



HFMA briefing
February 2020



IFRS 16 *leases*

Practical application



Background

IFRS 16 is applicable by NHS bodies applying the HM Treasury's *Financial reporting manual* (FReM) or the Department of Health and Social Care's (DHSC) *Group accounting manual* (GAM) on 1 April 2020 (the 2020/21 financial year).

In October 2017, the HFMA published a briefing¹ that summarised the requirements of the standard and identified those areas that were likely to be issues for NHS bodies. The briefing was regularly updated until July 2019 as guidance was issued to the public sector and the NHS.

This briefing is a supplement to the original one and is based on the discussions held at the HFMA's pre accounts planning conferences in January 2020. It does not cover the application of the standard as that has been covered elsewhere but instead considers wider implications of the application of this standard in the NHS.

¹ HFMA, *Accounting for leases – application of IFRS 16*, July 2019

The CPD Standards Office
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Practical steps

NHS bodies should have taken the following steps by the end of 2019/20:

- read the standard and the basis for conclusions and all available guidance (see the appendix to this briefing for information on accessing the standards and references to NHS specific guidance)
- developed, and significantly advanced, an implementation plan
- engaged with the audit committee so they have an understanding about the amount of work that is required to implement the standard and how much work is still to be done
- considered whether there are arrangements that contain a lease that have not been captured in the lease register
- reviewed the lease register for completeness including putting in place
 - a process to satisfy themselves that it is complete – this includes the point above
 - arrangements to capture key data points, for example, rent reviews, break clauses, termination points
 - arrangements to capture new lease arrangements as they are signed from 1 April 2020 onwards
- started to formalise and sign leases. Where this is not possible then judgments about the lease terms should be fully documented
- engaged with NHS lessors as part of the agreement of leases exercise
- engaged with the auditor to identify any expected changes, risk areas and what needs to be done as part of the 2019/20 accounts preparation
- considered whether valuers will need to be consulted and, where necessary, liaised with them
- have involved other departments, particularly estates and procurement, in the assessment of the impact of the standard and the exercise to ensure the completeness of the lease register
- have quantified the impact of the standard on 2020/21 and included this within operating plans
- discussed the standard with management accountants to ensure that the impact on budgets has been considered.

This list is not exhaustive. NHS bodies are also encouraged to have an early conversation with their auditors about what needs to be done by May 2020.

Management will need to ensure that they have arrangements in place to meet key milestones – this is likely to include:

- the submission of 2020/21 plans
- the agreement of leases exercise
- the preparation of 2019/20 annual report and accounts
- the production of a post-transition 1 April 2020 balance sheet and an agreed upon procedures exercise by auditors on that balance sheet
- another submission to inform the supplementary estimates process
- the preparation of the 2020/21 annual report and accounts.

Available guidance

It is important that those affected by the application of this standard are aware of the guidance available to them, including the full standards, basis for conclusions and illustrative examples. The appendix to this briefing lists the main sources of guidance.

2019/20 annual report and accounts

Although IFRS 16 does not come into force in the NHS until 2020/21, it is likely to be a key issue in the preparation and audit of the 2019/20 annual report and accounts. The impact on the 2019/20 annual report and accounts will vary depending on the materiality and complexity of the lease arrangements entered into by NHS bodies.

These disclosures are likely to be subject to audit scrutiny in 2019/20. Any judgements and estimates will also be reviewed and challenged by auditors.

Standards issued not yet adopted

Although IFRS 16 is not applicable until 2020/21, IAS 8 requires disclosures in relation to standards that have been issued but have not yet been adopted. Appendix 1 to the year-end reminders briefing² summarises the disclosures that need to be made and gives some examples of the disclosures made by organisations that have already adopted the standard.

The disclosure should clearly explain the change in policy from the old approach to the new approach.

Other than the name of the standard, the date of its adoption and mandated transitional provisions and practical expedients; it is unlikely that these disclosures will be the same from NHS body to NHS body.

Operating and finance lease disclosures in the 2019/20 accounts

Those leases disclosed in the operating and finance lease notes in the 2019/20 accounts will be the leases that form the opening balances for the transition to IFRS 16 on 1 April 2020. In the 2020/21 accounts there will be a transition note that sets out the difference, and reconciles, the old operating and finance lease notes with the opening balances under IFRS 16.

NHS bodies are required to apply the practical expedient outlined in paragraph C3 of the standard to all leases otherwise known as grandfathering. This means that where a contract has been determined to be a lease, or not, under the current accounting arrangements (IAS 17 and IFRIC 4) it will continue to be classified as a lease or not under IFRS 16.

However, this is only the case where there has been a robust assessment under the current accounting standards. Where NHS bodies have identified leases that are not currently included in either operating or finance lease disclosures, they should update their 2019/20 disclosures so that the reconciliation from one standard to the other on 1 April 2020 is simpler. Where the assessment under existing GAAP is wrong and the 2019/20 disclosures are amended, consideration should be given to whether the 2018/19 disclosures should also be restated. For example, an NHS body may have concluded that some of its managed service contracts and arrangements with NHS Property Services Ltd are leases, but they are not currently included in the notes about leases in the 2018/19 accounts. Equally, where arrangements have been previously disclosed as operating leases under IAS 17 and IFRIC 4 but are now considered not to be leases should be excluded from the 2019/20 disclosures. This may be the case for lease car arrangements.

When the 2020/21 accounts are prepared, there may be leases identified that were not included as leases in the 2019/20 accounts so an adjustment will have to be made to the 2019/20 comparatives to correct the error. Whether the error is accounted for as a prior period adjustment will depend on the materiality of the adjustment.

² HFMA, *2019/20 year end reminders: issues raised at the pre accounts planning conferences*, February 2020

Peppercorn leases³ will need to be reviewed as well – any that are currently assessed as a finance lease will transition in accordance with the standard but those that are currently not considered to be leases or are operating leases will transition in accordance with the HM Treasury requirements.

NHS bodies should expect their auditors to discuss work that they have done so far on ensuring that their lease register is complete, and therefore that the lease disclosures in 2019/20 are appropriate. Auditors are also likely to challenge lease assessments already made.

The annual report

The annual report should be a balanced and fair reflection of the performance of the NHS body in the year. It will also include consideration of the risks that the organisation faced in the year and continues to face. Where an NHS body has material and complicated lease arrangements, it may be that the application of IFRS 16 should be disclosed as a material risk in the annual report.

Budgetary implications

Although it is not a 2019/20 accounting issue, it is important to understand that IFRS 16 will have a budgetary impact on NHS bodies and the DHSC group as a whole. New leases or modifications of existing leases from 1 April 2020 will count against the capital departmental expenditure limit (CDEL).

For existing leases, the amount of expenditure recognised each year will be different. Previously, the amount paid to the lessor would have been recognised on a straight-line basis. Under the new standard, interest and depreciation will be expensed over the life of the lease meaning that costs will be higher at the start of the lease period and lower by the end. This means that there is expected to be an adjustment to the revenue departmental expenditure limit (RDEL). It is likely that, on transition, the expense will be higher immediately after adoption, so it is important that the RDEL impact is appropriately assessed.

The returns that NHS bodies make during 2020 to NHS England and NHS Improvement will be used by the DHSC as the basis for discussions with HM Treasury about the budgetary coverage, particularly CDEL, that will be needed to ensure that the change in accounting does not impact on the financial position of NHS bodies. It is therefore important that these returns are as accurate as possible as soon as possible.

As well as completing the detailed returns, NHS bodies should consider the internal logic of the returns. For example, where an asset is being used by an NHS body and it is not owned by that body, if it is not on the lease register then how is it being accounted for? This is particularly the case for property – as only a very small number of CCGs have property, plant and equipment on their balance sheet it is very likely that the buildings that they occupy are being leased.

The returns made between January and March will be used to inform the estimates process but later in 2020 this will be revisited to inform supplementary estimate requirements.

The DHSC and NHS England and NHS Improvement are working with auditors on the scope of an agreed upon procedures (AUP) engagement. This is likely to take place in the autumn and will look at the completeness and accuracy of the 1 April 2020 opening balances for leases and the reconciliation of these balances to the 2019/20 accounts. It is expected that NHS bodies will have to prepare these statements over the summer. The AUP engagement is not an audit, so it will be for auditors to decide whether to rely on it as part of their 2020/21 audit, although it should provide some comfort that the 1 April 2020 opening balance sheet is materially correct. These arrangements are still under discussion and are subject to agreement.

³ Peppercorn leases are unlikely to be classified under IAS 17 as finance leases because they are arrangements for nil, or minimal, consideration. HM Treasury requires that, assuming they meet the definition of a lease under IFRS 16 as interpreted by the FRoM, peppercorn leases are recognised on the balance sheet as part of the opening balance adjustment on 1 April 2020.

Management considerations

The application of IFRS 16 will require changes to systems and management reporting. This is not an accounting standard that can be managed by the financial accountants, it will have to be embedded into contract negotiation and management, management accounting as well as financial reporting.

It is really important that procurement colleagues understand what the standard is all about because they will be the first to read a contract, so they need to be able to identify those arrangements that include an identified asset⁴. They will also be the people involved in contract renegotiation so they will need to flag when contract terms are changed, when the rental changes or when a supplier/lessor changes. It is important that procurement and finance work together to identify the information that will need to be included on the lease register and the points at which the arrangement may need to be revisited.

Business cases and plans will need to be reviewed to ensure that the budgetary impact of leases has been properly calculated and included. This means that management accountants will need to understand IFRS 16 so they can include the right numbers in the right place.

Management accountants will also need to understand that there will be a cost pressure at the start of the lease so they can set the budget appropriately.

Budget managers may need to understand the standard too so they can assess its impact on their budgets. Currently, the cost of the leased asset (its rent) will hit the budget as it is incurred. From 1 April 2020, the rental will be replaced by a depreciation and interest cost. This makes managing the contract more difficult as the reported financial impact is different to the amount being paid to the lessor. Consideration should be given to setting up budget codes that reflect the payment to the lessor with separate control cost centres for the IFRS 16 impact of the leases.

Automatic processes relating to payments need to be reviewed to ensure that payments to lessors, which may be prepayments or accruals are properly accounted for as the payment will not necessarily be the same as the interest and depreciation cost.

The work on leases may identify arrangements where the NHS is seemingly paying more over the life of the lease than the value of the underlying asset. This may result in auditors flagging value for money issues. Where it looks like a right of use asset is overvalued then it may need to be impaired. Equally, the work on leases may identify arrangements that are no longer needed and should be terminated.

⁴ The [presentation](#) prepared by the DHSC on the NHS Improvement IFRS 16 site might be useful when planning training for other departments

Appendix 1: guidance on the application of IFRS 16

IFRS

The standard itself is accompanied by a basis for conclusions and worked examples.

Access to the unaccompanied IFRS standard and IFRIC interpretations is available through the [IFRS website](#).

All NHS bodies are able to access the full standards via the [EY Atlas Portal](#) by this email address (DFinStrat-TechnicalAccountingCOE@mod.gov.uk) copying in anyone else in the organisation that would value access to the portal.

The hub will then arrange access with EY who will then forward on the necessary details to those who have registered for access such as user manuals, passwords, usernames and links to the portal sign in. This may take some time.

HM Treasury

The HM Treasury Financial reporting manual 2020/21 includes guidance on IFRS 16. HM Treasury have also issued application guidance⁵ and supplementary budgeting guidance⁶.

DHSC, NHS Improvement and NHS England

The DHSC group accounting manual 2019/20 includes a supplement for IFRS 16⁷

The DHSC Group accounting manual 2020/21⁸ is out for consultation – it reflects the requirements of IFRS 16 for the 2020/21 accounts.

NHS Improvement has a website⁹ that includes all of the guidance issued by them as well as the supporting tools developed by the DHSC. These include:

- IFRS 16 implementation guidance
- IFRS 16 FAQs – this is updated regularly
- IFRS 16 implementation training presentation
- DHSC tools
 - example lease register
 - lease accounting tool
 - worked examples

NHS England guidance is available for NHS England entities on SharePoint – chapter 22. This chapter includes links to the IFRS 16 FAQs hosted on the NHS Improvement website. These FAQs includes examples that are relevant to CCGs and the DHSC tools are not sector specific.

Guidance on submissions and agreement of leases¹⁰ is available on the NHS Improvement financial reporting updates website¹¹ and on SharePoint chapter 22 for NHS England entities.

HFMA

The HFMA have issued a number of briefings as well as running webinars and producing a podcast:

- a briefing for financial accountants [Accounting for leases - application of IFRS 16](#), July 2019

⁵ HM Treasury, [IFRS 16 leases – application guidance](#), December 2019

⁶ HM Treasury, [IFRS 16 Leases - supplementary budgeting guidance](#), July 2019

⁷ DHSC, [Changes to the DHSC group accounting manual 2019/20](#), January 2019

⁸ DHSC, [DHSC group accounting manual 2020/21](#), January 2020

⁹ NHS Improvement, [Financial accounting updates — International Financial Reporting Standard 16 Leases implementation](#)

¹⁰ NHS Improvement, [DHSC agreement of leases guidance](#), January 2020

¹¹ NHS Improvement, [Financial accounting and reporting updates](#)

- a briefing for non-accountants intended to set out the impact of this new accounting standard *Accounting for leases - why it affects you*, November 2019
- a regularly updated briefing on financial reporting, *Financial reporting – watching brief 2019/20 and beyond*, last updated February 2020
- three webinars:
 - *an introduction to IFRS 16* on 28 November 2018
 - *practical application of the standard* on 18 July 2019
 - *frequently asked questions* on 13 November 2019
- a podcast *What do we need to know about leases?* published in January 2020

Commercial application of the standard

IFRS 16 was applicable to non-public sector bodies in accounting periods ending on or after 1 January 2019. Therefore, there is information available on the lessons learned outside of the NHS.

The IFRS foundation has issued supporting materials including webinars, educational materials and articles¹².

The FRC has issued a thematic review of interim disclosures in the first year of application of IFRS 16¹³.

¹² IFRS, *IFRS 16 supporting materials*

¹³ FRC, *IFRS 16 Thematic Review: Review of Interim Disclosures in the First Year of Application*, November 2019

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For nearly 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are 'fit for purpose' and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA's Academy which was launched in 2017 and has already established strong learner and alumni networks.

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