FRAB 147 (18)
30th June 2022

HM Treasury

Financial Reporting Advisory Board Paper

IFRS 16 *Leases*—Timing and approach to liability revaluations related to index linked payments for on balance sheet PPP arrangements

Issue:	This paper discusses the interaction between IFRS 16 and PPPs, with regards to the timing and approach for revaluing PPP liabilities related to index linked payments.
Impact on guidance:	Yes, if approved by the FRAB.
IAS/IFRS adaptation or interpretation?	
Impact on WGA?	Yes, FRAB's decision may have an impact on future years WGA, as PPP liability remeasurement would occur with a different approach and timing in departmental accounts and therefore WGA, depending on the option chosen..
IPSAS compliant?	Prior to IFRS 16, IPSAS and IFRS were broadly consistent for lease accounting. IPSASB are developing a new IPSAS on lease accounting.
Impact on budgetary regime?	No, the budgetary treatment of PPPs is aligned to ESA10.
Alignment with National Accounts (ESA10)?	No, neither lease accounting or PPP accounting is fully aligned between IFRS or national accounts.
Impact on Estimates?	No, the treatment of PPPs in Estimates is aligned to ESA10.
Recommendation	HM Treasury recommends Option 1: that PPP liabilities be revalued at 1 April 2022 for indexation changes which have taken place until that date, using a cumulative catch up approach.
Timing:	We ask the Board to make a decision at this meeting.

Background

1. The Board agreed at the November 2020 meeting that IFRS 16 requirements should be applied to the measurement of index linked payments in on balance sheet PPP arrangements from 1 April 2022 (FRAB paper 142 13).[1]
2. IFRS 16 requires that when lease payments change to reflect movement in an index or rate, the lease liability is recalculated. Therefore, if recording the future liability in accordance with IFRS 16, it will include the changes that have taken place to date. Future changes in lease payments would trigger additional recalculations of the lease liability.
3. It was noted that we would expect the cumulative catch-up provisions of IFRS 16 to be followed for this change on transition, so a full retrospective application would not be required.
4. HM Treasury agreed to look into the provision of further practical guidance on this change, as requested by some members.

Issue

5. Whilst writing this guidance, an issue has emerged concerning the timing and approach to revaluing the liability to include changes that have taken place to date.
6. Two alternatives could both be compatible with previous Board decisions, so we are seeking the Board's view.

Options

7. **Option 1** – Revalue the PPP liabilities at 1 April 2022 for indexation changes which have taken place until that date using a cumulative catch-up approach.
8. This can be seen as aligned with the previous view that the change would be accommodated via the cumulative catch-up provisions of IFRS 16.

9. **Option 2** – Do nothing at 1 April 2022 and remeasure individual PPP liabilities in year for changes which have taken place until that date. The remeasurement would be triggered by the first index linked change after 1 April 2022, which will vary depending on the individual PPP contract. It would be an in year remeasurement with no retrospective application.
10. This option reflects feedback received from some relevant authorities that PPP arrangements are most similar to existing finance leases, as they are on balance sheet prior to IFRS 16 adoption. IFRS 16 C11 sets out that under a cumulative catch-up approach, the carrying value on transition for existing finance leases should be the same as the previous IAS 17 carrying value. Therefore, if applying an existing finance lease approach, the remeasurement would not take place at transition but subsequently.
11. The Health sector have raised concerns over applying the Option 2 approach. Primarily noting that a staggered triggering of revaluation would be less clear than an aligned adjustment at 1 April 2022, and that a catch up adjustment would materially distort the SoCI for the year masking true performance which is of more interest to a reader of the accounts.

[1] This discussion emerged from concerns raised by a previous Board member that index linked payments in PPP arrangements had previously been treated in accordance with IAS 17, so expensed as contingent rents.

Recommendation

12. **HM Treasury recommends Option 1**. This is in line with the original intent for the change to be effective on transition and would avoid the issues for preparers and users of the accounts raised by the Health sector. Whilst this deviates from the treatment of existing finance leases, PPP arrangements are not leases and so the Board can determine how they wish IFRS 16 requirements to be applied in this case.

Question for the Board: Does the Board agree with HM Treasury's recommendation of Option 1?