



Financial Reporting Advisory Board Paper *IFRS 16 Leases – Work Plan*

Issue:	This paper provides the Board with HM Treasury's work plan to consider the public sector impacts of IFRS 16 and highlights some of the issues expected to be considered by the technical working group.
Impact on guidance:	None at this stage. The FReM will need to be updated in due course.
IAS/IFRS adaptation or interpretation for the public sector context?	This will be revisited in a later paper to the Board. IAS 17 and related Interpretations currently applies without adaptation or interpretation.
Impact on WGA?	None at this stage but the changes in the FReM will affect WGA.
IPSAS compliant?	Prior to IFRS 16, IPSAS and IAS 17 were broadly consistent. IPSASB are considering the impacts of IFRS 16 through their leases project.
Alignment with National Accounts	IFRS 16 is not fully aligned with National Accounts. A parallel work stream is being set up to consider the National Accounts impact.
Impact on budgetary regime and Estimates?	Impacts on the budgetary regime and Estimates will be derived from the outcomes of the review of the National Accounts and its alignment.
Recommendation:	The Board agree the work plan and seek their views on which aspects of the Standard to prioritise when reviewing the potential impacts on the public sector.
Timing:	No changes are expected to be made until 2019-20

DETAIL

Background

1. The International Accounting Standards Board (IASB) has issued IFRS 16 Leases which replaces IAS 17 Leases and related interpretations¹. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of IFRS 16. For the public sector this would be from 1 April 2018 if early adoption was permitted.
2. The Standard has not yet been endorsed by the European Union. The European Financial Reporting Advisory Group (EFRAG) draft endorsement is expected to be reached by the end of 2017.
3. HM Treasury's paper of March 2016 (FRAB 126) provided the Board with an overview of the new Standard and initial consideration to the main challenges that it presents for the public sector. This was followed by HM Treasury's paper (FRAB 127) analysing the existing leases disclosed in the 2014-15 Whole of Government Accounts and potential issues to consider for transition.
4. This paper provides the Board with HM Treasury's work plan to consider the public sector impacts of IFRS 16 and highlights some of the issues expected to be considered by the technical working group.

Work Plan

5. HM Treasury's work plan for considering IFRS 16 for the public sector can be found in Annex A. The Exposure Draft is expected to be issued December 2017 with a final FReM extracts and any associated application guidance to be available summer 2018.
6. The format of the work plan is similar to that adopted for IFRS 9 and 15. However as IFRS 16 provides a fundamental shift in accounting and associated impacts on other parts of the business, the plan allows for additional time for the technical working group to develop a detailed understanding and potential responses to issues identified.

HM Treasury would like the Board's agreement on the proposed work plan for considering the impacts and implementation in the public sector.

Issues for Consideration

7. The introduction of IFRS 16 will be challenging, especially for those that have a large lease portfolio. Whilst a lot of these challenges are currently being tackled by the private sector, where the public sector can draw upon best practice, there are also additional challenges from being in the public sector through the fiscal and financial management policies adopted.
8. Examples of issues relevant authorities and technical working group will be considering to assess the impacts on the public sector include:

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*.

- a) **Identifying lease agreements and extracting data:** entities will need to ensure they are fully aware of the existence and completeness of all their lease contracts whether held in hard copy or electronically and how they plan to extract the necessary data from these documents to apply the IFRS 16 criteria.
- b) **Low value assets:** The Standard permits low value assets to be expensed rather than come on-balance sheet. However what is the public sector definition of low value and should we mandate a single threshold across the public sector? The previous paper to the Board highlighted the lack of information disclosed in accounts about the other lease category and therefore we do not know the nature of these assets and whether they could be considered as low value.
- c) **Discount rates:** The Standard allows the option to use the rate implicit in the lease or the incremental rate of borrowing. Are entities able to identify the rate implicit? If not, what would be considered the government's incremental rate of borrowing? Are there any differences in this borrowing rate amongst different parts of the public sector?
- d) **New estimates and judgements:** The Standard introduces new estimates and judgements that affect the identification (is it a lease or a service contract?), classification and measurement of lease transactions. These considerations will need to be considered at lease inception, at reporting dates and any lease amendments. Are entities, especially those with large leasing portfolios prepared for reassessment of requirements on a regular basis?
- e) **Transition and Practical expedients:** There are a number of practical expedients available to aid implementation and reduce the costs of implementation. Which ones are most suited to the public sector and are there any options we wish to mandate or discount?
- f) **Changes in business practices:** There are a number of policy decisions made around the ability for government to lease. For example schools and academies are generally not permitted to enter into finance leases. Bringing assets and liabilities onto the balance sheet may affect covenants or financial metrics in local government or NHS. There are also tax considerations to be addressed. An understanding of these issues will be required to incorporate into the impacts for the public sector as well as departments needing to make any policy changes as a result of the new standard

HM Treasury would like to ask the Board for their views on which aspects of the Standard or implementation issues to prioritise when considering the impacts for the public sector.

National Accounts, Budgets and Estimates

9. IFRS 16 does not fully align with the European System of Accounts 2010, which currently distinguishes leases between finance and operating leases. This misalignment will impact on the data collected for the National Accounts, the fiscal aggregates measures and the budgeting framework. There will also be broader consequences arising from a departure from commercial norms (with the private sector fully applying IFRS 16) and the expectations from the leasing market.

10. As a result, HM Treasury, in collaboration with the Office for National Statistics, will operate a parallel work plan alongside the considerations for IFRS 16 to ensure the impacts on public

sector finances are understood. HM Treasury will consider a range of factors such as the costs associated with dual reporting and commercial realities and ensure they are incorporated into the considerations for IFRS 16 well before the proposed implementation date. By having a parallel work plan, HM Treasury aims to minimise any disruption to business practices or additional reporting requirements through having misaligned frameworks.

11. Future FRAB papers will include progress updates from this work stream and where the outcomes may impact on the IFRS 16 implementation plan and alignment.

IPSASB

12. IPSASB launched their leases project during June 2016 with the aim to issue a new IPSAS on leases (to replace IPSAS 13) which will be converged with IFRS 16. IPSASB highlighted that not amending or replacing IPSAS 13 will result in the use of different models for accounting for leases in the public and private sectors.

13. IPSASB aim to issue their Exposure Draft in summer 2017 with a final IPSAS expected June 2018.

Recommendation

14. HM Treasury ask that the Board agree the work plan and seek their views on which aspects of the Standard to prioritise when reviewing the potential impacts on the public sector.

HM Treasury

24 November 2016

Annex A: High Level Work Plan

Date		Activities
March 2016	FRAB	FRAB Paper – Overview of Standard
June 2016	FRAB	FRAB Paper – Summary of existing leases and transition impacts
November 2016	FRAB	FRAB Paper – Work Plan including potential key topics to consider for the working group
Dec 2016-Mar 2017	Technical Working Groups	To work through the Standard and understand the application and risk profile across the public sector and potential adaptations or interpretations. Informal public sector consultation
March 2017	FRAB	FRAB Paper - Update on technical working groups and informal consultation
Apr-May 2017 (TBC)	Technical Working Groups	To follow up on specific issues and consider adaptations and interpretations for the public sector
June 2017	FRAB	FRAB Paper – Update on technical working groups including potential interpretations/adaptations for the public sector
July - Oct 2017	Technical Working Groups	Consider Exposure Draft and Application Guidance
November 2017	FRAB	Exposure Draft and Application Guidance for approval for consultation (provided in advance of meeting)
Dec 17 – Feb 2018	Exposure Draft Consultation	Issue Exposure Draft inviting comment from stakeholders
Feb/Mar 2018	Exposure Draft Responses	HMT consideration of responses to Exposure Draft
March 2018	FRAB	FRAB meeting to consider adoption of the standard based on the exposure draft and response
April – Nov 2018		Publish FReM extract and Application Guidance or Further opportunity to consider any FReM changes
June 2018	FRAB	FRAB meeting for further consideration if needed.
November 2018	FRAB	Approve 2019-20 FReM
December 2018		Publish 2019-20 FReM
1 April 2019 (expected)		UK public sector implementation of IFRS 16