Management will also need to make new judgements and decide on the most effective accounting policies for the production of the financial statements. IFRS 16 will impact across the authority and it will be important that the changes are effectively communicated to its key stakeholders. It is likely to be the case that it will not just impact on financial reporting but also on local authority operational models.

⁷ IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, SIC 15 *Operating Leases Incentives* and SIC 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

58. CIPFA/LASAAC established a sub group to assist in the preparation of the ITC and Exposure Draft and consider the implications for local authorities of the adoption of IFRS 16. CIPFA/LASAAC would take this opportunity to express its gratitude to the sub group for its consideration of the issues raised in the ITC.

Scope

59. IFRS 16 applies to all leases except for contracts which are service concession arrangements specified in section 4.3 of the Code, licenses for intellectual property and rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets*. Paragraph 4.2.1.2 of the Exposure Draft sets out that leases to explore the use of minerals, oil, natural gas etc and leases of biological assets are outside the scope of section 4.2 but notes that such leases are unlikely to apply to local authorities. Paragraph 4.2.1.3 allows lessees to apply section 4.2 to leases of intangible assets (other than those intangible assets held under licensing agreements in accordance with the requirements of IFRS 16). The Exposure Draft has therefore maintained the approach in IFRS 16 to the scope of the Standard without adaptation.

Portfolio Application

60. The requirements for IFRS 16 are applied to individual leases. However, the application guidance in paragraph B1 includes a practical expedient to allow the Standard to be applied to a portfolio of leases with similar characteristics. This is provided that it is reasonably expected that effects on the financial statements of using the practical expedient will not differ materially from applying IFRS 16 to individual leases in that portfolio. The principle of portfolio application has been included explicitly in the Exposure Draft of section 4.2 of the Code to confirm that local authorities may use this practical expedient.

Separating Lease Components in a Contract

61. Contracts may sometimes contain lease and non-lease components with a supplier (for example, the lease of refuse lorries and their maintenance). IFRS 16 requires that the lease components are accounted for separately from non-lease components. IFRS 16, however, includes a practical expedient by class of underlying assets and permits lessees to ignore the requirement to separate non-lease and lease components and account for the entire contract as a single lease component. CIPFA/LASAAC and the CIPFA/LASAAC sub group consider a local authority is best placed, taking into account its own circumstances and reporting needs, to decide whether it wants to adopt this practical expedient. CIPFA/LASAAC therefore does not propose to adapt the Standard in this area and has retained the practical expedient but it is interested in whether there are any practical or application issues in this area for local authorities.

Recognition Exemptions

62. IFRS 16 includes two recognition exemptions permitting entities not to apply the recognition, measurement and presentation requirements of the standard for lessees. The exemptions are for short-term leases and leases for which the underlying asset is of low value.

Short-term Leases

63. Short-term leases are defined as leases that, at the commencement date, have a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease. CIPFA/LASAAC is of the view that the majority of local

authorities would apply the short-term exemption. Therefore to reduce the decision making requirements for accounts preparers in applying IFRS 16 it proposes to mandate the use of this exemption. It is seeking interested parties' views on this approach. This is consistent with the proposed approach of HM Treasury in the Government's Financial Reporting Manual (the FReM)⁸.

64. There are transitional reporting reliefs for leases for which the lease term ends within 12 months of the date of initial application (1 April 2019). From a consistency basis CIPFA/LASAAC has also mandated that these are treated as short-term leases, again this is consistent with the anticipated approach in the FReM.

Low Value Leases

65. IFRS 16 does not provide a definition of low value leases. It confirms that the assessment of the value of the asset is based on the asset when it is new and on an absolute basis ie this is regardless of the volume of transactions of a particular asset. The basis of conclusions for the standard, paragraph BC100 sets out that the IASB '*had in mind leases of underlying assets with a value, when new, in the order of magnitude of US \$5,000 or less*'⁹. The application guidance provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones.
66. IFRS 16 also sets out that leases of low value apply regardless of whether the leases are material to the lessee. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis. Paragraph 4.2.2.31 of the Exposure Draft includes the key elements of the application guidance in paragraphs B3 to B8 of IFRS 16 to assist local authorities in determining whether the underlying asset is of low value. CIPFA/LASAAC is seeking views on the approach in the Exposure Draft.

Low Value Leases – Application Issues

67. A number of respondents to the early consultation raised the issue of materiality and use of the de minimis. IFRS 16 is clear that the assessment of which assets qualify is to be made regardless of whether the lease is material to the particular lessee (IFRS 16 paragraph B4). It would subsequently be a decision for the authority on how it applied materiality and any de minimis to right-of-use asset recognition. However, this decision should be no different to other de minimis decisions made by local authorities.

Recognition Exemptions	
Q1	Do you agree with CIPFA/LASAAC's proposal to mandate the recognition exemption for short-term assets? If not, why not? What alternatives do you suggest?
Q2	Do you agree with CIPFA/LASAAC's approach to low value assets in the Exposure Draft? If not, why not? What alternatives do you suggest?

⁸ See [HM Treasury, IFRS 16 Leases: Exposure Draft](#).

⁹ Note that the IASB included this commentary as a part of the Basis of Conclusions – this is not a part of the Standard and therefore will not feature in the provisions of the Code.

Identifying a Lease

68. IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. Under the Standard accounts preparers will need to assess whether a contract conveys the right to use the asset or is instead a contract for a service that is provided using the asset.
69. At the inception of the contract IFRS 16 requires a local authority to assess whether a contract is or contains a lease. A contract is or contains a lease if the contract conveys the right to use an identified asset in exchange for consideration. The following paragraphs (70 to 77) highlight the key issues to be considered when assessing whether a contract is or contains a lease.

Explicitly or Implicitly Specified in the Contract

70. To be an identified asset the asset must be specifically identified in the contract. This may be either:
- explicitly specified in the contract (for example, by means of a serial number or other form of marking or identification of the asset), or
 - implicitly specified at the time that the asset is made available for use by the customer (for example, where only one asset is capable of being used to meet the contract terms).
71. The need to assess whether an asset is specified in a contract will apply to local authorities. It is recommended that local authorities particularly review their outsourcing contracts including finance and IT contracts and other types of contracts, for example, in the use of data centres, waste management, property and grounds maintenance, fleet and highways vehicles, and business equipment.

Substantive Right to Substitute an Identified Asset

72. IFRS 16 sets out that even if an asset is specified in the contract as set out in paragraph 70 a customer does not have the right to use the identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. Substitution rights are substantive if:
- the supplier has the practical ability to substitute the asset (for example, if alternative assets are readily available and the customer cannot prevent the substitution, this may be the case for authorities that lease fleet items of the same specification), and
 - the supplier would benefit economically from the substitution (ie the economic benefits of the substitution exceed the costs).
73. It should be noted that IFRS 16 does not intend that the evaluation of whether the supplier would benefit economically from the substitution should be onerous. Paragraph B19 confirms that if the customer cannot readily determine whether the supplier has a substantive substitution right, the customer is required to presume that any substitution right is not substantive.

Portions of Assets

74. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or a portion of an asset that is not

distinct is not an identified asset (for example, a capacity portion of a fibre optic cable) unless it represents substantially all of the capacity of the asset. However, if the number of fibres to be used in a fibre optic cable is specified in the contract throughout the duration then this could be deemed to be physically distinct.

Right to Control the Use

75. To assess whether the customer controls the use of the identified asset it must assess whether the contract conveys throughout the period of use the right to obtain substantially all the economic benefits and service potential from the use of the asset and the right to direct the use of the identified asset. It is important to note that the Exposure Draft of the Code in line with the approach in the rest of the Code in relation to the definition of an asset also includes reference to service potential as well as economic benefits (see paragraph 4.2.2.35 Code Exposure Draft).
76. To control the use of an identified asset a customer must have the right to obtain substantially all the economic benefits and service potential from the use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout the contract term). Economic benefits and service potential include the primary outputs from the asset and by-products (including potential cash flows).
77. A customer has the right to direct the use of an identified asset throughout the period of use if:
- the customer has the right to direct how and for what purpose the asset is used throughout the period of use (ie if the customer has decision making rights that can change how and for what purpose the asset is used throughout the period - for example, rights to change the type of output that is produced), or
 - the relevant decisions about how and for what purpose the asset is used are predetermined, and
 - the customer has the right to operate the asset throughout the period of use, without the supplier having the right to change those operating instructions, or
 - the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.
78. CIPFA/LASAAC and the sub-group do not propose adapting or interpreting IFRS 16 in any way in relation to the identification of the lease and have only included some of the application guidance on this issue in the Code to exemplify CIPFA/LASAAC's views on service potential. CIPFA/LASAAC would seek interested parties' views on this approach as outlined in the Exposure Draft. CIPFA/LASAAC would also note that this is an area where management may need to make decisions and/ or make appropriate judgements and local authorities will need to ensure they have the relevant information to take those decisions.

Identifying a Lease

Q3 Do you agree with the approach in the Exposure Draft to identifying a lease? If not, why not? What alternatives do you suggest?

Q4	Are there any practical issues that arise under IFRS 16 on identifying a lease? If so, what are they?
----	---

Lease term

79. In order to determine the period over which the lease is accounted for the lease term needs to be assessed. The lease term is defined as the non-cancellable period of the lease together with both periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option and periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
80. In making the assessment of whether the lessee is reasonably certain to take-up an option IFRS 16 sets out that all facts and circumstances creating an economic incentive for the lessee to exercise the option must be considered, and provides some examples of such factors in paragraph B37 of IFRS 16. They include, for example, significant leasehold improvements undertaken over the terms of the contract that are expected to have significant economic benefits for the lessee when the option to extend, or terminate or to purchase the underlying asset becomes exercisable or the importance of the underlying asset to the lessee's services.
81. Once established the lease term is only revised for accounting purposes in accordance with the limited circumstances outlined in paragraph 4.2.2.40 of the Exposure Draft.

Lessees - Initial Recognition and Measurement

Initial Recognition

82. At the commencement date of the lease a lessee is required to recognise a right-of-use asset and a lease liability.

Initial Measurement of the Right-of-Use Asset

83. At initial recognition the lease asset is measured at cost. The measurement of the right-of-use asset is initially directly related to the initial measurement of the lease liability with a number of potential adjustments including:
- any lease payments made at or before the commencement date, less any lease incentives received
 - any initial direct costs incurred by the lessee, and
 - an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease.
84. The initial measurement of the right-of-use asset is similar to the requirements for initial measurement of assets under IFRS and so should not raise substantial issues for local authorities. This is with the exception of the requirement to restore the asset to the condition required by the terms and conditions of the lease. CIPFA/LASAAC is interested in whether there are any practical application issues that might arise.

Initial Measurement of the Lease Liability

85. At the commencement date the lease liability is initially measured at the present value of the lease payments payable over the lease term. This is discounted at the rate implicit in the lease. If the rate implicit in the lease cannot be readily determined, the lessee is required to use its incremental borrowing rate.
86. The components of the lease liability include:
- fixed payments (including in substance fixed payments) less any lease incentives receivable
 - variable lease payments that depend on an index or a rate
 - amounts payable under residual value guarantees
 - the exercise of a purchase option if the lessee is reasonably certain to exercise the option, and
 - payments of penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease.

The measurement of the lease liability excludes payments made before the commencement date.

87. CIPFA/LASAAC considers that local authorities' leasing arrangements are likely to be subject to both variable and fixed payments. It is interested in any commentary that interested parties might have on the components of the lease liability.
88. Information from the private sector indicates that for many entities (particularly on initial application of IFRS 16) it will be difficult to identify the interest rate implicit in the lease and therefore a company's incremental borrowing rate will need to be used. CIPFA/LASAAC and its sub group consider that this may be the case for local authorities.
89. In theory this is not a new issue as the definition of the incremental borrowing rate is the same as the accounting requirements for finance leases in IAS 17. However, a relevant incremental borrowing rate will be based on a rate that would have to be paid in borrowing funds over a similar term and with a similar security to acquire an asset of a similar value in a comparable economic environment. Therefore this should vary across what is anticipated to be a wider range of different types of assets that local authorities hold under operating leases.
90. The early consultation on the approach to adoption of IFRS 16 raised the issue of the incremental borrowing rate. Some respondents considered that the relevant PWLB rate was an appropriate rate to use as this was considered to be the cost of borrowing to an authority. Another group of respondents considered that use of the PWLB rate was 'borderline' or might only be reasonable and appropriate in certain circumstances. One respondent considered that it was not appropriate because it *'is the rate that a lessee would be required to pay on a loan to acquire the same property that is being leased. This could be a secured or unsecured loan or a mix'*. It should be noted also that the IASB decided to define the lessee's incremental borrowing rate to take into account the terms and conditions of the lease. The IASB provided relevant examples of the rate in its basis of conclusions ie a rate that a lessee has paid, or would pay, to borrow money to purchase the

type of asset being leased, or the property yield when determining the discount rate to apply to property leases. The IASB noted that the lessee should adjust such observable rates as is needed to determine its incremental borrowing rate as defined in IFRS 16 (see Basis of Conclusions BC162).

91. Although an issue for application guidance CIPFA/LASAAC is interested in any comments that interested parties may have on whether local authorities will need to use the option in the Standard in relation to the use of the incremental borrowing rate and the practicalities of identifying this rate across an authority's portfolios of leased assets.

Leases at No Cost or Nominal Value

92. Where an asset is leased to an authority at no cost or at nominal values an authority will need to assess the substance of the transaction and whether an asset is donated to the authority.

Initial Recognition and Measurement	
Q5	Do you agree with the approach in the Exposure Draft to the initial measurement of the right-of-use asset and the lease liability? If not, why not? What alternatives do you suggest?
Q6	Do you have any commentary on the approach to determining the interest rate implicit in the lease or the authority's incremental borrowing rate?

Lessees - Subsequent Measurement

Subsequent Measurement of the Right-of-Use Asset

93. Currently subsequent measurement of leased property, plant and equipment is covered by the provisions of section 4.1(Property, Plant and Equipment) of the Code in accordance with the requirements of IAS 16, paragraph 4.

'For example, IAS 17 Leases requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard [IAS 16].'

94. IFRS 16 permits a choice in measurement approach for items of property, plant and equipment (where an entity uses the revaluation model under IAS 16 *Property, Plant and Equipment*) to measure the right-of-use asset under the cost model or to apply the revaluation model under IAS 16. The Code's current approach for finance leases and CIPFA/LASAAC's view, generally held in the Code, is that subsequent measurement of assets for local authorities should be at current value subject to cost/benefit considerations. The Exposure Draft of section 4.2 includes CIPFA/LASAAC's proposal to adapt the provisions of IFRS 16 and require that the subsequent measurement of the right-of-use asset for property, plant and equipment follows the measurement requirements in section 4.1 of the Code.
95. CIPFA/LASAAC is particularly keen to understand the practical consequences of this proposal and to assess its costs and benefits, as this will mean the

measurement of more and different types of assets as well as those assets that are currently accounted for as finance leases (which would currently be measured in accordance with the requirements of section 4.1 of the Code).

96. Assets that were held previously under operating leases are less likely than finance leases to have a material value. CIPFA/LASAAC is of the view that for some of the classifications of leased property, plant and equipment the proxy included in paragraph 4.1.2.32 of the Code for local authorities to use depreciated historical cost for low value/short-life assets will also be able to be used for the subsequent measurement of the right-of-use asset¹⁰. Also it will mean measurement of assets for only a portion of their economic life and local authorities will need to discuss the consequences of this for the current value measurement of the right-of-use asset with their valuers. It is likely that the measurement for current operating leases of property will require that specific instructions and assumptions will have to be provided to the valuers.
97. The measurement of any (current) operating leases of land may also require specific assumptions to be established for the valuer as it will be difficult to demonstrate and measure the amount of the underlying asset that will be consumed by the authority. However, CIPFA/LASAAC's sub group is of the view that an approach to measurement based on the discounted cash flows of the rental stream might be a suitable measurement approach.
98. CIPFA/LASAAC is also concerned about the cost/benefit balance for the measurement of the current value of the right-of-use asset. It is therefore seeking ways to ensure that the provisions in the Code provide an appropriate balance. CIPFA/LASAAC is seeking to develop an approach which maintains CIPFA/LASAAC's principle that non-current assets should be measured at current value, but which is also proportionate and still meets the needs of the users of local authority financial statements. CIPFA/LASAAC is proposing that the Code would adopt a measurement principle which is based on the materiality approach for low value/short life assets included in section 4.1 of the Code ie that depreciated historical cost is used as a 'proxy' for current value. The materiality approach would principally apply to leased property assets (as CIPFA/LASAAC considers that the proxy would normally apply to plant and equipment assets).
99. CIPFA/LASAAC therefore proposes an approach under which longer-term property leases (which would have previously been finance leases) should continue to be measured at current value whilst short-term property leases (which would have previously been operating leases) could use the proxy approach in section 4.1 of the Code and be measured at depreciated historical cost (using the cost model under IFRS 16) on a rebuttable presumption that this materially represents the current value of the asset. This is supported by the fact that the longer the lease the higher the value of the underlying asset is likely to be. CIPFA/LASAAC is therefore seeking evidence from the consultation to establish the length of those longer-term leases to be measured at current value. For example, the starting point might be property leases with a lease term of 25 years and above being measured at current value whilst leases of property below this lease term would use the proxy the cost model for current value. CIPFA/LASAAC would therefore seek information from local authorities on the average term of their finance leases and the average term of their operating leases. This question is included in the readiness assessment questionnaire (see questions 1A and 1B).

¹⁰ It should be noted that low value short life assets relate to the materiality threshold relevant to the individual authority and this is a different concept to low value leases under IFRS 16.

100. An alternative to this approach also being considered by CIPFA/LASAAC is that an authority will be required to measure the right-of-use asset at current value if the information needed to measure the asset is available to the authority without undue cost or effort. If the right-of-use asset cannot be measured at current value without undue cost or effort, CIPFA/LASAAC proposes that the right-of-use asset is measured under the cost model as a proxy for current value. This should ensure that only those right-of-use assets that are material to the authority are formally valued.
101. It is anticipated that local authorities will already have a level of understanding of the value of the economic benefit and/or service potential of the lease to its operations as this would be assessed in any cost/ benefit analysis undertaken as a part of an authority's material procurement decisions on entering into the lease and monitoring of its continuing effectiveness.
102. CIPFA/LASAAC is aware that HM Treasury is considering very similar issues and approaches under its consultation on the FReM's adoption of IFRS 16 (see HM Treasury consultation for further details¹¹). The HM Treasury consultation points out that the cost model in IFRS 16 is different from the cost model in IAS 16:
- IAS 16 requires the asset to be carried at cost less accumulated depreciation and impairment
 - IFRS 16 requires the asset to be carried at cost (the value of the lease liability with certain adjustments) less any accumulated depreciation (IAS 16), impairment losses (IAS 36 *Impairment of Assets*), and any adjustments for the re-measurement of the lease liability. Adjustments for re-measurement include changes in lease term, and changes in future lease payments resulting from a change in an index or a rate used to determine those payments, including, for example, a change to reflect changes in rental rates following a market rent review.
103. The HM Treasury consultation paper also comments that discussions with valuers have found that the most common way to value leased assets is by comparing the current rent to an equivalent market rate. Characteristics such as asset type, space occupied, lease term, upcoming rent reviews etc. are all considered by valuers when making their assessments. The consultation paper highlights that it may be significantly challenging to revalue right-of-use non-property assets using indices without disproportionate cost and effort.
104. As a practical expedient, HM Treasury proposes to adopt the IFRS 16 cost model for lessees as a proxy for the revaluation model adapted in the FReM under IAS 16. This is on the basis that leases provided by the private sector are generally constructed on market terms and contain regular rent reviews. This is in line with best practice per the Royal Institution of Chartered Surveyors Code for leasing business premises in England and Wales (2007). As such, both the asset and liability would be subjected to regular re-measurement and may be considered a proxy to undertaking formal professional valuations.
105. However, the HM Treasury consultation papers set out that it is recognised that this practice may not apply in all circumstances and rent reviews may not always fully update rental payments to current market rates. Therefore, some discussions have highlighted concerns over consistency of applying such a proxy, especially where assets may be held for their entire economic life. This is an

¹¹ [HM Treasury, IFRS 16 Leases: Exposure Draft](#)

issue of concern for CIPFA/LASAAC as is discussed in paragraphs 98 to 101 above.

106. CIPFA/LASAAC therefore would seek the views of interested parties on two options for the subsequent measurement of the right-of-use asset;
- Option 1 – Subsequent measurement at current value with practical expedients applying to the lower value property, plant and equipment which allow the IFRS 16 cost model to be used as a proxy for current value for those lower value items
 - Option 2 – The approach proposed by HM Treasury ie that as a practical expedient the cost model is used as a proxy for all items of property, plant and equipment.

CIPFA/LASAAC considers that the two approaches are consistent, following the same principles ie providing a cost effective approach to the measurement of the right-of-use asset and ensuring that it reflects public sector circumstances. It also considers that this is a complex issue and would be grateful if respondents set out the technical arguments for their responses but that they also focus on the practical consequences including, for example, such issues as information availability. Currently the Code Exposure Draft is drafted only from the perspective of requiring the right-of-use asset to be measured at current value.

Subsequent Measurement of Investment Properties

107. The subsequent measurement of investment properties in the Exposure Draft follows the requirements of IFRS 16 ie if an entity applies the fair value model in IAS 40 *Investment Property*, the same measurement requirements must also be applied to right-of-use assets that meet the definition of investment property. As local authorities are required to follow the fair value model except in exceptional circumstances subsequent measurement of any leased assets which are investment properties will be at fair value.

Subsequent Measurement of the Lease Liability

108. After the commencement date subsequent measurement of the lease liability requires that a lessee:
- increases the carrying amount to reflect interest on the lease liability
 - reduces the carrying amount to reflect the lease payments made, and
 - remeasures the carrying amount to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease payments.
109. Subsequent measurement of lease liabilities is similar to other financial liabilities and is measured using the effective interest rate method so that the carrying amount of the lease liability is measured at amortised cost and interest expense is allocated over the lease term.
110. Under IFRS 16 an authority will recognise the effects of the remeasurements in paragraph 108 as an adjustment to the carrying value of the lease liability and right-of-use asset as at the time of remeasurement; prior period figures are not adjusted. If the carrying value of the right-of-use asset is less than the amount of an adjustment, the carrying value is reduced to zero with any further reductions being recognised in the Surplus or Deficit on the Provision of Services.

Reassessment of a Lease

111. Lease payments can differ from those used to measure the lease liability on initial recognition. IFRS 16 specifies when the lease liability is to be reassessed as summarised in the table below.

Discount Rate	Circumstances Requiring Reassessment	
Revised Discount Rate (Note that this is the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined).	Change in the lease term - the lessee is required to determine the revised lease payments on the basis of the revised lease term.	Change in the assessment of an option to purchase the underlying asset - the lessee is required to determine the revised lease payments to reflect the change in amounts payable under the purchase option.
Unchanged Discount Rate	Change in the amounts expected to be payable under a residual value guarantee - the lessee is required to determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.	Change in future lease payments resulting from a change in an index or a rate used to determine those payments - the lessee is required to remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows. The lessee is required to determine the revised lease payments for the remainder of the lease term based on the revised contractual payments. Note that the discount rate has to be updated if there is a change in floating interest rates.

Lease Modifications

112. IFRS 16 defines lease modifications as changes in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. The accounting for the modification is dependent on whether the modified terms increase or decrease the scope of the lease, and whether increases in scope require consideration commensurate with a 'stand-alone price' for the new scope of the lease. A modification of a lease, for example, might be in

cases where an authority leases a number of floors or area in a building and the contract is modified to increase the number of floors or area leased.

113. A lessee will account for a lease modification as a separate lease (and follow the initial recognition and measurement requirements for leases set out above) if the following conditions are both met:
- the modification increases the scope of the lease by adding the right to use one or more underlying assets, and
 - the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
114. For a lease modification which is not a separate lease at the effective date of the modification the lessee is required to modify the originally recognised components of the lease contract as follows:
- remeasuring the lease liability using the revised discount rate (either the interest rate implicit in the lease or the lessee's incremental borrowing rate if the interest rate in the lease cannot be readily determined), and:
 - for lease modifications that decrease the scope of the lease, decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease and recognise the gain or loss in the Surplus or Deficit on the Provision of Services relating to the partial or full termination of the lease, and
 - for all other lease modifications making a corresponding adjustment to the right-of-use asset.
115. CIPFA/LASAAC and the sub-group are of the view that there are no specific local government circumstances applying to the remeasurement of the lease liability requiring interpretation or adaptation and this has been reflected in the Exposure Draft.

Subsequent Measurement

- Q7 a) Which approach to the subsequent measurement of the right-of-use asset summarised in paragraph 106 do you consider best reflects local government's measurement of the right-of-use asset ie:
- option 1 - current value measurement with materiality based practical expedients or
 - option 2 - HM Treasury proposal as a practical expedient, to adopt the IFRS 16 cost model for lessees as a proxy for the revaluation model?
- Please set out the technical financial reporting and the practical issues relating to your response.
- Q7 b) If you consider option 1 to be a viable option, which approach do you prefer ie the materiality based approach to current value measurement (see paragraphs 98 to 99) or the approach which relies on information which is available without undue cost or effort (see paragraph 100)? Please provide the reasoning for your response.

Q8	Do you agree with CIPFA/LASAAC's approach to the subsequent measurement of the lease liability? If not why not? What alternatives do you suggest?
----	---

Presentation

116. IFRS 16 requires that the right-of-use asset is presented separately in the Balance Sheet or in the notes. If the asset is not presented separately in the Balance Sheet it must be recognised in the same line item in which the underlying item is presented. IFRS 16 permits that the lease liability is presented either separately on the face of the balance sheet or within other financial liabilities. If the liability is not presented separately in the Balance Sheet then IFRS 16 requires that the carrying amount of those items and the line items that they are reported in are disclosed in the notes.
117. The Exposure Draft specifies that depreciation on the right-of-use asset should be recognised in the same way as for other assets in the relevant service lines and the interest expense on the lease liability is recognised with other financing costs in the financing and investment income and expenditure line in the Comprehensive Income and Expenditure Statement.
118. It also specifies that in the Cash Flow Statement lease payments are classified in the same way as other financial liabilities:
- cash payments for the principal proportion of the lease liabilities are included in financing activities
 - cash payments for interest are classified in accordance with IAS 7 *Statement of Cash Flows* requirements for interest paid, and
 - short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.
119. CIPFA/LASAAC can see no local government circumstances requiring adaptation in the Code for the presentation requirements within IFRS 16 and this is set out in the relevant provisions in the Exposure Draft.

Concessionary Leases – Lessees Only

120. Interested parties may be aware that the International Public Sector Accounting Standards Board (IPSASB) has issued its Exposure Draft (ED) 64 *Leases*. ED 64 recognises that a frequent transaction for public sector entities is that they enter into leases at below market terms. At initial recognition IFRS 16 requires a lease to be measured at cost and therefore this would lead to an understatement of the cost of the right-of-use asset on initial recognition and no recognition of the subsidy from the lessor to the lessee.
121. The IPSASB proposals for concessionary leases are consistent with IPSASB provisions on non-exchange transactions (in IPSAS 23) and concessionary loans (IPSAS 29¹²). CIPFA/LASAAC is of the view that as the Code has already adopted both of IPSAS 23 and the same approach for concessionary loans (known in the Code as 'soft' loans), the IPSASB treatment for concessionary leases is not a new

¹² IPSAS 29 *Financial Instruments Recognition and Measurement*

accounting concept for the Code and therefore these provisions should be adopted for lessees.

122. Note that ED 64 uses a right-of-use model for lessors and includes appropriate treatment for concessionary leases (for lessors). As the right-of-use model for lessors is not included in the ED of the Code see paragraphs 135 to 138 below then the concessionary lease approach for lessors has also not been included. However, the ED of Code has maintained its principles basis to accounting for leases at a peppercorn or a nominal rent (see paragraph 4.2.2.68).
123. Following the approach in the draft IPSAS, CIPFA/LASAAC considers that the right-of-use asset for concessionary leases should be measured at fair value by discounting the market based lease payments using the market rates. CIPFA/LASAAC also proposes recognising a subsidy in accordance with IPSAS 23¹³ as income on the initial entry into the transaction, except where a present obligation exists, it is recognised as a liability. As an authority satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognised. This latter change is reflected in section 2.3 (Government and Non-Government Grants) of the Code. The statutory accounting requirements are also reflected in section 4.2.
124. CIPFA/LASAAC would note that this approach is different to the proposed approach in the FReM¹⁴ for leases provided at a peppercorn rent which requires that:
- a right of use asset is recognised and measured using the initial measurement criteria under IAS 16 as adapted and interpreted in the FReM
 - a lease liability is recognised and measured in accordance with IFRS 16
 - any difference between the carrying amount of the right- of-use asset and the lease liability is recognised as non-operating income
 - subsequent measurement of the right-of-use asset should follow the principles of IAS 16 as adapted and interpreted in the FReM.
125. Although the two approaches are different – there are similarities and it is unclear whether a fair value measurement based on market rates would be materially different to an asset measured in accordance with the requirements of IAS 16 on initial recognition. CIPFA/LASAAC would be grateful for interested parties’ views on this issue.

Concessionary Leases – Lessees Only

Q9 Do you agree with CIPFA/LASAAC’s approach for accounting for concessionary leases for lessees? If not why not? What alternatives do you suggest?

Lessor Accounting

126. The lessor accounting model and classification tests remain substantially unchanged from those in IAS 17. Lessors are still required to split leases between

¹³ IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers)

¹⁴ See [HM Treasury, IFRS 16 Leases: Exposure Draft](#)

finance and operating leases. Leases that transfer substantially all of the risks and rewards incidental to ownership of the underlying asset are finance leases; all other leases are operating leases.

Finance Leases

127. At the commencement date, a lessor is required to recognise assets held under a finance lease in its Balance Sheet and present them as a receivable at an amount equal to the net investment in the lease. The lessor is required to use the interest rate implicit in the lease to measure the net investment in the lease. The net investment in the lease now explicitly requires that the payment includes variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date.
128. The lessor is required to recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease. The lessor is required to apply the derecognition and impairment requirements in IFRS 9 *Financial Instruments* to the net investment in the lease.
129. For finance leases the Code uses the same provisions that were previously included to accommodate transactions which are under non-commercial terms and requires that local authorities consider the substance of the transaction, for example, a finance lease at a peppercorn rent for a lessor may in substance be a donation of an asset to another entity (see paragraph 4.2.2.68).

Operating Leases

130. IFRS 16 requires a lessor to recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis, if that is deemed more representative of the pattern in which the benefit of the underlying asset diminishes.
131. Costs incurred on earning leased income including depreciation are recognised as an expense. Depreciation of leased assets should be on a basis consistent with the lessor's normal depreciation policy for similar assets and accounted for under the Code's adoption of IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. Section 4.7 and IAS 36 should be applied to consider if the underlying asset is impaired. When initial indirect costs are incurred by lessors entering into an operating lease such cost should be added to the carrying amount of the underlying asset and recognised as an expense over the lease term on the same basis as leased income.

Approach to Drafting for Lessors

132. The approach to the Code's provisions on lessors ie classification and measurement are relatively unchanged from the provisions relating to IAS 17. This includes leases that are not provided on commercial terms.

Sublease Classification

133. A lessee may become an intermediate lessor if it sublets an asset it in turn leases from another lessor (the head lessor) who ultimately owns the asset from a legal perspective. Under IAS 17 a sublease was classified with reference to the underlying asset. Paragraph B58 of IFRS 16 requires that an intermediate lessor classifies the sublease as a finance lease or an operating lease as follows:

- if the head lease is a short-term lease, the sublease is classified as an operating lease
- otherwise, the sublease is required to be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant and equipment that is subject of the lease).

Lessor Accounting

Q10 Do you agree with CIPFA/LASAAC's approach for accounting for lessors? If not why not? What alternatives do you suggest?

The Use of the Lessor Accounting Model in IFRS 16

134. A number of respondents to the early consultation on the Code did not agree with the approach to the lessor accounting model in IFRS 16 which still retains the classifications of finance and operating leases which do not exist for lessees and were concerned about the lack of symmetry of the lessee and lessor accounting models. One of the respondents to the consultation considered that this *'concept may be difficult for users of the accounts to understand particularly in a group scenario where leases are made between the group'*. The Board is interested in any commentary that local authorities might have on this issue.
135. CIPFA/LASAAC would highlight that in its ED 64 the IPSASB is of the view that when the lessor and the lessee are public sector entities in the same lease contract, the lack of consistency between lessor and lessee accounting in IFRS 16 will lead to:
- the underlying asset not being recognised by the lessor nor by the lessee if the lessor classifies the lease as a finance lease, and
 - the lessor not recognising a lease receivable if the lease is classified as an operating lease, while the lessee always recognises a lease liability.
136. The IPSASB is of the view that this could give rise to a number of practical issues it considers are more prevalent in the public sector:
- consolidation issues - ie where the lessor and lessee are part of the Group Accounts and separate records need to be maintained for the underlying asset and lease receivable
 - understandability issues – ie due to different accounting models for the same transaction - it may be difficult for users of the financial statements to distinguish between a lease and the sale of an asset in lessor's financial statements (note this is similar to the view held by one of the respondents to last year's early consultation)
 - asymmetrical information in the public sector – different recognition criteria for the same transaction distorts the analysis of the financial position of public sector entities. This may be particularly an issue in relation to Whole of Government Accounts and the asymmetry was an issue raised by the respondents.
137. For lessors ED 64 proposes:

- continuing to recognise the underlying asset in the balance sheet because the lessor continues to control the underlying asset and measuring this in accordance with the current requirements for that asset
 - recognising a liability (unearned revenue) at the value of the lease receivable plus the amount of any lease payments received at or before the commencement date because the lessor sells an unrecognised right-of-use asset to the lessee and has a present obligation to provide access to the underlying asset to the lessee. Note that the IPSASB at a glance summary indicates that this is consistent with the approach to measurement of similar liabilities in IPSAS 32 *Service Concession Arrangements Grantor*
 - recognising a lease receivable because the lessor gains control of the right to receive payments. This is measured initially at the present value of the future lease payments.
138. CIPFA/LASAAC has highlighted the approach in the ED 64 to the right-of-use model for lessors as the asymmetry in the standard was raised by respondents to last year's consultation. However, CIPFA/LASAAC has decided not to take it forward as the IPSAS is not intended to be issued until June 2019. However, CIPFA/LASAAC is interested to understand whether there are substantial leasing arrangements between local authorities and other public sector entities (including local authorities).

The Use of the Lessor Accounting Model in IFRS 16

Q11 Do you agree that CIPFA/LASAAC should retain the dual lessor accounting model (ie which maintains the operating and finance lease split) in the Code? If yes why? If not, why not? What alternatives do you suggest?

Sale and Leaseback Transactions

139. In addition to the changes for the reporting requirements for lessees the introduction of IFRS 16 will introduce substantial changes to the sale and leaseback transactions reporting requirements.
140. In a sale and leaseback transaction a lessee (seller-lessee) sells an asset to a lessor (the buyer-lessor) who then leases it back to the lessee. To determine how to account for a sale and leaseback transaction the sale must first be assessed as to whether it qualifies as a sale in accordance with the requirements of IFRS 15 *Revenue from Contracts with Customers* (as adopted by the Code).

Transfer of the Asset to the Buyer-Lessor is a Sale

141. If the transfer of the asset to the buyer-lessor qualifies as a sale the seller-lessee de-recognises the asset and applies the lessee accounting model to the leaseback. The seller-lessee measures the right-of-use asset arising from the leaseback as a proportion of the previous carrying amount of the asset that relates to the right of use retained. The gain or loss that the seller-lessee is required to recognise is limited to the proportion of the total gain that relates to the rights transferred to the buyer-lessor.
142. Adjustments are required if the consideration for the sale is not equal to the fair value of the asset. Any below market terms are accounted for as a prepayment of

lease payments and any above market terms are accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

143. The buyer-lessor will apply the lessor accounting requirements to the asset.

Transfer of the Asset to the Buyer Lessor is not a Sale

144. If transfer of the asset to the buyer-lessor is not a sale the seller-lessee continues to recognise the asset and amounts to be received by the seller-lessee are recognised as a financial liability under the Code’s adoption of IFRS 9. The buyer-lessor will recognise a financial asset for any amount paid to the seller-lessee.
145. CIPFA/LASAAC is aware that sale and leaseback transactions do occur in local government. However, it is not aware that they are frequent transactions for local authorities. It is also of the view that there are no specific local government circumstances in relation to sale and leaseback transactions requiring adaptation or interpretation of the Standard on adoption in the Code.

Sale and Leaseback Transactions	
Q12	Do you agree with CIPFA/LASAAC’s approach for sale and leaseback transactions? If not why not? What alternatives do you suggest?

Disclosure Requirements

146. IFRS 16 has increased the disclosure requirements for leases. It has introduced a disclosure objective for both lessees and lessors: to disclose information in the notes that, together with the information provided in the Balance Sheet, Comprehensive Income and Expenditure Statement and Cash Flow Statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee and lessor as relevant. The standard has introduced both quantitative and qualitative disclosures to meet this objective.

Disclosures for Lessees

147. The table below sets out the quantitative disclosures for lessees as applied to local authority financial statements.

Quantitative Disclosures for Lessees

Financial Statement	Disclosure
Balance Sheet	Additions to right-of-use assets
	The carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset
	Lease liabilities
	Maturity analysis for lease liabilities
Comprehensive Income and	Depreciation charge for the right-of-use

Financial Statement	Disclosure
Expenditure Statement	asset by class of underlying asset Interest expense on lease liabilities Expense relating to short-term leases for which the recognition exemption is applied Expense relating to low value leases for which the recognition exemption is applied Expense relating to variable lease payments not included in the measurement of lease liabilities Income from subletting right-of-use assets Gains or losses arising from sale and leaseback transactions
Cash Flow Statement	Total cash outflow for leases.

148. The Standard also requires a number of qualitative disclosures for lessees including:
- the nature of the authority’s leasing activities
 - future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities including:
 - variable lease payments
 - extension options and termination options
 - residual value guarantees
 - leases not yet commenced to which the lessee is committed,
 - restrictions or covenants imposed by leases, and
 - sale and leaseback transactions.
149. There are a number of other disclosures for lessees including, for example, the commitments for short-term leases if the current period expense is dissimilar to future commitments.

Disclosures for Lessors

150. The quantitative disclosures for lessors are summarised in the table below:

Quantitative Disclosures for Lessors

Finance Lease	Operating Lease
Selling profit or loss	Lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate
Finance income on the net investment in the lease	Maturity analysis of lease payments receivable
Income relating to variable lease payments not included in the measurement of the net investment in the lease	Disclosure requirements OF IAS 16, IAS 36 and 38 for (separately for leased assets)
Significant changes in the carrying amount of the lease	
Maturity analysis of the lease payments receivable	

151. IFRS 16 includes the following qualitative disclosures for lessors:

- the nature of the lessor’s leasing activities, and
- how the lessor manages the risk associated with any rights it retains in underlying assets.

152. IFRS 16 also sets out that the quantitative information should be provided in a tabular format, unless another format is more appropriate.

153. CIPFA/LASAAC would highlight that the increased disclosure requirements are very likely to require new or different information to be produced which may also require changes or new systems to be developed and it is seeking interested parties’ views on this issue. CIPFA/LASAAC would note that materiality considerations would apply to the disclosure requirements under IFRS 16 but it is of the view that there are no local government circumstances requiring adaptation to the Code.

Transition

154. IFRS 16 will (subject to CIPFA/LASAAC’s decisions) apply to the 2019/20 Code and will have an effective date of 1 April 2019. This will therefore be the date of initial application and the transitional provisions in the Exposure Draft have been drafted from that perspective.

Definition of a Lease

155. IFRS 16 offers entities the option of applying a practical expedient on the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:

- to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and IFRIC 4

- not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.
156. If an entity applies the practical expedient it is required to apply it to all of its contracts and is also required to disclose that fact.
157. CIPFA/LASAAC has mandated this accounting policy choice in the Exposure Draft of the Code. It is of the view that opting to use the practical expedient will substantially reduce the reporting burden on transition and therefore anticipates that local authorities would normally take-up this option. HM Treasury has also proposes mandating this option in its consultation on IFRS 16. However, it would seek interested parties' views on this issue.

Retrospective Application

158. IFRS 16 provides for two approaches to transition ie to apply the Standard:
- retrospectively with full retrospective restatement (following the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*)
 - retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application (for local authorities - 1 April 2019) as an adjustment to reserves (retained earnings) – preceding year information is not restated.

The cumulative catch-up approach offered by the second option is also accompanied by a number of practical expedients on transition discussed below. The approach chosen by an entity has to be applied to the entire lease portfolio.

159. CIPFA/LASAAC has mandated the second option in the Exposure Draft of the Code as this is consistent with its approach to the adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. This option will reduce the reporting burden for local authorities on transition. This is also consistent with the proposed approach in the HM Treasury consultation on IFRS 16.

Practical Expedients

160. For leases previously classified as operating leases the standard offers the lessee the choice of measuring the right-of-use asset at:
- its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application, or
 - an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet before the date of initial application.
161. The approach in the Exposure Draft of the Code is to use the second option. CIPFA/LASAAC has opted for this approach on a cost benefit basis as it is of the view that the second option is easier to estimate and arguably more understandable for the users of the financial statements. However, CIPFA/LASAAC is seeking views on this option as there are arguments that the first option might be considered to be more transparent in terms of ascertaining

the best measurement of the right-of-use asset. The HM Treasury consultation on IFRS 16 also proposes mandating this option.

162. There are also a number of practical expedients for measurement. Under the cumulative catch-up retrospective approach to transition a lessee:
- is not required to make any adjustments on transition for leases for which the underlying asset is of low value
 - may apply a single discount rate to a portfolio of leases with reasonably similar characteristics
 - may use hindsight, such as in determining the lease term
 - may rely on its assessment of whether leases are onerous applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* immediately before the date of initial application as an alternative to performing an impairment review
 - may account for leases for which the lease term ends within 12 months of the date of initial application as short-term leases
 - may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application

CIPFA/LASAAC proposes mandating the first two of these expedients as it considers that most local authorities will take-up these practical expedients and they are consistent with the approach to short-term leases. The FReM proposals are to mandate the first three options. However, CIPFA/LASAAC is of the view that local authorities are best placed to determine whether hindsight should be used.

163. There are a number of other transitional provisions under the cumulative catch-up retrospective approach including those for leases that were previously finance leases. The right-of-use asset and the lease liability at 1 April 2019 are required by the Standard to be measured at the carrying amount of the lease asset and the lease liability at the date immediately before that date.
164. There are also a number of transitional disclosures which the Standard requires in accordance with paragraph 28 of IAS 8. However, the transitional disclosures for the adoption of a new financial reporting standard are stipulated by the Code, under the Code's approach to the adoption of IAS 8. Therefore those reporting requirements relevant to local authorities on the adoption of IFRS 16 have been included in paragraph 4.2.2.96 of the Exposure Draft.

Transition	
Q13	Do you agree with CIPFA/LASAAC's approach to the definition of a lease on transition? If not, why not? What alternatives do you suggest?
Q14	Do you agree with CIPFA/LASAAC's approach to retrospective transition? If not, why not? What alternatives do you suggest?
Q15	Do you agree with CIPFA/LASAAC's proposal in relation to the transitional approach to measuring the right-of-use asset for those assets previously classified as operating leases? If not, why not?

	What alternatives do you suggest?
Q16	Do you agree with CIPFA/LASAAC's approach to the practical expedients on transition? If not, why not? What alternatives do you suggest?

Consequential Amendments - Service Concession Arrangements (PFI/PPP Arrangements)

165. Section 4.3 of the Code (Service Concession Arrangements: Local Authority as Grantor) requires the measurement of a service concession arrangement (PFI/PPP arrangement) liability to follow those provisions in the Code for a finance lease in section 4.2 of the Code and IAS 17. As IAS 17 will no longer be an extant standard CIPFA/LASAAC proposes changing the service concession arrangement liability measurement to that of IFRS 16. This is a similar measurement approach ie the liability is measured on an amortised cost basis. However, CIPFA/LASAAC would note that IFRS 16 requires that where there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review, the lessee is required to remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (ie when the adjustment to the lease payments takes effect). This would mean where PFI contract payments are increased (annually), for example, by RPI that the liability would need to be remeasured.
166. CIPFA/LASAAC considers an alternative might be to retain the current IAS 17 provisions in section 4.3. This would retain the economic effect of the current measurement provisions for service concession arrangements (PFI/PPP). CIPFA/LASAAC would seek interested parties' views on the approach to the measurement of service concession arrangement liabilities under the standard.

Consequential Amendments - Service Concession Arrangements (PFI/PPP Arrangements)	
Q17	Do you agree with CIPFA/LASAAC's proposals for the consequential amendments to the measurement of service concession arrangement (PFI/PPP) liabilities or do you consider that the current approach to measurement (ie the IAS 17 measurement as a finance lease) should be retained? If you agree, why do you agree? If not, why not? What alternatives do you suggest?

Effective Date

167. IFRS 16 has an effective date of 1st January 2019. IFRS 16 has already been adopted by the European Union (EU) in December 2017. The Code applies EU adopted IFRS. This means that CIPFA/LASAAC currently expects to follow the process for application of the new Standard consistent with the rest of the public sector and therefore the new standard will be applied in local government in the 2019/20 Code and have an effective date of 1 April 2019.

Effective Date

- Q18 Do you agree with the proposed effective date for public sector implementation of IFRS 16? If yes, why? If not, why not? What alternatives do you suggest?

Further Guidance

168. CIPFA/LASAAC would be interested to hear interested parties' views on whether there are any areas within the Code in relation to IFRS 16 where additional guidance is required.

Further Guidance

- Q19 Are there any areas within the Code in relation to IFRS 16 where additional guidance would be helpful?

Impact on the Group Accounts

169. IFRS 16 has implications for the group accounts of local authorities. Local authority companies and other subsidiaries are likely to account under UK GAAP. FRS 102 T currently uses the IAS 17 approach to lease accounting. In September 2016 the FRC consulted on the UK GAAP approach to adoption of IFRS 16 in its Triennial Review. The original timetable in that consultation was for UK GAAP to incorporate the IFRS 16 requirements by 2022. However, the FRC Feedback Statement¹⁵ now indicates that '*Further evidence-gathering and analysis needs to be undertaken before a decision can be made on the most appropriate timetable and approach for reflecting the principles of IFRS 16 in FRS 102, if at all.*'
170. Local authority Group Accounts will therefore need to align their accounting policies and recognise and measure the right-of-use asset for leases held by the Group in accordance with the requirements of the Code. This will have practical implications for local authority accounts preparers.
171. As IFRS 16 accounting requirements are not symmetrical for lessees and lessors, there is a single classification model for lessees whilst for lessors the dual model retains the finance and operating lease split. Therefore for intra-group leasing arrangements the right-of-use assets will need to be eliminated on consolidation.

Capital Financing Requirements - Impact on the General Fund

172. The recognition of the right-of-use asset will bring leases into the scope of the Prudential Framework. The cost (on initial recognition) of the right-of-use asset will meet the definition of capital expenditure in contrast to the current revenue treatment of operating leases.
173. This does not introduce any issues which need to be resolved by amendment to the Code. However, CIPFA/LASAAC is interested in any practical impacts that the new accounting arrangements might have in relation to:

¹⁵ Feedback Statement - Consultation Document Triennial Review of UK and Ireland Accounting Standards, Approach to Changes in IFRS, FRC June 2017.

- whether operating leases in existence at the transition date meet the definition of capital expenditure
 - the impact on the Capital Financing Requirement (CFR) of recognising the right-of-use assets for all leases (particularly for the HRA in England)
 - the making of the Minimum Revenue Provision and the Statutory Repayment on Loans Fund Advances for the capital cost of the right-to-use asset.
174. Some of the impact on local authorities in relation to the capital financing implications has been clarified for English authorities in the new [Minimum Revenue Provision Guidance](#). Paragraph 43 extends the recommended treatment of finance leases to leases where the right of use asset is recognised on the balance sheet (when that accounting policy becomes applicable to local authorities) to extend the current approach for finance leases. The effect of the statutory guidance is such that the recommended approach for the MRP for leases where a right of use asset is recognised will be a top-up so that the aggregate charge to revenue for the lease will effectively be the annual lease payment. CIPFA and CIPFA/LASAAC are committed to working with both local authorities and the devolved administrations to ensure the effective adoption of IFRS 16 for local authorities.

Preparations for Adoption of the Standard – Practical Application Issues

175. The adoption of IFRS 16 will require effective preparation by local authority accounts preparers. There are practical implications for financial reporting but there may also be an impact on the way in which assets are procured for the authority.

New Information Requirements

176. The adoption of IFRS 16 brings forward a number of new information requirements, for example, new information will be required to:
- enable local authorities to separate lease and non-lease components - the standard does permit an accounting policy choice ie lessees are able to recognise the lease and non-lease components as a single lease component on the balance sheet. However, it should be noted that this will have the effect of increasing the lease obligation on the balance sheet
 - to define the lease term, for example, including identification of when an authority is reasonably certain to exercise an option to extend the lease (in such cases the authority will need to consider all the relevant facts and circumstances that create an economic incentive for the lessee to exercise the option for extending the lease term)
 - identify and make decisions about the two permitted recognition exemptions ie for short-term leases and leases of low value
 - meet the new presentation and disclosure requirements
 - identify the authority's incremental borrowing rate where it cannot identify the interest rate implicit in the lease.

New or Amended Systems or Processes

177. The new information requirements are likely to give rise to a need for new or amended systems for data collection or to store information required to make the relevant calculations, judgements or assessments. This may include extracting, gathering and validating lease data. In addition an important early task will be to perform an inventory of the relevant contracts which are, or may contain, leases.

Impact on the Financial Statements

178. Local authorities with substantial operating leases will see an increase in leased assets (the right-of-use) asset being recognised on their balance sheet with a commensurate increase in lease liabilities. Lease payments will be replaced by depreciation and interest expense in the Comprehensive Income and Expenditure Statement (see also paragraphs 172 to 173 above in relation to the statutory reporting and capital financing requirements for the adoption of the Standard). Paragraph 118 sets out that there will be presentational changes relating to the Cash Flow Statement. IFRS 16 will therefore change the reporting of both financial performance and position in local authority financial statements. Local authorities do not face the scrutiny of private or even other public sector entities as a result of the need to avoid breaches of loan covenants and reporting of financial ratios is limited. However, the changes to the statements may impact on local authorities that are issuing bonds and the impact on reports of performance will need to be communicated to an authority's key stakeholders.

New Accounting Policies

179. The new standard will also require specific preparations by local authorities in respect of financial reporting requirements. New judgements are required, for example, in evaluating whether a contract contains a lease, there are also the aforementioned judgements on the lease term and the accounting requirements for lease modifications. These will need to be reflected in local authority accounting policies and financial statements. Additionally decisions will need to be taken on the identification of low value leases and other accounting policy choices including the choice to separate lease and non-lease components. There are also options on transition that accounts preparers need to consider, for example, the definition of a lease as outlined in paragraph 158 above and the practical expedients outlined in paragraph 162.

Impact on Key Stakeholders across the Authority

180. It will be important that the financial reporting changes are communicated to local authority stakeholders, both internally and externally. This will include departments outside the finance department, for example estates management and other departments that use or manage leases assets, management, members and other key stakeholders.
181. The new leasing standard will also impact on other functions of the authority, for example, treasury management, internal audit and the legal and professional services of the authority. Local authorities will need to review their prudential framework positions (including the relevant indicators) and their capital strategies to ensure that they have taken on board the implications of the adoption of IFRS 16. Additionally each part of the authority affected will need to understand the impact of the standard and the information they will need to provide. Key examples will be the estates department, all the major services (including locally provided services) and schools. Note that in the early consultation on the approach to the adoption of IFRS 16 a number of respondents were concerned about the processes necessary to obtain the relevant lease information from

schools. Again CIPFA/LASAAC is seeking interested parties' views on the practical issues that arise on the adoption of IFRS 16.

182. It is likely that training will need to be built into a local authority's project plan for adoption of the new standard to ensure that key stakeholders understand the reporting requirements and the impact on the financial statements.

Implementation and Readiness Questionnaire

183. The adoption of IFRS 16 is likely to require substantial preparation. It will in many cases be similar to the move to IFRS. CIPFA/LASAAC and the sub group recommend that local authorities establish appropriate governance structures to implement the change ie an effective project plan and implementation structure. The project will need to be broken down into phases with key roles and responsibilities and time scales clearly outlined. Local authorities will need to ensure that this project plan considers the organisation as a whole as lease information may be available and used across the authority.
184. CIPFA/LASAAC is concerned to ascertain the readiness and resource implications for local authorities as a result of the changes that will be adopted in the 2019/20 Code for IFRS 16. Appendix 1 to this ITC therefore includes readiness assessment questions and a separate Word document is also included in the consultation documents. Local authorities may want to use these questions for internal assessment. However, CIPFA/LASAAC would be grateful if local authorities could complete the questionnaire and return it with their consultation responses. CIPFA/LASAAC would note that an important part of its assessment of local authority preparedness and the resource implications of the adoption of the new standard will be question 1.

Impact on Operational Models

185. Local authorities will also need to assess the impact of the changes introduced by the leasing standard on their operational models. Consideration will need to be given to how the leasing market may change. Local authorities currently entering into new leases or renegotiating current leases will need to consider the future implications of adopting IFRS 16 as a part of their appraisals of the leases. However, there may be some benefits ie the increased transparency of financial information provided by the standard may lead to improved insight into the economic cost of leases and more effective decisions being made.

Readiness Assessment Questionnaire (see separate Word document for return to CIPFA/LASAAC).

- Qu1 Can the authority identify all its lease contracts?
- (Supporting questions - does the authority have a central contracts register for all its leases? If not how does the authority intend to identify leases held across the authority's departments/services?)
- 1 A) i) How many finance leases does the authority have?
- ii) What is the carrying value of the finance lease assets held by the authority?
- iii) What is the total of future minimum lease payments at the 31 March 2018?
- iv) What is the average lease term of the authority's finance leases?¹⁶
- If possible CIPFA/LASAAC would be grateful if the minimum lease payments could be broken down into time series ie less than one year, between two to five years, between 6 to 10 years and over 10 years and information on asset type ie the asset classes in the Code.
- 1 B) i) How many operating leases does the authority have?
- ii) What is the total of future minimum lease payments at the 31 March 2018?
- iii) What is the average lease term of the authority's operating leases?¹⁷
- If possible CIPFA/LASAAC would be grateful if the minimum lease payments could be broken down into time series ie less than one year, between two to five years, between 6 to 10 years and over 10 years and information on asset type ie the asset classes in the Code.
- 1C) i) How many finance leases does the authority have with other public sector entities (including other local authorities)?
- ii) What is the carrying value of the finance lease assets held by the authority with other public sector entities (including other local authorities)?
- 1D) i) How many operating leases does the authority have with other public sector entities (including other local authorities)?
- ii) What is the total of future minimum lease payments at the 31 March 2018 with other public sector entities (including other local authorities)?

¹⁶ Note that lease term refers to the lease term from commencement of the contract.

¹⁷ See note 6.

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?
2	<p>Can the authority identify all contracts that might contain leases across its departments?</p> <p>(Supporting question- has the authority considered contracts, for example, for finance and IT contracts and other types of contracts, for example, in the use of data centres, waste management, property and grounds maintenance, fleet and highways vehicles, and business equipment – see ITC paragraphs 68 to 78 and IFRS 16 paragraphs B9 to B33¹⁸.)</p>
3	<p>Is the authority content with the information it produces for its lease commitments for its operating leases?</p> <p>(Background - this will be a useful information base to assess the availability of information in readiness for the adoption of the standard.)</p>
4	<p>Does the authority have the systems and processes in place to be able to assess whether a contract is or contains a lease?</p> <p>(Background - see ITC paragraphs 68 to 78 and IFRS 16 paragraphs B9 to B33)?</p>
5	<p>Does the authority have the systems, processes and information in place to make the relevant judgements and decisions under the standard?</p> <p>(Background - judgements include the elements of the definition of a lease, whether the authority is reasonably certain that an extension or termination option will be exercised, the appropriate rate by which to discount the lease liability and various accounting policy choices including those on transition).</p>
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)?
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?
8	Has the authority developed a communications strategy to train and inform key stakeholders of the impact of the changes?
9	Has the authority considered the impact of the introduction of the standard on its procurement decisions?

¹⁸ Note that this would include leases for assets currently recognised under IFRIC 4 *Determining Whether an Arrangement Contains a Lease*

- | | |
|----|--|
| 10 | Has the authority considered the impact of the adoption of the standard on its capital strategies and prudential indicators? |
| 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? |
| 12 | Does the authority consider that it will be able to implement the reporting requirements of IFRS 16 for the 2019/20 financial year, please tick the following: <ul style="list-style-type: none">• Strongly agree• Agree• Neither agree nor disagree (possibly)• Disagree• Strongly disagree |