



## Financial Reporting Advisory Board Paper

### IFRS 16 Leases – Progress update and Exposure Draft

<b>Issue:</b>	This paper provides the Board with an Exposure Draft for adopting IFRS 16 with the proposed public sector adaptations and interpretations. This paper also provides the Board with potential divergence with CIPFA/LASSAC and an update on the alignment issues with the National Accounts.
<b>Impact on guidance:</b>	The Exposure Draft details the proposed changes to the FReM as a result of adopting IFRS 16. Changes are also proposed to the accounting for service concession arrangements.
<b>IAS/IFRS adaptation or interpretations?</b>	Adaptations and interpretations are proposed for IFRS 16 for the definition of a contract, short term leases, transition options, subsequent asset measurement, peppercorn leases and incremental rate of borrowing.
<b>Impact on WGA?</b>	None at this stage, but decisions on transition and disclosure requirements will affect how IFRS 16 is applied in WGA.
<b>IPSAS compliant?</b>	IFRS 16 is not IPSAS compliant. IPSASB have a leases project with an Exposure Draft issued February 2018.
<b>Impact on budgetary regime?</b>	IFRS 16 does not currently align with the budgetary regime which is based on the National Accounts.
<b>Alignment with National Accounts (ESA10)?</b>	IFRS 16 does not align with the National Accounts which maintains the operating and finance lease distinction.
<b>Impact on Estimates?</b>	IFRS 16 will not align with the Estimates as this is based on the budgetary regime.
<b>Recommendation:</b>	The Board is asked to review the Exposure Draft, consider the divergences with CIPFA/LASSAC and note the issues with alignment with the National Accounts.
<b>Timing:</b>	No changes are expected to be made to the FReM until the 2019-20 financial year.

15 March 2018

## DETAIL

### *Background*

1. The International Accounting Standards Board (IASB) has issued IFRS 16 Leases which replaces IAS 17 and related Interpretations. IFRS 16 was adopted by the EU in December 2017 with an effective date of 1 January 2019.
2. As agreed by the Board at the November 2016 meeting (FRAB 128), when HM Treasury provided the Board with their high-level work plan for implementation, the planned timetable for implementation of IFRS 16 in the public sector is the 2019-20 financial year.
3. At the last meeting, the Board received an update following the responses from the initial consultation exercise. This paper provides the Board with the Exposure Draft, areas for divergence with CIPFA/LASSAC Code of Practice and an update to the issues with alignment.

### *National Accounts*

4. At the date of this paper the Office of National Statistics has not been reached a position regarding the assessment of leases under the ESA 10 criteria. However, to progress the accounting considerations for IFRS 16, the Exposure Draft has been prepared, with a reference to the potential areas for divergence if leases were to be recognised in the Statement of Financial Position under ESA 10 as well.

### *Exposure Draft*

5. The exposure draft is detailed in Annex B. The following public sector adaptations and interpretations are being suggested in the Exposure Draft:
  - a. (Adaptation) Definition of a contract
  - b. (Interpretation) Short term leases
  - c. Transition
    - i. (Interpretation) Grandfathering
    - ii. (Interpretation) Transition approach
    - iii. (Interpretation) Asset measurement on transition
    - iv. (Interpretation) Further transition options
  - d. (Interpretation) Incremental rate of borrowing
  - e. (Interpretation) Subsequent asset measurement
  - f. (Adaptation) Peppercorn leases

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## ***Alignment with CIPFA/LASSAC***

6. In the majority of areas, the proposals for the FReM and the Code of Practice are aligned. This will facilitate consolidation into the Whole of Government Accounts. However, there are some areas of divergence; Annex A provides a summary of these. The Board should note the proposals by CIPFA/LASSAC are still under discussion.

## ***Next steps***

7. The next steps in the implementation work will include the following:
- a. Issue the Exposure Draft for public consultation (proposed end of March 2018)
  - b. Agree methodology for calculating the internal rate of borrowing
  - c. Develop Application Guidance to assist preparers
  - d. Finalise the alignment issues with the National Accounts

## ***Recommendation***

8. The Board is asked to review the Exposure Draft for consultation, consider the divergences with CIPFA/LASSAC and note the issues with alignment with the National Accounts.

HM Treasury  
15 March 2018

Annex A – Areas of divergence with CIPFA/LASSAC  
Annex B – IFRS 16 Exposure Draft



## Annex A: Areas of potential divergence between the FReM and the Code of Practice

	Proposal for the FReM	Proposal for the Code
<b>Definition of a lease contract</b>	Proposed Public Sector Adaptation: The definition of a contract is expanded to include intra UK government agreements where non-performance may not be enforceable by law.	This does not apply to local authorities therefore there are no proposals to adapt the Code for the definition of a lease contract.
<b>Transition – definition of a lease</b>	Proposed Public Sector Interpretation: 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) unless they have the explicit approval from the relevant authority otherwise.	<p>The CIPFA/LASSAC sub group and the Board have considered this practical expedient and anticipate that local authorities will use it but have considered that local authorities are best placed to decide their needs in relation to this issue.</p> <p>It is anticipated that as most authorities are likely to apply this approach there should not be too much of a difference between the FReM and the Code.</p>
<b>Practical expedients on transition</b>	<p>Proposed Public Sector Interpretation: The option available for the following transition options has been withdrawn. All entities must apply the following transition options in IFRS 16:</p> <ul style="list-style-type: none"> <li>• No requirement to make 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))</li> <li>• A lessee may elect not to transition to leases for which the lease terms ends within 12 months of the initial date of application (C10 (d)).</li> </ul>	CIPFA/LASAAC and the sub group had not anticipated mandating these practical expedients on the basis again that local authorities would be best placed to decide how to use them. However, as this issue was not debated CIPFA/LASAAC is invited to consider whether it wishes to mandate the use of these practical expedients.

	Proposal for the FReM	Proposal for the Code
	<ul style="list-style-type: none"> <li>A lessee may use hindsight, such as determining the lease term if the contract contains options to extend or terminate the lease (C10 (e))</li> </ul>	
<b>Incremental rate of borrowing</b>	Proposed Public Sector Interpretation: Where entities cannot readily obtain the interest rate implicit in the lease, they should use the HM Treasury discount rate promulgated in PES papers	This is not an issue for local authorities and therefore the setting of a central rate has not been proposed. HM Treasury sets a number of discount rates for central government and the Code has not followed this approach.