



HM TREASURY

Financial Reporting Advisory Board Paper

IFRS 16 progress update

Issue:	This paper provides an update on the implementation plan of IFRS 16 within the public sector and highlights the potential divergence with the CIPFA/LASSAC proposed treatment. It also sets out next steps.
Impact on guidance:	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.
IAS/IFRS adaptation?	Per exposure draft already issued, 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.
Impact on WGA?	None at this stage, but decisions on transition and disclosure requirements will affect how IFRS 16 is applied in WGA.
IPSAS compliant?	IFRS 16 is not IPSAS compliant. IPSASB have a leases project with an Exposure Draft issued, with comments due by 30 June.
Impact on budgetary and Estimates regimes?	This is still to be determined and is an area that HMT will focus on in upcoming months. Refer to relevant section within this paper.
Alignment with National Accounts	IFRS 16 does not align with the National Accounts which maintains the operating and finance lease distinction. Refer to relevant section within this paper.
Recommendation:	HM Treasury welcome the Board's comments on the paper.
Timing:	HM Treasury will use the steers from the Board to inform the next steps discussed in the paper with implementation of the Standard within the public sector planned from 2019-20.

Introduction

1. The International Accounting Standards Board (IASB) issued IFRS 16 Leases in January 2016 and this replaces IAS 17 and related Interpretations. IFRS 16 was adopted by the EU in December 2017 with an effective date of 1 January 2019. As agreed at the November 2016 meeting (FRAB 128), IFRS 16 is planned for government implementation in the 2019-20 financial year.
2. At the March FRAB meeting, the Board provided feedback on the Exposure Draft, noted potential misalignment with National Accounts and provided commentary on divergences with the proposed CIPFA/LASAAC treatment.
3. This paper provides an update on these issues and next steps and welcomes any comments from the Board.

Exposure Draft

4. Since the last Board meeting and subsequent out of meeting comments received on the Exposure Draft, the [IFRS 16 Leases Exposure Draft](#) was published on 9th May 2018 and is open for consultation until the 31st July. Some initial comments have already been received.
5. HMT will collate, analyse and provide responses on comments subsequent to the end of the consultation period and provide details of the findings to the Board
6. The consultation responses will help inform decisions regarding the potential adaptations or interpretations of the Standard relevant for public sector financial reporting, if deemed relevant.

National Accounts, Budgets and Estimates

7. As noted in the March 2018 FRAB meeting (132) there is likely misalignment between ESA 10 and IFRS 16. An ongoing priority for the implementation work plan of IFRS 16 is to agree the treatment of leases in budgets and Estimates, determining areas of alignment and misalignments with National Accounts. This is in order to ensure that IFRS 16 and National Accounts can fulfil their specific requirements, while ensuring budgeting treatment is reasonable, offers appropriate financial management incentives to departments and does not create an unnecessary burden of work.
8. Currently, National Accounts will misalign with IFRS 16 in respect of non-full repair and insure property leases and in respect of operating leases. These types of leases are unlikely to be treated as on balance sheet for the purposes of National Accounts.

9. Following further discussions with the ONS, HMT is investigating how this misalignment can be addressed. A data collection exercise is due to be undertaken with departments to help in this assessment (co-ordinating with the data request in the Exposure Draft). This will help assess the likely impact of misalignment of non-full repair and insure property leases and operating leases.
10. We will outline the proposed approach at the November Board meeting, before which we will continue to work with and obtain input from the IFRS 16 Technical Working Group.

Alignment with CIPFA/LASAAC

11. The CIPFA/LASAAC [consultation](#) on IFRS 16 and the Code of Practice was issued on 22nd May, with a response date of 7th September. 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. Some may result in material misalignment; for example, the potential divergence on Subsequent Asset Measurement.

Next steps

Next steps and the timeline for this includes:

- Issue data requests to departments for National Accounts, budgeting and Estimates work (June/July)
- Collate and analyse data in partnership with the ONS to identify misalignments and to clarify the budgeting and Estimate treatment of leases (August)
- Collate and analyse responses to the Exposure Draft (August)
- Identify and propose the financial reporting treatment and relevant adaptations and interpretations for the public sector in relation to IFRS 16 application (August and September)
- Draft application guidance for preparers, update the FReM 2018-19 to include the Standard, and update budgetary and Estimate guidance (September and October)
- Obtain input from the FRAB on guidance drafted and the final measures required to implement IFRS 16 (November – this may be out of meeting with the final draft FReM to be agreed at the November FRAB meeting)
- Issue the FReM 2019-20 including the implementation of IFRS 16 (December 2018)

HM Treasury
14 June 2018

Annex A: Areas of divergence between the FReM and the Code of Practice per respective consultations

	Proposal for the FReM	Proposal for the Code
Definition of a lease contract	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.
Practical expedients on transition	<p>The option available to implement the following transition options has been withdrawn and instead all entities must apply the following transition options in IFRS 16:</p> <ul style="list-style-type: none"> • No requirement to adjust for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a)) • 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)). • A lessee may use hindsight, such as determining the lease term if the contract contains options to extend or terminate the lease (C10 (e)) 	<p>The option available to implement the following transition options has been withdrawn and instead all entities must apply the following transition options in IFRS 16:</p> <ul style="list-style-type: none"> • No requirement to adjust for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a)) • A single discount rate could be applied to a portfolio of leases with reasonably characteristics
Incremental rate of borrowing	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.
Subsequent asset measurement	HMT proposes the IFRS 16 cost model as an expedient for subsequent asset measurement. While the cost model is withdrawn from the FReM, the IFRS 16 cost model is different to the IAS16 equivalent (for example it allows revaluations based on changes to lease terms as a result of market rent reviews).	<p>The consultation offers two options for subsequent asset measurement:</p> <ul style="list-style-type: none"> • The cost model proxy proposed by HMT. • The application of fair value with practical expedients applying for lower value property which will allow

	Proposal for the FReM	Proposal for the Code
		the IFRS 16 cost model to be used as a proxy for fair value.
Peppercorn leases/Leases with concessions	Leases with concessions or for nominal (i.e. Peppercorn) consideration will measure the liability including the concession, while PPE will be measured as if no concession had been provided. As the lease unwinds, the difference between PPE and the lease liability is posted to income.	Leases with concessions or for nominal (i.e. Peppercorn) consideration will measure the liability and PPE as if no concession had been provided. A separate liability will be created for the value of the concession. This liability will unwind to income over the course of the lease.
Portfolio exemption	As a practical expedient, the standard can be applied to a portfolio of leases with similar characteristics, as long as the effect would not be materially different from applying the standard to individual leases. The Exposure Draft does not cover and does not propose to apply mandate this expedient.	As a practical expedient, the standard can be applied to a portfolio of leases with similar characteristics, as long as the effect would not be materially different from applying the standard to individual leases. The Consultation indicates this will be mandated.
Separating Lease Components	IFRS 16 includes a practical expedient that permits, by class of asset, lessees to ignore the requirement of separate non-lease and lease components and account for the entire contract as a single lease component. The Exposure draft does not cover and does not propose to mandate this expedient.	IFRS 16 includes a practical expedient that permits, by class of asset, lessees to ignore the requirement of separate non-lease and lease components and account for the entire contract as a single lease component. The Consultation does not mandate this expedient, but does imply this could be widely applied.
Service concession arrangements	It is proposed that all references in the FReM to service concession arrangements will be updated from IAS 17 to IFRS 16.	It is suggested that references in the Code of Practice to service concession arrangements will not be changed from IAS 17. This is suggested as a practical measure to avoid the yearly remeasurement of, for example, PFI contracts.