

Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	Update on CIPFA/LASAAC development of the <i>Code of Practice on Local Authority Accounting in the United Kingdom</i> (the Code)
Impact on guidance:	This report sets out the current position with regard to the Update to the 2019/20 Code (for Transport for London (TfL) only).
IAS/IFRS adaptation?	This report relates to the adaptation across the public sector to peppercorn (nil consideration) leases.
Impact on WGA?	WGA issues for the Update of the 2019/20 Code may require adjustments for TfL though this is not directly related to this issue
IPSAS compliant?	Not directly related to this issue.
Impact on budgetary regime?	None – local authorities only.
Alignment with National Accounts	WGA issues for the Update of the 2019/20 Code may require adjustments for TfL though this is not directly related to this issue.
Impact on Estimates?	None – local authorities only.
Recommendation:	This report requests FRAB to both note and provide any comments on this issue.
Timing:	2019/20: IFRS 16 <i>Leases</i> early adoption consideration affects 2019/20

DETAIL

Background

1. Transport for London (TfL) has been kept updated on the progress of the Update to the 2019/20 Code permitting them to adopt IFRS 16 early this included being sent drafts of the Update. TfL raised concerns in connection with the application of 2019/20 Code amendments which would allow them to apply IFRS 16 in 2019/20.
2. These relate to peppercorn (nil consideration) leases, where TfL explained that it has not followed the proposed treatment in the Code, but has followed the standard approach in IFRS 16, and it would be extremely difficult to change this at this stage. TfL therefore enquired as to whether it would be possible to obtain some form of relief from application of this requirement in 2019/20 and 2020/21.
3. CIPFA/LASAAC discussed this at their June meeting, expressing some sympathy for the TfL position, but noted that the treatment of peppercorn leases was set out in the July 2019

consultation on the 2020/21 Code, and TfL did not raise any comments in relation to that. Without further information it would be difficult to justify giving TfL the ability to adopt IFRS 16 early while not requiring them to follow all of the requirements agreed in the 2020/21 consultation, notwithstanding the fact that general implementation of those requirements has been delayed.

4. Consideration was given to CIPFA Secretariat concerns that the issue identified by TfL, if valid, might apply to wider classes of commercial operations operated by local authorities (including but not limited to other transport authorities), and it might therefore warrant review before implementation of IFRS 16 in the 2021/22 Code.
5. The Chair of CIPFA/LASAAC suggested that no decision on whether to allow relief to TfL should be made at the meeting, but that the CIPFA Secretariat should seek further information from TfL as to how this situation arose.

Findings from further enquiries

6. In line with the above the CIPFA Secretariat sought more information on TfL, with a view to gaining insight into the situations in which these difficulties might occur, and to better understand why TfL did not identify the problems at an earlier stage. Much of this served to clarify information which TfL had already provided, rather than providing new information.
7. A key point arising from these discussions is that IFRS 16 was being applied directly without modification, because the transactions and arrangements which give rise to peppercorn leases are in relation to Rail for London Limited, which reports under the Companies Act rather than the Code. The issues around application of the Code requirements on peppercorn leases therefore only apply on consolidation, and would be processed as consolidation adjustments.
8. The CIPFA Secretariat notes that it is not usual for the public sector requirements of the Code to require a wholly different accounting treatment to be applied on consolidation of entities applying IFRS. In general, the adaptations and interpretations in the Code may require additional information to be required for accountability purposes, or they may require a specific accounting policy choice within IFRS to be made, or they may set out a treatment of transactions which do not occur in IFRS accounts because they reflect public sector specific economic substance.
9. The other information provided by TfL concerned the nature of the transactions to explore why the peppercorn leases were not being treated as finance leases under IAS 17 *Leases*. The information reiterated the point that these were being accounted for under standard IFRS rather than the Code, and that contracts without consideration do not satisfy the definition of a lease.
10. TfL also provided detail explaining that station leases are entered into by train operators Arriva and MTR in service concession arrangements between Rail for London Limited through which the operators provide train services for London Overground currently and the Elizabeth Line in the near future. Because stations may be used by several different

operators, Arriva/MTR hold leases for some stations, while in other cases they have access to stations where another train operator holds a lease. Payments are made under these arrangements but they are long term maintenance payments rather than rent; determination of whether they should in practice be considered to be rent (consideration for a right of use asset) is a technical matter, but it does seem possible that there is no such consideration and the treatment adopted by TfL is valid under IFRS 16.

11. TfL explained that these types of arrangement and charging are standard in the industry. TfL also explained that the use of the station assets is highly restricted, that Network Rail's ownership of the stations also carries obligations which potentially outweigh their earning power and that determining a market value under these circumstances may not be meaningful. So the discussion is not just about whether TfL have the time or resources to carry out valuation.
12. The purpose of this enquiry exercise was not to validate the TfL treatment under IFRS but to get a better idea of the issues involved and whether they warrant further investigation. However, if the IFRS treatment is valid, then it may be that it provides a better view of the economic substance of the arrangements, and it would seem strange to disallow this treatment if that is the case.
13. Similar concession arrangements seem to be in place in other transport authorities such as Strathclyde Partnership for Travel and Merseytravel. So it is possible that other authorities might need to consider whether they can provide meaningful information under the Code requirements for peppercorn leases, and there is the same question as to whether this treatment is appropriate or practical.
14. The CIPFA Secretariat also reviewed whether issues around peppercorn leases had arisen in other contexts, and determined that possibly similar issues around restricted assets had been identified in the Australian not for profit sector where restricted assets and assets with obligations are a common feature. The Australian standard setter has allowed a one year delay in implementation of the requirement to use fair value; the cost option is allowed which will generally have the same effect as not recognising a lease. The AASB anticipates the development of revised guidance on measurement, which might allow the use of non-market values.

Options CIPFA LASAAC was invited to consider

15. The information provided by TfL makes it clear that this issue arises only on consolidation of companies reporting under IFRS. The need to make such significant consolidation adjustments is unusual (and in fact there may be no other instances where this is so substantially the case). This might be seen to provide a reason why TfL did not spot this issue at an earlier stage. For that reason, CIPFA/LASAAC was invited to grant TfL a delay of implementation of the requirements in relation to peppercorn leases. This could be done either by specifically providing relief on that aspect of the Code, or by providing relief from the need to carry out this consolidation adjustment in 2019/20.

16. Separately, it seems as there is at least some doubt as to whether the public sector adaptation and the related treatment of peppercorn leases provide the best depiction of economic substance. Even if they do, the difficulties of measurement may not just be practical - it may be necessary to provide an additional interpretation to inform measurement in situations where the market value of restricted assets is difficult to meaningfully assess, or to cross refer to other approaches taken where there is difficulty in determining market value.
17. CIPFA/LASAAC was invited to comment by an email vote and although there was a slight majority in favour of granting the dispensation there were not enough votes to reach the threshold to make changes to the Code. There was a substantial positive response to review peppercorn leases and consider whether the peppercorn leases application should be reviewed and no dissenting views on this issue though CIPFA/LASAAC votes have not yet reached the point at which it has positively made this decision.

Summary and recommendation for the Code of Practice on Local Authority Accounting in the United Kingdom

18. This report requests FRAB to both note and provide any comments on this issue.

**CIPFA/LASAAC
June 2020**