Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	Update on CIPFA/LASAAC development of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code)
Impact on guidance:	Planned amendments for the 20/21 Code of Practice on Local Authority Accounting.
IAS/IFRS adaptation?	• Adaptation relating to IAS 16 *Property, Plant & Equipment* disclosure requirements (see para 12 item A1). • Adaptation relating to IFRS 16 *Leases* relating to Housing Revenue Account tenancies (see paragraph 17 item 1); nil consideration amendment for lessees only (item 3); and revaluation on transition (item 5).
Impact on WGA?	• Consistency of service concession arrangements (PFI/PPP etc) liability measurement sought (paragraph 12 item A2). • Planned disclosure requirements accompanied by statement of WGA information requirements (paragraph 17 item 1, Appendix A items C4, C5) • Consistency of IFRS 16 *Leases* implementation practices -see paragraph 17 relating to: definition of a lease for lessors (item 3); transition practices for nil consideration leases (item 4); valuation on transition (item 5), valuation at 31/3/21 (item 6).
IPSAS compliant?	N/A – No planned change to IPSAS references in the Code
Impact on budgetary regime?	None – local authorities only.
Alignment with National Accounts	IFRS 16 *Leases* early application by Transport for London (paragraph 16)
Impact on Estimates?	None – local authorities only.
Recommendation:	The Board is requested to discuss and comment on the planned 20/21 Code and future direction of the Code.
Timing:	CIPFA/LASAAC Strategic Plan : Primarily affecting 21/22 Code or later Planned Code text for 20/21 effective from 1 April 2020

DETAIL

Background

1. CIPFA/LASAAC met on 6 November 2019. Items discussed included:

   a) Feedback from stakeholder engagement and Code strategic direction
   b) Responses to the 20/21 Code consultation process and amendments to the 20/21 Code
   c) IFRS 16 Leases implementation in 20/21

Feedback from stakeholder engagement and Code strategic direction

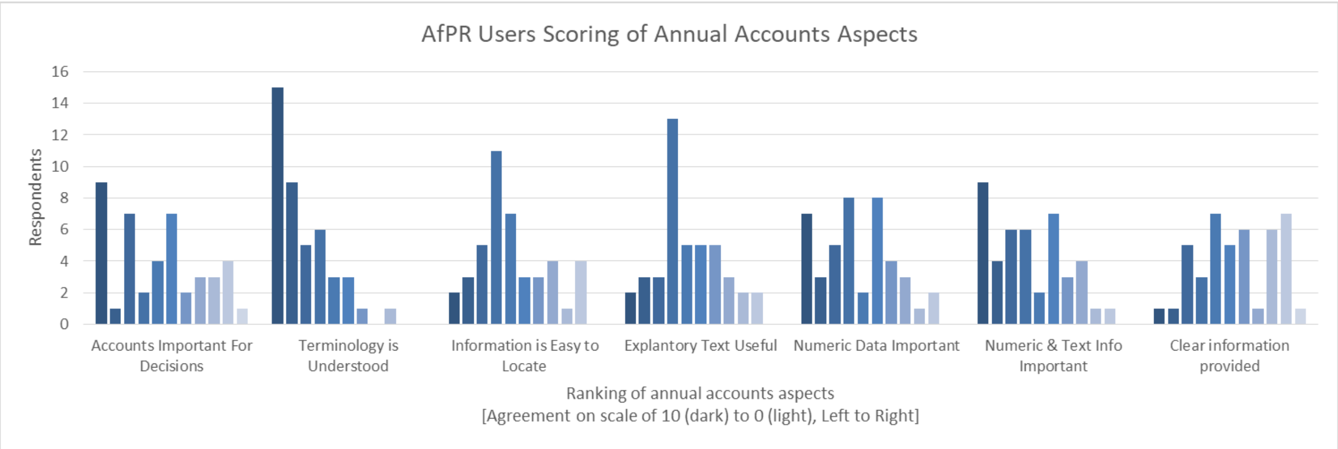
2. To achieve its vision statement, CIPFA/LASAAC has initiated a strategic plan. At the 6 November 2019 meeting CIPFA/LASAAC considered:

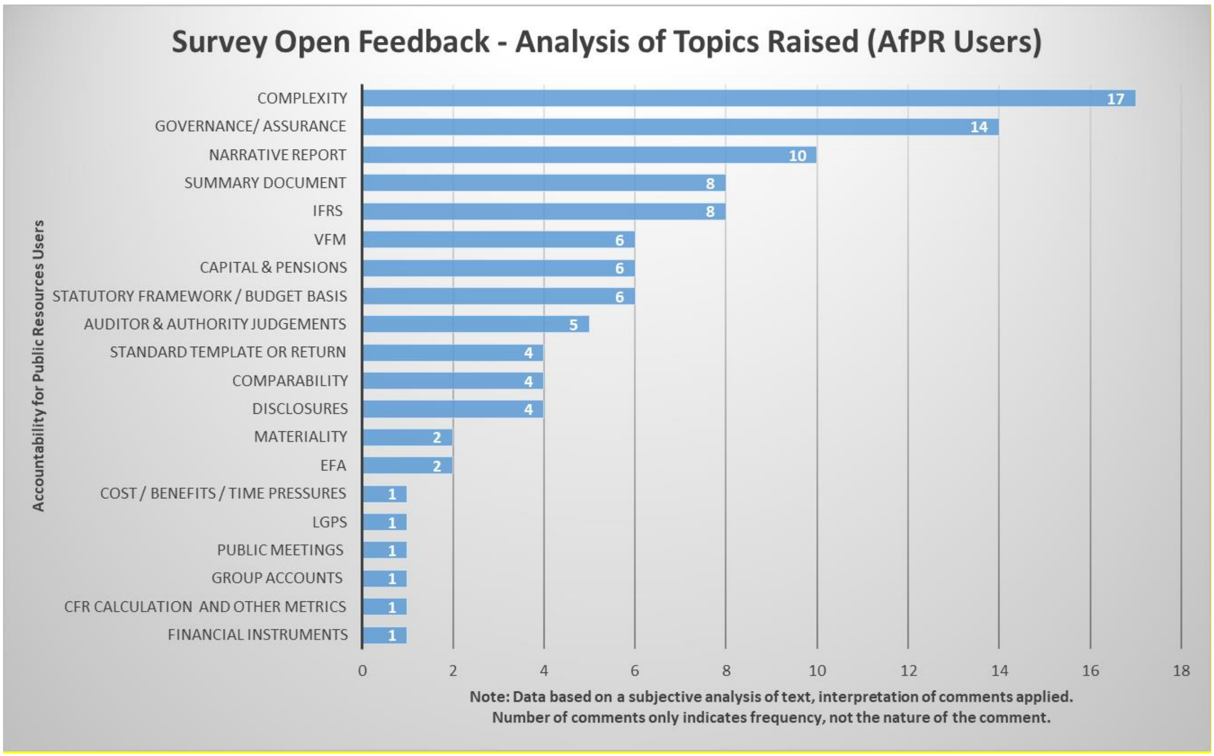
   1. Feedback from the stakeholder survey undertaken over summer 2019

   2. Early feedback from discussion papers issued following the results of the stakeholder survey.

<u>Stakeholder Survey Feedback</u>

3. For FRAB reference charts indicating feedback from users interested in "accountability for public resources" (AfPR) are provided below:





4. Open commentary feedback from the survey was also reviewed with key themes noted as summary accounts, materiality and disclosures. Other comments included suggestions that the default application of IFRS for local government annual accounts may not be appropriate, or that more use of adaptations and interpretations should be considered.

5. Following the survey CIPFA/LASAAC issued two discussion papers: a Code strategy paper and a differential reporting paper, accompanied by a short summary overview of the two.

6. CIPFA/LASAAC considered the responses received to date. Generally a clearer focus on accountability for public resources was agreed, with feedback that improved narrative reporting was a key element in supporting this. Additional comments suggesting the need for more adaptation and interpretation of standards were received.

7. Divergent views on many other aspects emerged with some criticism of capital accounting; pensions; financial instruments; and group accounts. Other respondents however noted the importance of the accounting information and concern at a potential return to a 'cash accounting' approach.

8. Reponses on differential reporting demonstrated mixed views.

CIPFA/LASAAC Future Action

9. CIPFA/LASAAC will progress with the strategic plan with key steps including further work on identifying the key messages that are required for stakeholders; further outreach and engagement with stakeholders; a review of the Code structure; consideration of differential reporting; disclosure and materiality practices; and development of narrative reporting.

Responses to the 20/21 Code consultation

10. Following consideration of the responses CIPFA/LASAAC plans to implement amendments to the Code for 20/21. The full Code text has been drafted and has been provided to CIPFA/LASAAC members for review. A copy of the full Code text will be provided to FRAB members as a separate paper (to follow) prior to the meeting.

11. Appendices A and B are provided as a summary statement of the planned changes. Appendix A lists changes excluding IFRS 16 *Leases* (provided in Appendix B), with items A1 and A2 suggested for specific discussion; B1 and B2 for specific note by FRAB; and C1 – C11 provided for noting and scrutiny by FRAB if desired.

12. The following is provided as a brief overview to assist discussion of items A1 and A2:

A1	**Capital Disclosures: Adaptation to permit presentation of a 'net book value' table for property, plant & equipment.**
	Stakeholder engagement (see later) and Invitation To Comment responses have provided clear feedback that users of local government financial statements consider that existing financial statements are too complex and lack clarity. An issue that has been identified is the level of detail provided in disclosures. The importance to users of clear information on assets, particularly property, plant and equipment (PPE), is noted. In particular engagement and ITC responses supports the desire for users to be provided with a clearer and simpler understanding of changes in asset balance sheet values during the reporting period. To address the needs of users of local government accounts CIPFA/LASAAC plans to permit, but not require, authorities to present a single table of PPE net book value movements in lieu of the normal dual table split between cost/valuation and depreciation/impairment (see IAS 16 paragraph 73 (e)). Specification of the line items required is provided. The optional nature of the adaptation is to allow local judgement to apply to ensure identified user needs are met. It should be noted that WGA returns continue to require a split between cost/valuation and depreciation/impairment. This may be taken as an indication that the readership profile of WGA differs from the readership profile for some local government entities. The WGA requirements are specifically noted in the Code (via a statement and a footnote). This is expected to be highlighted as a factor for consideration by authorities in the preparation of their working papers. **Adaptation to permit a net book value table is planned.**

A2	Service Concession Arrangements (SCA): Liability Measurement
	The 2018 Code consultation process on IFRS 16 *Leases* implementation included discussion of the application of IFRS 16 to SCA liability measurement. Responses in 2018 indicated significant concern regarding the practicality of using IFRS 16 for SCA liabilities, given the increased requirement to remeasure the liability when indexation uplifts occur. Consequently this year's Code ITC for 20/21 revisited the discussion. Respondents re-iterated their concerns. The relevance, decision usefulness and appropriateness of IFRS 16 for SCA liability measurement was questioned. HM Treasury have indicated that central government's liability measurement practices for liabilities arising from Service Concession Arrangements (SCA eg PPP/PFI) is not anticipated to change. Consistency of public sector measurement is anticipated to be a key factor for WGA. Local government stakeholders will expect the code to provide clarity regarding the requirements. **It is planned to liaise with HM Treasury regarding public sector practice.**

13. FRAB scrutiny and questions on items B1-B2, and C1-C11 are welcome.

IFRS 16 Leases implementation in 20/21

14. CIPFA/LASAAC consulted on the implementation of IFRS 16 Leases in 2018. The planned Code text was issued with the 20/21 Code ITC, but was not re-exposed with specific consultation questions.

15. The FReM has already provided details of the central government requirements accompanied by application guidance.

16. Transport for London (TfL) has requested permission to apply IFRS 16 requirements for 19/20. CIPFA/LASAAC has indicated that early application is subject to confirmation from TfL, WGA and ONS that satisfactory arrangements to support WGA and National Accounts preparation are in place. Confirmation relating to National Accounts is currently pending.

17. Following provision of the Code text with the ITC, feedback and queries on a number of implementation aspects have arisen. Code implementation plans are provided in Appendix B, with items 1-6 suggested for FRAB discussion. For ease of reference these are noted below:

1	**School buildings provided by Trusts & Religious Institutions under mere licences**
	Stakeholders have noted that the application of IFRS 16 Leases to school properties used under 'mere licences' is not clear, and that application may raise significant third party stakeholder concerns. Concerns reflect the previous discussions and sensitivities which arose concerning a review in 2013-14 regarding the determination of local authority 'control' of schools in England and Wales. For further detail and considerations please see Appendix C. **It is planned to undertake further research and stakeholder engagement prior to Code finalisation. FRAB liaison will be maintained.**
2	**Adaptation to exclude to Housing Revenue Account (HRA) Tenancies**
	The potential for IFRS 16 to be applicable to HRA tenancies (ie lessor treatment) has been raised. Potentially it may be applicable for some, but not all, tenancies. The Code currently requires a separate and specific statement for the HRA which requires information relating to HRA rents. HRA rents are generally set annually on a statutory basis by the council. Statutory disclosure requirements also apply regarding HRA assets. Application of IFRS lease accounting requirements to the HRA would be a significant change for local government and it is considered it would not appropriately reflect the statutory framework and arrangements for HRA tenancy arrangements. For further detail and considerations please see Appendix C. **Adaptation to exempt HRA tenancies from IFRS 16 is planned.**
3.	**Nil Consideration Leases: Removal of adaptation of definition applying to lessor arrangements**
	Code text previously adapted the definition of a lease to exclude the requirement for consideration. This would apply to both lessee and lessor arrangements. It is noted that lessor accounting was generally not amended by IFRS 16. The key focus of changes were on improvements in reporting lessee arrangements. This was reflected in the FRAB discussions relating to the adaptation where no shortcomings in the existing treatment of lessor arrangements was made. Applying the adaptation to lessor arrangements is anticipated to lead to additional work and audit scrutiny of evidence, with no significant benefit in financial reporting arising. For further detail and considerations please see Appendix C. **Restricting the removal of 'nil consideration' to the definition of a lease for lessees only is planned.**
4.	**Nil Consideration Leases: Grandfathering application**

	It is anticipated that the 'nil consideration' adaptation will mean that grandfathering reliance is not appropriate for existing nil consideration arrangements. Consequently specific identification of nil consideration arrangements is anticipated on transition. **Confirmation of central government practice is sought to support public sector consistency.**
5.	**Valuation: Adaptation of Transition Arrangements (for Lessee: Finance Leases)**
	Adaptation to allow revaluation changes to be undertaken and presented as part of transition adjustments is planned.
6.	**Valuation Requirements as at 31 March 2021**
	Transition arrangements do not require substantial additional revaluation work to be undertaken on the transition date. It is anticipated however that as at 31 March 2021 the requirement for carrying values to reflect valuation at the balance sheet date will lead to all, or most, previous finance lease assets requiring to be revalued. This will represent significant additional work for authorities and auditors. For further detail and considerations please see Appendix C. **Confirmation of central government practice is sought to support public sector consistency.**

Summary and recommendation

18. This report sets out details of CIPFA/LASAAC proposals regarding

    1. CIPFA/LASAAC strategic direction implementation actions

    2. Planned changes to be implemented in the 20/21 *Code of Practice on Local Authority Accounting in the United Kingdom*.

19. The Board is requested to discuss and comment on the plans affecting the development of the Code for 20/21 and future years.

CIPFA/LASAAC
November 2019

Appendix A: Code 20/21 Amendments

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
A1	Capital Disclosures	Discuss adaptation	7-9	Adaptation to permit, but not require, use of a Net Book Value disclosure table (subject to maintaining records for WGA compliance).	Allowance for optional (not mandatory) alternative net Book Value PPE table: 4.1.1.6 (list of adaptations) 4.1.4.3 f). Statement and footnote included to note that WGA requires IAS 19 information.
A2	Service Concession Arrangements – Liability Measurement	Discuss public sector liability measurement practices required.	28	For discussion: Alternative liability measurement required to replaces reliance on IAS 17 *Leases*.	Amendments to the following pending discussions: 4.3.2.20; 4.3.2.21; 4.3.2.23; 4.3.2.25
B1	IAS 19 Amendments: Plan Curtailments etc	Note– No adaptation but guidance on application provided.	19	Implementation of amendments to IAS 19. This is accompanied by application guidance regarding initial (proxy) assessment of materiality.	Amendments to reflect IAS 19 requirements eg 6.4.3.13, 14B, 29, 31, Initial assessment of material on a proxy basis specified in 6.4.3.4B. Proxy assessment based on proportion of active scheme members and whether actuarial assumptions would be materially different.

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
B2	Other: LOBO Clauses	Note – clarification of existing interpretation	33A	Clarification of an existing interpretation to emphasise that it does not extend to compound embedded derivatives.	7.1.1.3 c first bullet amended to clarify it does not apply to compound embedded derivatives. Additional text to the effect that "This interpretation only applies where the specified derivative elements are separable. It does not apply to a compound embedded derivative where separation of the exempted derivative is not possible."
C1	Materiality: Definition of Materiality	Note	1	Implement '*Definition of Material: amendments to IAS 1 and IAS 8'* to ensure that material information is not obscured.	2.1.2.14-2.1.2.14C
C2	Disclosure Assessment: Prior Period Disclosures	Note	6.	Based on the IFRS Practice Statement 2: Making Materiality Judgements (2018) indicate that prior period descriptive information may be summarised in some instances.	3.4.2.27C

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
C3	Capital Disclosures	Note	7-9	To provide a paragraph in the materiality section to state that quantitative materiality of a figure does not include a presumption that all supporting disclosures providing extra detail, whether quantitative or qualitative, are required for that figure. Cross reference to this made at the individual disclosure level for capital disclosures which include a higher risk of obscuring material information.	2.1.2.14B2 drafted and cross referenced in 4.1.4.3 4) [details of revaluation process] 4.1.4.5 [Fair Value disclosures for surplus assets]; 4.4.4.2B [FV disclosures for investment property] by the addition of text to the effect that "subject to the application of paragraph 2.1.2.14B2 to ensure that material information is not obscured"

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
C4	Pensions Disclosures	Note	10 - 12	To cross reference to the new paragraph (see capital disclosures) regarding not obscuring material information. References added at the individual disclosure level for disclosures which include a higher risk of obscuring material information	The below are amended to include text to the effect that "Subject to the application of paragraph 2.1.2.14B2 to ensure that material information is not obscured," 6.4.3.42): 8) disaggregation of fair value of plan assets 9) fair value of authority's transferable financial instruments held as plan assets / property plan assets used by the authority 10) the significant actuarial assumptions used 11) sensitivity analysis of assumptions 12) asset matching strategies used to manage risk 8) and 10) have footnotes indicating the expected WGA return information

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
C5	Financial Instrument Disclosures	Note	13 - 15	To cross reference to the new paragraph (see capital disclosures) regarding not obscuring material information. References added at the individual disclosure level for disclosures which include a higher risk of obscuring material information	The below amended to include text to the effect that : "Subject to the application of paragraph 2.1.2.14B2 to ensure that material information is not obscured," 7.3.2.3 – Soft Loans – opening & closing reconciliation; nominal value; purpose & type; valuation assumptions 7.3.3.11-12 – credit risk management practices explanation; inputs, assumptions & estimations 7.3.3.21 b) description of management of liquidity risk 7.3.3.22 b) and c) market risk methods & assumptions used for sensitivity analysis, and changes from prior year
C6	IFRS 3 Definition of a Business	Note	20	To implement IFRS amendments	D.1.3 – new standards in Code C.2.3B prospective application
C7	Amendments to Conceptual Framework	Note	21	To implement IFRS amendments	2.1.2.5 - Concepts
C8	Provisions for UK withdrawal from the EU	Note	22	To allow for change to reliance on UK adopted IFRS.	1.2.7

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
C9	Pension Fund Accounts: Pensions SORP Alignment	Note	24	To align Net Funds Statement to Pensions SORP requirements.	6.5.3.6 Specification of asset lines on funds statement
C10	Legislation Amendments	Note	25	To implement statutory requirements.	1.4.5; 2.3.3.5-6; 3.4.2.56; 3.4.5.1; 4.1.3.12; 4.4.3.1; 7.1.93B; 7.3.8.1; 8.2.3.1-3; Appendix B
C11	Financial Instruments – Specification of FVPL entries in CIES	Note	30	To provide clarity regarding presentation in the Comprehensive Income and Expenditure Statement	Code amended to provide specification 3.4.2.38 c)
C12	Minor Code Updates	Note	31	Minor clarification updates re housing rental income being fees & charges under statutory requirements; and the status of revenue funded from capital under statute (REFCUS).	2.1.2.51; 4.6.2.1
C13	Other: Loan Modifications	Note	33B	To reflect IASB clarification regarding the treatment of financial liability modifications.	7.1.1.3 e amended to reflect the IASB clarification regarding loan modifications treatment. Footnote added to 7.1.2.20 to indicate that modifications treatment for liabilities are effectively the same as those for assets
C14	Other: Soft loans	Note	33D	To allow for the potential for zero, or even negative, market interest rates when identifying soft loans.	7.1.6.4

Ref	Item	Requested FRAB Action	ITC Q	Summary of Planned Amendment	Code Text Ref (Code draft text to follow)
C15	Other: Impairment requirement exemptions	Note	33E	To clarify the exemption allowed in respect of financial assets arising from central and local government counter parties.	7.2.9.1 Text and footnote added.
C16	Other: CIES Total Line Presentation	Note	33V	To improve clarity for users regarding signage used.	3.4.2.38 q) footnote added to state that signage used should be explained / indicated.
C17	Other: RICS references need updated	Note	33W	Updated RICS valuation references.	Updated references to RICS valuation specifications in 2.1.2.60A; 4.1.1.6; 4.1.2.4 ,4.1.2.7; 4.1.2.9; 4.1.2.10 (some amends in footnotes only)
C18	Other: Text Corrections	Note	33X, Y	Amend Code for editorial corrections, improved alignment to IFRS text, or cross referencing to IFRS.	Various paras, including improved alignment to IAS 19 text in section 6.4

Appendix B: Code 20/21 IFRS 16 *Leases* Implementation

No.	Item	Requested FRAB action	Summary of Planned Amendment	Code Text Ref (Code text to follow)
1.	School buildings provided by Trusts & Religious Institutions under mere licences	Discuss application of IFRS 16 to mere licences and WGA impact	Further specific stakeholder engagement prior to Code text finalisation.	**N/A**
2.	Housing Revenue Account– IFRS 16 Leases Application to Housing Rents	Discuss adaptation to exclude Housing Revenue Account tenancies	Adaptation to specifically exclude HRA housing tenancies from the scope of IFRS 16 Leases and Section 4.2 of the Code.	4.2.1.4 (adaptations) 4.2.2.28B – specification of adaptation
3.	Nil Consideration Leases: Adaptation of definition applying to lessor arrangements	Discuss restriction of the 'nil consideration' adaptation to lessee arrangements only	Adaptation regarding 'nil consideration' to apply only to lessee arrangements.	4.2.1.4 4.2.2.11
4.	Nil Consideration Leases: Grandfathering application: prospective or retrospective application	Discuss to confirm public sector treatment	No text amendment proposed, subject to confirmation of central government practices.	No change in principle from the text issued with the 20/21 Invitation To Comment.
5.	Valuation: Transition Arrangements (for Lessee: Finance Leases)	Discuss regarding adaptation applied to IFRS 16 transition arrangements	Permit voluntary revaluation, or reversion to the cost model (where criteria met), to be undertaken and presented as part of transition.	4.2.1.4 4.2.2.98B
6.	Valuation Requirements as at 31 March 2021	Discuss to confirm public sector practices	No text amendment proposed, subject to confirmation of central government practices.	No change in principle from the text issued with the 20/21 Invitation To Comment.

No.	Item	Requested FRAB action	Summary of Planned Amendment	Code Text Ref (Code text to follow)
7.	Nil Consideration (Lessee) Leases: RoU Asset Measurement	Note	On transition, where fair value determination is not commensurate with the benefits to users allow valuation at current value as a proxy for fair value.	4.2.2.92 (a) 4.2.2.46
8.	Valuation: Reversion to Cost Model	Note	Explicitly specify that reversion to the cost model requires a cost based on IFRS 16 Leases requirements as applied after transition.	4.2.2.50B
9.	Disclosure Requirements	Note	To cross reference to the new paragraph regarding not obscuring material information. References added at the individual disclosure level for disclosures which include a higher risk of obscuring material information	4.2.4.6 – Lessee disclosure re lease commitments for short-term leases 4.2.4.8 – Lessee disclosure of details of revaluations
10.	Cost Model: Includes Decommissioning Obligation Changes	Note	Explicitly specify that the cost model includes decommissioning obligations.	4.2.2.50 b)
11.	Other Text Amendments	Note	Text amendments to improve clarity of alignment with IFRS 16 requirements.	Various amendments. Please see the Code pdf Section 4.2 (currently pages 168-195).

Appendix C: IFRS 16 Leases Implementation – Specific Item Details

No.	Item
1.	**School buildings provided by Trusts & Religious Institutions** Some trusts and religious bodies provide buildings under 'mere licences' to be used to deliver educational services. These may either normally be for nil consideration or for non-market rentals. During 2013 and 2014 the status and accounting treatment of such situations was considered by a formal working group which examined the accounting for public sector schools in England and Wales. A particular concern on the part of stakeholders was the potential inclusion of such properties on the public sector balance sheet, effectively as long-term finance lease assets. Current accounting treatment, under IAS 17 and IFRIC 4, is that such properties are not normally expected to be shown on the public sector balance sheet. There are a number of areas of IFRS 16 application to mere licences which may benefit from clarification. Aspects include: • Whether a 'mere licence' passes any legal rights to the authority • The trust's right and ability to substitute an asset • The authority's right to substantially all of the service potential of the asset throughout the period of use (eg whether the authority has exclusive rights of use) • The authority's right to direct the use of the asset during the period of use, potentially based on a 'predetermination' basis. Dependent on exact circumstances and interpretation, application of IFRS 16 *Leases* may potentially give rise to the recognition of public sector right-of-use assets relating to the use of the properties. These may be restricted to a maximum of two years' right of use. Risks Stakeholder engagement and involvement in agreeing on the application of IFRS 16 is advisable. In particular the discussions in 2013-2014 indicated a degree of initial stakeholder feedback and concern which would indicate that caution and clarity regarding IFRS 16 implementation is advisable. The planned adaptation of the definition of a lease was not subject to formal public consultation. There is therefore a risk that not all the implications of the adaptation, in local government circumstances, have been identified. There is also a risk of negative stakeholder comment arising during implementation. The application of IFRS 16 will also have practical considerations for authorities in the event that right-of-use assets, potentially for two years' use of a property, are recognised. Difficulties and resources relating to valuation of any potential right-of-use assets, and the audit focus that the valuations will attract, will affect authorities. Some stakeholder comment on the cost of compliance may be anticipated

No.	Item
	It is considered that there will be no material impact in Whole of Government Accounts (WGA) or National Accounts (NA) on reported debt or borrowing. The materiality of right-of-use-asset recognition on WGA and National Accounts is not clear. It is not clear whether the Department for Education will have schools provided under mere licences within its remit. In the event these do exist, the consistency of public sector treatment will be a consideration.
2.	**Housing Revenue Account– IFRS 16 Leases Application to Housing Rents** The 19/20 Code, using IAS17, does not specifically indicate whether housing tenancies are considered to be leases. The Housing SORP is understood to define housing association standard rental agreements as operating leases. Current practices Local government (HRA): it is considered that at present housing tenancies are not normally reported as specific lease disclosures. Reliance is normally placed on the presentation of housing rents prominently on the face of the HRA statements and the statutory disclosure requirements as meeting user needs. Example: Birmingham City Council 18/19 annual accounts. Lessor operating lease policy p35; lessor operating lease disclosures p120. HRA accounts p141 on Housing Associations: Example1: Clarion Housing Group 2017/18 accounts. Does not appear to explicitly treat or disclose housing rents as being operating lease income. See rent income disclosures Notes 4a) & 4b) page 68. Lease obligations are disclosed in note 31 page 101. Example2: Aster Group 18/19 accounts. No apparent substantive disclosures or treatment of rental income as operating lease income. For operating lease commitments see note 40 p164; finance leases note Potentially it is assumed that specific operating lease disclosures are not provided on the basis that the arrangements are regarded as short-term (eg 4 weeks notice) and disclosures would not be material. *Statutory Basis of Arrangement: Potential Rebuttal of IFRS 16 Application* It is arguable that HRA tenancies would not meet the definition of a lease due to the statutory basis, and specific terms, of HRA tenancies. For example see English HRA legislation , such as the Housing Act 1985 part IV which deals with secure tenancies (see sect 79-81, which is considered to mean that HRA tenancies are normally secure tenancies, with limited powers of the

No.	Item
	authority to terminate the arrangement (see section 82). Section 25 of the same act suggests that some letting arrangements may not be secure tenancies (ie not have the same legal conditions). Secure tenancies have no date for which a tenant has an obligation to return the underlying asset. There is therefore arguably no specified period of use and so there could be no right-of-use asset. It is recognised that in some cases there may be a right to inherit the tenancy (see Shelter England). The gov.uk website states "Different council tenants have different tenancies. These give you different rights and responsibilities." Potentially different portfolios (introductory, secure, flexible, joint tenancies) may apply within the HRA, with different assessments as to whether a lease exists and what term might be applicable. In particular flexible tenancies include an option for HRA cessation of the tenancy after a set period (with the tenant having a right to challenge this). *Clarity for Users* It can be noted that the primary focus of IFRS 16 was to amend lessee accounting, to clarify funding obligations and asset rights. Lessor accounting was not a primary focus of the amendments. The current arrangements may be considered as providing appropriate clarity for users. An additional consideration may be that statistical reporting returns would require amendment and trend analysis information would be affected. *IFRS 16 Transition: Reliance on IAS 17/ IFRIC 4 Classification* Transition to IFRS 16 may cause uncertainty as to whether HRA tenancies are included in the 'grandfathering' arrangements. *IFRS 16 Operating or Finance Lease* If it is considered that HRA tenancies should be treated as leases under IFRS 16 it is suggested that classification would normally be considered to be as operating leases. This is on the basis that the authority determines the deployment of the HRA asset and retains the underlying responsibility for repairs, maintenance and the future use of the asset as housing stock. Potentially where a 'right to buy' exists is involved this may arguably affect whether classification as a finance lease is appropriate ie removal from the balance sheet with a receivable shown. *IFRS 16: Lease Term Assessment* Under IFRS 16 determination of the lease term may be challenging. As indicated above the length of the rental is not time specified. The planned Code text currently states: *"The lease term is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:*

No.	Item
	a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option, and *b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option."* In many cases it is considered the lessee has the right to cancel at relatively short notice (eg 4 weeks). *IFRS 16: Sub-leases* Where the authority leases in housing stock and then lets these to tenants, potentially an argument for treatment as finance leases may arise. Therefore some HRA rental income could become 'capital' in nature. *IFRS 16: Accounting Treatment of Operating Leases* Potentially income recognition profiles (systematic basis) may be affected, although possibly not material. Initial direct costs of a lease (tenancy) may be required to "reduce the amount of income recognised over the lease term". Disclosures would be required, including lease income; separate identification of leased out assets; maturity analysis of lease payments - per annum for 5 years, then the remaining years (Note that this would be similar to declaring the expected cash flows of future HRA income. HRA rent setting is the responsibility of the council on an annual basis.) Risks: • The additional information provided by IFRS 16 treatment, over and above the existing clarity and transparency provided by the existing code and legislative requirements may not be beneficial for users. • There may be a lack of clarity, and some uncertainty on transition • The legal status and rights relating to different lease types could require investigation and legal views • Some tenancies may be determined not to be leases, however some tenancies (eg flexible tenancies) may meet the criteria • Any tenancies which may meet the definition of a finance lease would be removed from the balance sheet, with a receivable shown for future rents. • The resources incurred in providing and auditing the additional information may be considerable. • Rental income where the HRA is sub-leasing the accommodation to the tenant could potentially become a capital receipt
3.	**Nil Consideration Leases: Adaptation of definition applying to lessor arrangements** Currently the adaptation of the definition of a lease applies to lessor arrangements as well as lessee arrangements. The 'nil consideration' adaptation was not specifically consulted on with stakeholders either in the 2018 or 2019 ITCs.

No.	Item
	IFRS 16 has not fundamentally changed lessor accounting. For previously unrecognised nil consideration (lessor) arrangements: • IFRS 16 operating lease – asset retained on balance sheet, no annual income. Existing nil consideration lessor arrangements will continue to show the asset on the balance sheet, with no receivable on the balance sheet. • IFRS 16 finance lease – asset off balance sheet, no receivable shown. For existing nil consideration lessor arrangements which transfer "substantially all the risks and rewards incidental to ownership" of an asset (effectively a 'finance lease' without consideration) de-recognition from the balance sheet may potentially already have been applied eg as a donation to the third party. Identification of new nil consideration lessor arrangements as leases will however mean that some lease disclosures will apply (eg see 4.2.4.15). Work is also considered likely to arise on transition for authorities to confirm, for audit purposes, that all nil consideration (lessor) leases have been identified. <u>Risk</u> That there are minimal benefits to the users of local government financial reporting and WGA from the application of the nil consideration adaptation to lessor arrangements in local government. The restricted opportunity for stakeholder comment on the adaptation means that there is limited ability to assess this risk.
4.	**Nil Consideration Leases: Grandfathering application: prospective or retrospective application** The proposed code text currently indicates that grandfathering cannot directly apply under Code for nil consideration leases as they were not previously included by the previous Code requirements. The FReM does not specify the treatment. Possible options are: a. Identification on transition (as currently drafted): require transition work to specifically identify nil consideration leases or b. Prospective: amend the proposed Code text to apply grandfathering as specified, only identifying new arrangements (or as & when existing arrangements change) <u>Risk:</u> That by specifying identification on transition the Code requirements may require additional work by local authorities and auditors, compared to central government implementation.
5.	**Valuation: Transition Arrangements** The proposed text Code follows IFRS 16 *Leases* transition requirements (para C11) by specifying that the carrying value of finance lease assets is carried forward on transition. The Code does not specify revaluation on transition is

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	required or allowed. Potentially however authorities may wish to revalue, or revert to the cost model as proxy, as part of transition. Consideration may be given to specifically allow authorities the option of voluntary revaluation or reversion to the cost model (where criteria are met) on transition (at 1/4/20), and show as part of transition <u>Risk</u>: That transition arrangements are unclear for authorities and auditors, leading to inconsistent practices.
6.	**Valuation Requirements as at 31 March 2021** The proposed text Code transition arrangements are based on IFRS 16 Leases transition arrangements. They do not involve mandatory wide-scale finance lease asset revaluations on transition (ie 1/4/20). It has been noted however, at the end of 20/21, by requiring valuation to be undertaken in accordance with section 4.1; the requirements of 4.1.2.37 are likely to be applicable: "revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using the current value at the end of the reporting period." In particular it may be noted that following transition RoU assets which were previously finance lease assets: a) May be overvalued since asset currently valued on 'ownership equivalent' basis not limited to the 'RoU' asset term. b) May exclude any land value element previously classed as an operating lease under IAS 17 would have transitioned over and be on the balance sheet based on the lease liability measurement, not existing use value. <u>Risk</u> There is a potential that widespread revaluations of right-of-use assets as at 31/3/21 may be expected. <u>Options</u> Options appear limited. 4.2.2.50 e) which specifies that the requirements of section 4.1 (valuations) apply to r-o-u assets could be amended to specify that this is with the exception of 4.1.2.37. Instead it could be specified that valuations stand until the earlier of (a) liability re-measurement; (b) next planned valuation; (c) voluntary revaluation; (d) reversion to the cost model. This may resolve a need for significant revaluations at 31/3/21 but may give rise to audit process and WGA consistency concerns. Risk may be reduced for those authorities which can place more reliance on use of the cost model as proxy.