Department of Health & Social Care

Group Accounting Manual

IFRS 16 Supplement

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1. Introduction

1.1 IFRS 16, Leases, is set to supersede IAS 17, Leases, SIC 15, Operating Leases – Incentives, SIC 27, Evaluation the Substance of Transactions Involving the Legal Form of a Lease, and IFRIC 4, Determining whether an Arrangement contains a Lease.

1.2 The objective of IFRS 16 is to report information that faithfully represents lease transactions and provides a better basis for users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases.

1.3 IFRS 16 as adapted and interpreted by the Financial Reporting Manual (FReM), will be effective from 1 April 2020. This represents a one-year deferral in the adoption of and transition to IFRS 16. The deferral was confirmed in the 2019-20 FReM published on the 19 December 2018.

1.4 The scope of this deferral does not extend to a limited number of entities across government who report following EU adopted IFRS in accordance with the Companies Act 2006 (CA 2006), for their individual statutory accounts.

1.5 As the Group Accounting Manual (GAM) forms part of the accounts direction that is issued to reporting entities within the Department of Health and Social Care (DHSC) accounting boundary, the accounting requirements detailed within the GAM reflect the appropriate requirements for that financial year.

1.6 Therefore, guidance around lease accounting in the draft 2019-20 GAM reflects the appropriate treatments and reporting requirements per IAS 17, than the revised requirements under IFRS 16.

Purpose of this Document

1.7 This guidance is designed to both advise group bodies required to implement IFRS 16 in their statutory accounts for 2019-20, as to how best to align with DHSC group policies when the Standard is adopted by the FReM in 2020-21 and to assist other group bodies adopting the Standard in 2020-21 in developing their preparedness.

1.8 At time of issue in January 2019, public sector application guidance for the adoption of IFRS 16 remains a work in progress. This document signposts areas of application guidance that are yet to be agreed between HM Treasury and the Financial Reporting Advisory Board (FRAB). As such this guidance will be updated in Spring/Summer 2019.

1.9 As a participant in HM Treasury's IFRS 16 technical working group and a member of FRAB, the Department maintains visibility on the development of the public sector approach to IFRS 16 and will continue to update entities as the agreed approach for IFRS 16 evolves and is finalised.

1.10 DHSC is keen to obtain user feedback on the guidance being offered for IFRS 16, so that the finalised guidance inserted into the 2020-21 GAM represents an improved version of what is currently detailed below. We will seek user feedback through both the 2019-20 and 2020-21 GAM consultation processes.

Format

1.11 This document contains the guidance that is to be included in Chapters 2, 4 and 5 of the 2020-21 GAM.

1.12 Text describing the intended location of the IFRS 16 guidance in the GAM will precede each guidance extract. Guidance extracts are contained within quotation marks.

1.13 For the purposes of this document the definitions employed in Chapter 1 of the 2019-20 GAM should be interpreted as equally applicable to this guidance.

2. IFRS 16 Guidance for Chapter 2 of the GAM

2.1 The extent to which IFRS 16 is covered in Chapter 2 of the GAM rests on the resolution as to the budgeting approach for IFRS 16.

2.2 Budgeting and accounting treatments for leases currently align, using an IAS 17 approach. The Office for National Statistics (ONS) have confirmed that for National Accounts purposes, 2019-20 budgetary information is required on IAS 17 basis.

2.3 HM Treasury and ONS are discussing whether alignment between budgets and accounts will continue, with budgets moving to an IFRS 16 approach, or whether leases will become an additional area in which adjustments are required to calculate the appropriate budget outturn.

2.4 As such additional detail will be provided in Chapter 2, Budgeting Framework, if accounting and budgeting treatments misalign when IFRS 16 is adopted by the FReM.

2.5 On confirmation of the budgeting approach paragraphs will be inserted to this guidance and subsequently the 2020-21 GAM, to reflect any necessary guidance required for DHSC group bodies on the budgeting approach for IFRS 16.

3. IFRS 16 Guidance for Chapter 4 of the GAM

3.1 Significant changes will be made to Chapter 4 of the GAM with the introduction of IFRS 16.

3.2 On top of additional text covering the various FReM adaptations and interpretations of IFRS 16, additional text will be provided regarding accounting for sale and leaseback transactions and an additional annex has been constructed to provide more detailed application guidance for group bodies.

3.3 These additions and revisions to the GAM are detailed below.

Sale and Leaseback Transactions

3.4 IFRS 16 requires an entity to consider whether a transaction meets the requirements of IFRS 15 to determine the appropriate accounting treatment.

3.5 The following text has been developed to be inserted into Chapter 4, Accounting for Income and Expenditure;

3.6 "IFRS 16 governs arrangements where a seller transfers an asset to another entity and leases the asset back from the buyer. Both parties are required to apply paragraphs 99 to 103 of the Standard.

3.7 IFRS 16 requires entities to assess whether a performance obligation is satisfied to determine whether the transfer is accounted for as a sale. Where the sale satisfies the requirements of IFRS 15;

- The seller and lessee measures the right of use asset at the proportion of the previous carrying amount that relates to the right of use retained by the seller and lessee
- The buyer and lessor shall account for both the purchase applying the appropriate standards and the lease as a lessor arrangement per IFRS 16.

3.8 Where either the sale is below fair value or the leasing arrangement below market rates adjustments are made to measure the proceeds at fair value. Below market terms are to be accounted for as a prepayment of lease payments and above market terms shall be accounted for as additional financing provided by the buyer to the seller. The adjustment must be measured with reference to the more determinable of the consideration of the sale as compared to the fair value of the asset or the difference between the lease payments and the market rate equivalent.

3.9 If the transaction does not meet the requirements of IFRS 15 the seller shall continue to recognise the asset and will recognise a financial liability equal to the proceeds and the buyer will recognise a financial asset equal to the proceeds, but will not recognise the transferred asset. As such it is the substance of the arrangement that determines whether IFRS 15 and 16 or IFRS 9 are applied to a sale and leaseback transaction."

IFRS 16 Adaptations and Interpretations

3.10 The leased asset section of Chapter 4 will be replaced. The below text also contains the currently agreed set of FReM adaptations and interpretations for transition to and adoption of IFRS 16.

3.11 "The relevant standard is IFRS 16 Leases. This Standard supersedes IAS 17, Leases, SIC 15, Operating Leases – Incentives, SIC 27, Evaluation the Substance of Transactions Involving the Legal Form of a Lease, and IFRIC 4, Determining whether an Arrangement contains a Lease.

3.12 Under IFRS 16 a contract, or arrangement per the adaptation referenced in paragraph 3.18, is assessed to be or contain a lease, if a right to control use of an asset for a period time in exchange for consideration is conveyed.

3.13 Identification of a lease is governed by an assessment of the substance of the arrangement against the criteria set out in paragraphs B9 to B31 of the Standard and where appropriate, the transition expedient referenced in paragraph 3.17 below.

3.14 IFRS 16 further develops the concept of a right of use asset as established by IFRIC 4. It is through this and the IASB’s conclusion that an arrangement establishing the use of such an asset, meets both existing and proposed definitions of an asset under the Conceptual Framework, that a singular lessee approach to measurement and classification of leases is based. Regarding lessor accounting, the accounting treatments are predominantly carried forward from IAS 17.

3.15 Asymmetrical accounting treatments are established through this Standard due to the persistence of most lessor accounting treatments. This will have an impact on DHSC group reporting requirements.

3.16 Practitioners should make themselves familiar with the definitions, classifications and measurements employed, application appendices in the Standard together with public sector application as per the below FReM interpretations and adaptations.

3.17 IFRS 16 is interpreted by the FReM as follows;

- The option to apply the election in IFRS 16 (5) has been withdrawn. All entities must apply the election in IFRS 16 (5) to not apply the requirements in paragraphs 22-49 to short-term leases.

- There is a presumption that, where entities cannot readily determine the interest rate implicit in the lease, they should use the HM Treasury discount rates promulgated in PES papers as their incremental borrowing rate. However, if an entity can demonstrate that another discount rate would more accurately represent their incremental borrowing rate (for example, if they undertake external borrowing independently of the Exchequer), they should use that discount rate as their incremental borrowing rate.

- The option to reassess whether a contract is, or contains, a lease at the date of initial application has been withdrawn. All entities should use the practical expedient detailed in IFRS 16 (C3). There is a presumption that entities have been applying guidance in IAS 17 and IFRIC 4 appropriately in the past. Therefore, any known misapplication of the definition of a lease guidance should be corrected as a prior period error in accordance with IAS 8.

- Upon transition, the accounting policy choice to retrospectively restate in accordance with IAS 8 has been withdrawn. All entities applying this Manual shall recognise the cumulative effects of initially applying IFRS 16 recognised at the date of initial application as an adjustment to the opening balances of taxpayers' equity (or other component of equity, as appropriate) per IFRS 16(C5(b)). This should include the elimination of any revaluation reserve associated with existing finance leases.

- Upon transition, entities should measure the right-of-use asset for leases previously classified as operating leases per IFRS 16((C8 (b)(ii))); at 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 statement of financial position immediately before the date of initial application.

- Upon transition, the option available for the following transition options has been withdrawn. All entities applying this Manual must apply the following options:

- No adjustments for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a))

- No adjustment for leases for which the lease term ends within 12 months of the date of initial application. (C10 (c)) There remains a requirement to include costs associated with these leases in the short-term leases expense disclosure.

- Use hindsight in determining the lease term if the contract contains options to extend or terminate the lease. (C10 (e))

3.18 Additionally, IFRS 16 is adapted by the FReM as follows;

- The definition of a contract is expanded to include intra-UK government agreements where non-performance may not be enforceable by law.

- All lessees shall account for peppercorn leases, which are defined in the FReM as leases for which the consideration paid is nominal (significantly below market value) using the following criteria:

    - Recognise a right-of-use asset and initially measure it at current value in existing use or fair value, depending on whether the right-of-use asset will be held for its service potential and as set out in paragraphs 7.1.4 and 7.1.6 of the FReM and measured in accordance with paragraphs 7.1.34 to 7.1.39 if the right of use asset meets the definition of a heritage assets.

    - Recognise a lease liability measured in accordance with IFRS 16.

    - Recognise any difference between the carrying amount of the right-of-use asset and the lease liability as income as required by IAS 20 as interpreted in this Manual.

    - Subsequently measure the right-of-use asset following the principles of IFRS 16 as adapted and interpreted in this Manual. The initial measurement shall serve as its deemed cost for subsequent measurement purposes.

    - Upon transition, any peppercorn leases that were classified as operating leases under IAS 17 shall be recognised as follows;

        (i) The right-of-use asset shall be measured at current value in existing use or fair value, depending on whether the right-of-use asset will be held for its service potential and as set out in paragraphs 7.1.4-7.1.6 of the FReM, as at the date of initial application.

        (ii) The lease liability shall be measured at the present value of lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.

(iii) The difference between the carrying amount of the right-of-use asset and lease liability shall be included as part of the adjustment to the opening balances of taxpayers' equity (or other component of equity, as appropriate) per IFRS 16 (C5(b)).

3.19 More detailed guidance on lease accounting is given in Chapter 4 Annex 11 and in HM Treasury's IFRS 16 application guidance."

Additional lease accounting annex for Chapter 4

3.20 An additional annex has been constructed to offer application guidance in the manner provided for IFRS 9 as part of the 2018-19 update to the GAM.

3.21 It should be noted that HM Treasury and FRAB have not agreed an approach on subsequent measurement of a right of use asset.

3.22 Whilst mandating the cost model was the most popular response to consultation questions around subsequent measurement of right of use assets to both HM Treasury and DHSC group exercises, concern has been raised around the validity of maintaining such conceptually divergent approaches for the valuation of owned and leased assets.

3.23 As such HM Treasury is exploring instances in which applying a revaluation approach to leased assets will result in presenting a true and fair view of the value of the leased assets at the reporting date, compared to application of the cost model.

3.24 This signals an approach more aligned to Chapter 7 of the FReM governing valuation of owned assets. The FReM indicates that there are instances in which depreciated historical cost can serve as a proxy for current value in existing use, where PPE is either of low value or possessing a short useful life or both. Where this is not the case a revaluation approach determined to be appropriate, in conjunction with a valuer following RICS Red Book, should be employed.

3.25 Whilst the guidance offered below will be updated on resolution of such discussions around the subsequent measurement of a right of use asset, the following text has been developed to be inserted into the 2020-21 GAM;

Chapter 4 Annex 11: Accounting for Leases under IFRS 16

"Introduction

3.26 This annex provides an overview of the revised accounting requirements for leases and guidance on how to apply them. It describes how IFRS 16 is adapted and interpreted in the FReM and in this manual. It also addresses the transition from IAS 17 to IFRS 16 in the 2019-20 financial year.

3.27 IFRS 16, Leases was published in its completed version in January 2016. It introduces a singular lessee accounting approach to the measurement and classification of leases, as well as a modified classification approach for lessors. The standard provides for enhanced disclosure requirements for both lessee and lessors.

IFRS Standards

3.28 The relevant Standard is:

- IFRS 16, Leases

3.29 The accounting for some leases is already covered by specific IFRS Standards and thus fall outside of scope of IFRS 16. This includes:

- leases relating to the exploration for or use of minerals, oil, natural gas and similar non-regenerative resources
- leases of biological assets within the scope of IAS 41 Agriculture held by a lessee
- service concession arrangements within the scope of IFRIC 12 Service Concession Arrangements, though noting the continuation of the FReM interpretation of IFRIC 12, applying lease accounting in scenarios of accounting for PPP arrangements per Chapter 4 Annex 5 of this manual and Chapter 7 of the FReM
- licenses of intellectual property by a lessor in scope of IFRS 15 Revenue from Contracts with Customers
- rights held by a lessee under licensing arrangements within the scope of IAS 38 Intangible Assets to those assets described in paragraph 3 (e) of the Standard. It is noted that entities may, though are not required to, apply the Standard to leases of intangible assets not listed in paragraph 3 (e).

3.30 Additionally, practitioners should have an awareness of where application of other standards is required by IFRS 16. Instances include IFRS 9 impairment reviews and IFRS 15 to govern sale and leasebacks as well as consideration allocation of non-lease components for lessors.

HM Treasury interpretations and adaptations

3.31 HM Treasury has interpreted and adapted IFRS 16 as set out in the FReM and detailed in this guidance at paragraphs 3.17 and 3.18.

Identifying a Lease

3.32 Paragraphs B9 to B31 of the Standard offers significant guidance on the systematic approach to be taken to determine whether a contract or arrangement contains or is a lease. This approach requires the consideration of three high level questions:

- Is there an identified asset (inferred or specified by the arrangement) that the supplier doesn’t have a substantive right to substitute throughout the period of use? Substitution that cannot be prevented by the customer, or enables the supplier to economically benefit from such a substitute would be viewed as delivering substantive substitutional rights for the supplier.

- Does the customer have the right to obtain substantially all of the economic benefits from use of the asset throughout the assets period of use by the customer? Economic benefits can be direct and indirect, primary outputs and by-products.

- Does the customer have the right to direct how and for what purpose the asset is used? The customer is viewed most basically as having this right if it can make changes to how and for what purposes during the period of use. Examples given in the Standard include rights to change; type of output produced, when the output is produced, where the output is produced and whether output is produced.

3.33 It is important to note that in identifying a lease there are FReM adaptations to consider, alongside the transitional expedient mandated to be employed which does not require the application of paragraphs 9 to 11 in IFRS 16 adoption.

3.34 The FReM adaptation to widen the definition of a contract to cover intra governmental arrangements that aren’t legally enforceable, ensures that all lease like arrangements of an intra governmental nature, formal or informal, should be interpreted as in scope of IFRS 16, as the substance of the arrangement is akin to an enforceable contract.

3.35 Despite the adaptation, it remains necessary to assess such arrangements to ensure the intra governmental arrangement meets the requirements of IFRS 16 described above, to be determined a lease.

3.36 Arrangements that involve a peppercorn sum are to be identified as a leasing arrangement and are to be accounted for in accordance of the adaptation detailed in paragraph 3.18

3.37 A lessee is able to employ the expedient offered in paragraph in 15 of IFRS 16 in which by class of underlying asset, a lessee can account for lease and non-lease components of a contract as a single lease.

3.38 Such componentisation is only available where the entity is a lessee. For lessors, consideration for non-lease components of a contract must be allocated in line with IFRS 15 paragraphs 73 to 90.

Lessee Accounting

Measurement of a Lease

3.39 Guidance concerning the initial and subsequent measurement of a lease is clearly articulated through the Standard and is therefore briefly summarised below. Greater detail is offered regarding the application of the mandated recognition exemptions concerning lease length and low value.

Initial Measurement

3.40 Paragraphs 23 to 28 of IFRS 16 govern the initial measurement of the right of use asset and lease liability. Per paragraphs 24 and 27 of the Standard the initial measurement of the asset and lease liability should factor in a number of variables.

3.41 Regarding measurement of the lease liability, this should include; fixed and variable payments, amounts payable under residual value guarantees, exercising purchase options if reasonably certain to exercise, or termination payment if the lease term reflects the exercise of this.

3.42 Note the interpretation offered in paragraph 3.17 that where entities cannot readily determine the implicit interest rate in the lease, entities should employ the discount rate promulgated in the PES and repeated in Chapter 4 annex 7 of the GAM. This is to ensure that the lease liability is measured at the present value of lease payments not paid at that date.

3.43 In regards to measurement of the right of use asset, this should include; the lease liability, lease prepayments or incentives, initial direct costs or an estimate of any dismantling, removal or restoring costs relating to either restoring the location of the asset or restoring the underlying asset itself, unless costs are incurred to produce inventories.

Subsequent Measurement

3.44 For subsequent measurement of the right of use asset entities are currently open to utilise either measurement model available under the Standard. Entities should be aware that the FReM's approach to subsequent measurement is expected to more closely reflect the valuation approach for owned assets, than sole application of the cost model approach will allow.

3.45 If transferring ownership of the underlying to the lessee at the end of the term or if the costs of the asset reflects that the lessee will exercise a purchase option, depreciation should be incurred from the commencement date to the end of the useful life of the underlying asset. Except in such instances as described above, depreciation should be incurred at the shorter of the useful life or the end of the lease term.

3.46 Subsequent measurement of the lease liability should factor in increases and decreases in the carrying amount relating to interest incurred and lease payments made respectively, as well as any remeasurement made to reflect a re-assessment of or modification made to the lease. Paragraphs 39 to 46 of the Standard govern reassessment of the lease.

Recognition Exemptions for Short-Term and Low Value Leases

Short-Term Leases

3.47 HM Treasury has mandated the employment of the recognition exemption offered in paragraph 5 (a) of the Standard in relation to short-term leases. In such instances the lessee shall recognise lease payments as an expense on a straight line or other systematic basis.

3.48 A short-term lease is any lease that at the commencement date of the lease (when the lessor makes an underlying asset available for use), has a lease term of 12 months or less. Where a modification or change in lease term occurs the lease is required to be accounted for as a new lease.

3.49 It is important to note that the exemption does not remove the requirement for the lessee to consider the lease term in line with paragraphs 18 to 21 and B34 to B41 of the Standard. Per paragraph 19 a range of relevant facts and circumstances must be considered in determining the incentive for the lessee to exercise or not exercise an option. Paragraph B40 emphasises that past practice regarding the period over which similar assets have been typically used, may provide assistance in determining lease terms and the exercising or otherwise of options.

3.50 Given the above and the explicit assertion in B39 that the shorter the non-cancellable period of a lease, the more likely it is expected the lessee will exercise an option to extend, it is critical for the lessee to consider the substance of the arrangement to determine the lease term and therefore the appropriate application of the recognition exemption. BC94 of IFRS 16 asserts that the rigour of the assessment expected to be applied to determine the lease term, reduces the risk of non-substantive break clauses being inserted into contracts, solely for accounting purposes.

Low Value Leases

3.51 The low value lease exemption carries greater complexity in its application. The FReM does not mandate the employment of 5 (b) which requires the lessee to expense on a straight line or other systematic basis over the term of a lease, a lease for which the underlying asset is of low value. It is proposed for entities to consider application of the exemption individually and on a lease by lease basis per the Standard.

3.52 Low value leases and the materiality of a lease are unrelated concepts. Where a lease governs an underlying asset judged to be of low value, the lease qualifies for the exemption regardless as to whether the lease is material to the lessee.

3.53 Whilst not providing an exhaustive list of characteristics to determine whether an underlying asset is of low value, the Standard expects different lessees to come to similar conclusions on the nature of low value leases and offers guidance in making such determinations;

- Examples of low value assets are given which includes tablets, personal computers, small items of furniture and telephones. Further to this, assets that are not of low value when new, are not considered to be caught under the exemption. A car is an example of an asset that is not of a low value when new. BC 100 confirms that the IASB considered a threshold of $5,000 or less when new as indicative of when an underlying asset is of low value.

- An underlying asset can only be low value if the underlying asset can benefit the lessee on its own or with resources that are readily available and is not highly dependent or interrelated with other assets.

- Where the lessee engages or expects to engage in a sublease, the head lease cannot be a low value asset.

3.54 With reference to the first two bullets, it should be identified there are both similarities and differences between the guidance on low value assets under IFRS 16 and DHSC's capitalisation policy for PPE under IAS 16. The consideration of a value of $5,000 or less aligns with capitalisation thresholds offered per Chapter 5 Annex 1, but the emphasis on the underlying asset being stand alone or not highly interrelated is divergent from the considerations employed for capitalisation of PPE.

3.55 As such practitioners should be aware that all elements of the IAS 16 or IAS 38 accounting policies are not equally appropriate for informing the application of the low value lease exemption.

3.56 HM Treasury is considering whether further guidance around low value leases will assist public sector entities in reaching similar conclusions as to what assets constitute a low value asset.

3.57 It is important to note that there are disclosure requirements based on the application of the recognition exemptions.

Lessor Accounting

3.58 As lessor accounting is predominantly carried forward from IAS 17, with IFRS 16 maintaining the distinction between finance and operating leases based on whether the arrangement substantially transfers all the risks and rewards incidental to ownership of an underlying asset and their accounting treatments accordingly, the focus of this annex regarding lessor accounting, relates to the enhanced disclosure requirements and the change in approach regarding the classification of subleasing arrangements.

Accounting for Subleases

3.59 Given the extent to which public sector entities sublease, both internally and externally to the DHSC Group, it is expected that this may have a significant impact on entities.

3.60 Under IFRS 16 an intermediate lessor must classify the sublease with reference to the head lease rather than with reference to the underlying asset. As such the sublease would be classified;

- As an operating lease if the head lease is expensed on a systematic basis per the short-term lease recognition exemption mandated to be applied by the FReM, or,

- Otherwise by reference to the right of use asset arising from the head lease.

3.61 It is anticipated that more subleasing arrangements will therefore be classified as finance leases. The IASB set out their reasoning behind this in BC232 to BC234 of IFRS 16. In short, they identify that;

- It is appropriate for the head lease and sublease to be accounted for separately as generally each contract is negotiated separately with different counterparties and thus obligations from the head lease aren't extinguished by the sublease.

- It is the right of use asset that the intermediate lessor controls than the underlying asset, which justifies the classification of the lease with reference to the right of use asset than the underlying asset.

- The intermediate lessors risk associated with the right of use asset can be converted into credit risk via a subleasing arrangement. Accounting per a finance lease and recognising a receivable for the net investment in the sub lease does reflect that risk.

- If the sublease covers the remaining term of the head lease the intermediate lessor no longer has the right to use the underlying asset and in such instances, it is appropriate to recognise the right of use asset and recognise the net investment in a sublease.

- The approach reflects a real economic difference as the intermediate lessor only has the right of use asset for a period of time and if sub-letting for all of the remaining term then it does effectively transfer the asset. This is a distinct economic reality compared to an operating lease in which a lessor will derive economic benefit once the lease term has ended.

3.62 On transition to IFRS 16 there are additional requirements for intermediate lessors.

3.63 Practitioners should therefore ensure they are familiar with the implications of this aspect of IFRS 16.

Transition

3.64 The FReM mandates a number of transition arrangements. It is therefore important for lessees and lessors to be aware of the treatments required.

Identifying a Lease

3.65 The FReM mandates the application of the practical expedient outlined in paragraph C3 of the Standard in which IFRS 16 is applied to contracts that fell within the scope of IAS 17 and IFRIC 4 and not applied to those identified as not containing a lease under the previous standards.

3.66 As such only leases entered into, or modified after the date of initial application, require the revised assessment to be undertaken per paragraphs 9 to 11 and B9 to B31 of IFRS 16, described above.

3.67 Entities should be aware that the interpretation put forward by HM Treasury presumes that IAS 17 and IFRIC 4 had been appropriately applied to all arrangements and is therefore caveated to identify that any known misapplication of should be corrected as a prior period error in accordance with IAS 8.

3.68 In applying the expedient offered in C3, entities need to apply the transition requirements outlined in C5 to C18 to those arrangements assessed as containing a lease.

Lessee Accounting

3.69 The FReM mandates the application of C5 (b) in which the prior year comparatives are not restated, but entities shall recognise the cumulative effect of initially applying the Standard at the date of initial application, as an adjustment to taxpayers' equity (or other component of equity as appropriate). This is in line with the transition arrangements for IFRS 9 and 15.

3.70 The 'cumulative catch up approach' coupled with FReM interpretations surrounding transition, require specific approaches to be taken for leases previously classified as operating leases. These are;

- Recognition of a lease liability measured at the present value of the remaining lease payments, discounted by the incremental borrowing rate,

- The election to measure the right of use asset at an amount equal to the lease liability adjusted by prepaid or accrued amounts recognised in the statement of financial position immediately before application of IFRS 16, has been mandated via the FReM for transition.

- The need to apply IAS 36 to right of use assets at the date of initial application unless the entity uses the expedient offered to rely on its assessment under IAS 37 as to whether leases are onerous immediately before the date of initial application, as an alternative to performing an impairment review.

- A need to measure a right of use asset at fair value if previously accounted for as an operating lease but will now be accounted for under IAS 40 at the date of initial application.

- The election to not make any adjustment for leases for which the underlying asset is of low value is mandated by the FReM.

- The expedient to not apply the requirements in paragraph C8 and described in bullets one and two above is mandated by the FReM where the lease term is to end within 12 months of the initial date of application. Such arrangements are to be accounted for in the same way that all short-term leases are.

- The option to employ hindsight in determining the lease term if the contract contains options to extend or terminate the lease is mandated by the FReM.

3.71 Paragraphs C9 and C10 offer additional expedients and options that lessees should be familiar with.

3.72 Regarding leases previously classed as finance leases, the carrying amounts of the right of use asset and lease liability should remain as the same as they were immediately before the date of initial application.

3.73 Paragraph C12 of the Standard prescribes specific disclosure requirements based on employment of the cumulative catch up approach. Note that where expedients are employed, mandated by the FReM or selected to be applied by the entity, their employment is disclosed as per the example accounting policy note in Chapter 5 Annex 1.

Lessor Accounting

3.74 In line with the carry forward of the lessor approach from IAS 17, there is no requirement for a lessor to make adjustments on transition to IFRS 16.

3.75 The most notable transition impact is felt for intermediary lessors. Under paragraph C15 all intermediary lessors are required to reassess subleases classified as operating leases under IAS 17 to determine whether they should be reclassified. Entities should note that this reassessment is required despite the expedient in C3 being applied.

3.76 The assessment is required to be performed at the date of initial application on the basis of the remaining contractual term and terms and conditions of the head lease and sublease at that date. Further detail is provided above as to the assessment of subleases under IFRS 16.

Sale and Leaseback Transactions

3.77 On transition, whilst an entity is not to reassess sale and leaseback transactions entered into before the date of initial application, entities should note that if the transaction generated a sale and a finance lease, the lease should be accounted in the same way as any finance lease in existence at the initial date of application, by the seller. If generating an operating lease, the operating lease should be measured in the same way as any other operating leases at the initial date of application. The right of use asset in this instance must also be adjusted to recognise any deferred gains or losses in relation to below market terms recognised in the statement of financial position immediately before the initial date of application.

Disclosures

3.78 IFRS 16 provides enhanced disclosure requirements based on the objective identified in paragraphs 51 and 89 of the Standard, to give a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of lessee's and lessor's.

3.79 Entities are reminded that the materiality considerations offered in the Conceptual Framework and in IAS 1 are pervasive across all standards. Care must be taken to not reduce the understandability of financial statements.

Lessee Disclosures

3.80 IFRS 16 requires disclosure through a single note or separate section in the financial statement for where an entity it is a lessee. When information is already presented elsewhere, a cross reference to this detail in the lessee note is sufficient to avoid duplication.

3.81 There are a number of quantitative disclosures requested to be presented in a tabular format under IFRS 16. For each reporting period, these include disclosure as to the level of;

- Depreciation charge
- Interest expense on lease liability
- Expense relating to short term leases that have a remaining term between 12 months and 1 month. This may involve disclosing the amount of lease commitment if the portfolio of short-term future commitments is dissimilar to those reported in during the period
- Expense of low value assets that aren't accounted for as short-term leases. The application of the recognition exemption must also be disclosed

- Expense relating to variable lease payments not included in the measurement of a lease liability
- Income from subleasing right of use assets
- Total cash outflow for leases
- Additions to right of use assets
- Gains or losses from sale and leaseback transactions
- The carrying amount of right of use assets by underlying class at the end of the reporting period.

3.82 Regarding the maturity of lease liabilities, a lessee shall disclose separately a maturity analysis through applying the applicable requirements of IFRS 7 (paragraphs 39 and B11). This must be separate to the maturity analyses of other financial liabilities.

3.83 Further quantitative and qualitative information regarding the leasing activities of an entity may be required to meet the disclosure objective of enabling users to assess impacts of leases on financial performance and the financial statements per paragraph 59 of the Standard. Paragraphs B48 to B52 of IFRS 16 provide further detail as to the nature of the considerations that should be made to determine whether additional information is required.

3.84 Considerations regarding the relevant and apparent nature of the context in which entities enters into lessee arrangements will determine as to whether additional information relating to variable lease payments, the exercising or otherwise of options, residual value guarantees and sale and leaseback transactions, is appropriate to be disclosed.

3.85 Examples given in the Standard include deviations from industry practices, or exposure to other risks arising from lessee arrangements.

Lessor Disclosures

3.86 A lessor is required to provide the following disclosure in a tabular format per IFRS 16;

- Selling profit or loss on finance leases
- Finance income on the net investment in finance leases

- Income relating to variable lease payments not included in the measurement of the net investment for finance leases

- Lease income on operating leases, but separately disclosing variable lease payments that don't depend on an index or rate.

3.87 Regarding finance leases a lessor shall also provide a quantitative and qualitative explanation of significant changes in the carrying amount of the net investment in finance leases.

3.88 A lessor is also required to disclose a maturity analysis of the lease payments receivable conveying the undiscounted payments to be received on an annual basis for each of the next 5 years with a total of the amounts for receivables due over 5 years. The lessor is required to reconcile this to the net investment in a lease, which is expected to identify unearned finance income and unguaranteed residual value.

3.89 Regarding operating leases, for items of PPE the lessor shall apply the disclosure requirements of IAS 16, disaggregating asset classes into those assets subject to operating leases and those not subject. Therefore IAS 16 disclosures for assets subject to operating leases will be disclosed separately from owned assets held and used by the lessor.

3.90 Where appropriate lessors must disclose per the requirements of IAS 36, IAS 38, IAS 40 and IAS 41 for assets subject to operating leases.

3.91 As per for finance leases a maturity analyses showing the undiscounted lease payments to be received on an annual basis for each of the next 5 years and then a total amount for all other payments beyond 5 years should be disclosed.

3.92 Further to the quantitative disclosures and similar to the rationale behind lessee disclosures, a lessor shall disclose additional information as prescribed by paragraph 92 of IFRS 16, where it is judged that such additional information enables the entity to achieve the disclosure objective of the Standard.

Transition

3.93 In employing the cumulative catch up approach per C5 (b) of IFRS 16, as well as disclosing the necessary detail per IAS 8 paragraph 28 on initial application of the Standard, in place of detail requested in 28 (f) of IAS 28, entities must disclose;

- The weighted average lessee's incremental borrowing rate applied to lease liabilities recognised in the statement of financial position on initial application

- An explanation of any difference between operating lease commitments disclosed at the end of the reporting period preceding initial application discounted using the incremental borrowing rate determined and lease liabilities recognised on initial application
- The practical expedients employed.

Lessee Presentation

Statement of Financial Position

3.94 The Standard prescribes that right of use assets and lease liabilities are presented separately from other assets and liabilities. If there isn't separate presentation in the statement of financial position the lessee must include the right of use assets within the same line item as if they were owned and then disclose which line items in the statement of financial position contain right of use assets and lease liabilities.

3.95 Where right of use assets meet the definition of investment property, these are exempt from the above requirement and are required to be disclosed as part of investment property.

Statement of Comprehensive Income / Statement of Comprehensive Net Expenditure

3.96 It is noted that interest expense on the lease liability is a component of finance costs. Depreciation charge on a right of use asset must be separately presented from the interest expense.

Statement of Cash Flows

3.97 The cash payments for the principal of the lease liability shall be classified within financing activities, with the interest element being classified per the requirements of IAS 7 for interest paid.

3.98 Payments related to short-term leases, low value assets and variable lease payments not included in the measurement of the lease liability being included within operating activities.

Lessor Presentation

3.99 A lessor must present underlying assets subject to an operating lease according to the nature of the underlying asset in its statement of financial position.

Further Guidance

3.100 HM Treasury has published its current version of the IFRS 16 public sector application guidance."

4. IFRS 16 Guidance in Chapter 5 of the GAM.

4.1 The substantial changes developed for Chapter 5 of the 2020-21 GAM relate to the revised accounting policy note developed for transition to IFRS 16 in Chapter 5 Annex 1 of the GAM. Minor changes are detailed in the main body of Chapter 5

IFRS 16 guidance in Chapter 5 - main body

4.2 The changes made to the disclosure requirements in Chapter 5 reference the detail that will be set out in Chapter 4 Annex 11. It is important to note that as disclosures for PFI, LIFT and other service concession arrangements utilise IAS 17, these will reflect the revised requirements under IFRS 16 on adoption.

4.3 As such the main changes developed for the main body of Chapter 5 is per the following text;

"IFRS 16 Leases

4.4 The disclosures prescribed by this Standard and the specific disclosure objective for both lessee and lessor are outlined in Chapter 4 Annex 11. It is expected in the Standard that these disclosures take the form of one note, but where the information is disclosed elsewhere in the financial statements, the detail should be cross referenced in the leases note rather than duplicated.

Commitments under PFI, LIFT and other service concession arrangements

4.5 The relevant standards for this note are IFRIC 12, Service Concession Arrangements, SIC 29, Service Concession Arrangements: Disclosures, and IFRS 16, Leases.

4.6 The disclosures in SIC 29, Service Concession Arrangements: Disclosures and IFRS 16 Leases must be provided.

4.7 Where relevant, DHSC group bodies must include the following disclosures separately for LIFT contracts and for PFIs and other service concession arrangements.

4.8 DHSC group bodies must disclose total future minimum payments following the requirements of paragraph 39 of IFRS 7, which per B11 of the Standard, requires an entity to judge the appropriate time bands with which to provide liquidity risk disclosures under IFRS 16. Sector consolidation schedules will provide indication of the appropriate time bands. Individual entities must judge whether such bands are appropriate for their individual accounts

4.9 Whilst there remains scope under IFRS 16 for there to be off SoFP arrangements where, per the FReM flowchart of accounting for PPP arrangements in Chapter 7, the agreement is not judged to contain a lease, it is expected for such circumstances to be less common

4.10 DHSC group bodies must disclose the total obligations, including obligations in respect of ongoing service elements of the contract, analysed by the same periods as above. Additionally, DHSC group bodies must provide the IFRS 16 disclosures for lease obligations, specified in Chapter 4 Annex 11."

IFRS 16 disclosure in Chapter 5 Annex 1 of the GAM

4.11 Per the overhaul of the disclosure requirements for IFRS 9 and 15 in the accounting policy note on transition to those standards, a similar revision has been developed for IFRS 16 per the following text;

"1.18 Leases

IFRS 16 Leases is applied for annual reporting periods beginning on or after 1 January 2019. The transition to IFRS 16 has been completed in accordance with paragraph C5 (b) of the Standard, applying IFRS 16 requirements retrospectively recognising the cumulative effects at the date of initial application.

In the transition to IFRS 16 a number of elections and practical expedients offered in the Standard have been employed. These are as follows;

[The entity] has opted to apply the practical expedient offered in the Standard per paragraph C3 to apply IFRS 16 to contracts or arrangements previously identified as containing a lease under the previous leasing standards IAS 17 Leases and IFRIC 4 Determining whether an Arrangement contains a Lease and not to those that were identified as not containing a lease under previous leasing standards.

[The entity] has elected to measure right of use assets for leases previously classified as operating leases per IFRS 16 C8 (b)(ii), at an amount equal to the lease liability adjusted for accrued or prepaid lease payments.

No adjustments will be made for operating leases in which the underlying asset is of low value per paragraph C9 (a) of the Standard

The election to not apply transitional provisions to operating leases whose terms end within 12 months of the date of initial application has been employed per paragraph C10 (c) of IFRS 16

The election under C10 (e) of IFRS 16 to use hindsight to determine the lease term when contracts or arrangements contain options to extend or terminate the lease

[List any other transition expedients employed by the entity at its discretion]

Due to transitional provisions employed the requirements for identifying a lease within paragraphs 9 to 11 of IFRS 16 are not employed for leases in existence at the initial date of application. Leases entered into after the 1st April 2019 will be assessed under the requirements of IFRS 16.

There are further expedients or election have been employed by [the entity] in applying IFRS 16. These include;

The election under paragraph 5 (a) of IFRS 16 in which measurement requirements under IFRS 16 are not applied to leases with a term of 12 months or less

[List any other expedients employed by the entity (such as low value 5(b) or 15 on componentisation]

The nature of the accounting policy change for the lessee is more significant than for the lessor under IFRS 16. IFRS 16 introduces a singular lessee approach to measurement and classification in which lessees recognise a right of use asset. For the lessor leases remain classified as finance leases when substantially all the risks and rewards incidental to ownership of an underlying asset are transferred to the lessee. When this transfer does not occur, leases are classified as operating leases.

1.18.1 [The entity] as lessee

At the commencement date for the leasing arrangement a lessee shall recognise a right of use asset and corresponding lease liability. [the entity] employs a [cost / revaluation] model for the subsequent measurement of its right of use assets.

Lease payments are apportioned between finance charges and repayment of the principal. Finance charges are recognised in the Statement of Comprehensive [Income / Net Expenditure].

Lease payments are recognised as an expense on a straight-line or another systematic basis over the lease term, where the lease term is in substance 12 months or less, or is elected as a lease containing low value underlying asset by [the entity].

1.18.2 [The entity] as lessor (where relevant)

Amounts due from lessees under finance leases are recorded as receivables at the amount of [the entity]’s net investment in the leases. Finance lease income is allocated to accounting periods to reflect a constant periodic rate of return on [the entity]’s net investment outstanding in respect of the leases.

Income from operating leases is recognised on a straight-line or another systematic basis over the term of the lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight-line basis over the lease term."

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