



HFMA Webinars



IFRS 16 Leases

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Chaired by Debbie Paterson, Policy and Technical Manager, HFMA

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IFRS 16 Update

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17 December 2021

IFRS 16 Update

Ground to be covered today

1	IFRS 16 Overview – quickly covering the basics	Page 3
2	IFRS 16 public sector approach updates...	Page 20
3	Q&A	



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IFRS 16 – Implementation Overview

IFRS 16 overview

The accounting treatment for leases, **currently classified as operating leases**, will change for lessees.

IAS 17

Statement of financial position

SOCNE

Lease payments	XXX
Net Expenditure	XXX

Off balance sheet

IFRS 16

Statement of financial position

Lease Assets	XXX
Lease Liabilities	XXX

SOCNE

Depreciation	XXX
Finance cost	XXX
Net Expenditure	

Right to use underlying leased asset

Obligation to make lease payments

Depreciation on lease assets and finance cost of lease liability

Summary

- Lessee's have a **single accounting model** for all leases, except for the following exemptions:
 - Short-term leases up to 12 months; and
 - Where the underlying asset is of low value (<£5,000).
 - Leasing of Intangible Assets (account for per IAS 38)
- Lessor accounting is **substantially unchanged** compared to IAS 17.
- There will be a major impact on **budgets**.
- There will be an impact on many activities across organisations including: procurement; commercial; IT; and finance functions.



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Accounting for leases under IFRS 16

Transition

Upon transition to IFRS 16 the entities recognise the **cumulative effect** of initially applying the Standard as an adjustment to equity representing the difference between the asset and the liability.

For leases previously classified as operating leases:

Recognise a
lease liability

Derived by:

- measuring the lease liability at the present value of the **remaining lease payments**; and
- discounting through use of the lessee's **incremental borrowing rate** at the date of initial application.

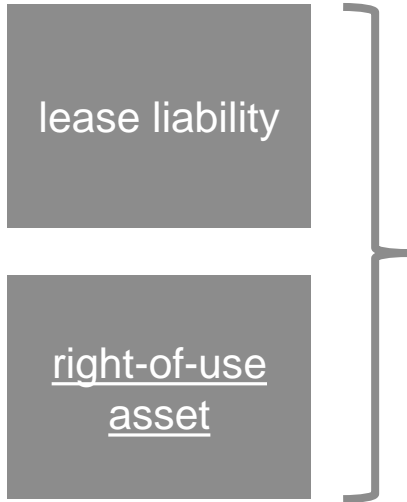
Recognise a
right-of-use
asset

By taking:

- the amount **equal to the lease liability**; and
- adjusting by the amount of any prepaid or accrued lease payments relating to that lease.

Transition

For leases previously classified as finance leases:

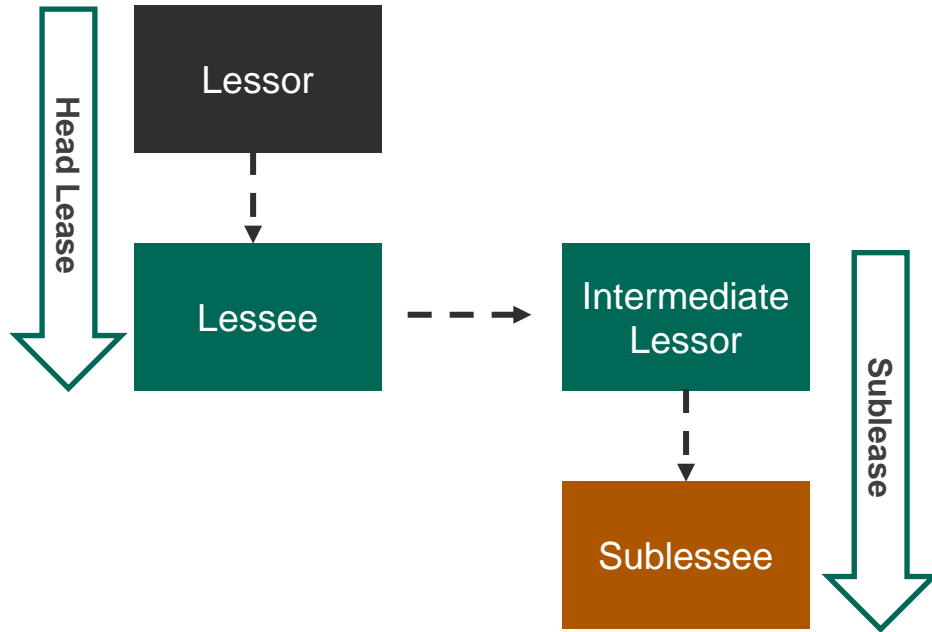


The carrying amounts of the right-of-use asset and lease liability should remain the same as they were immediately before the date of initial application.

“Fair Value Cap”

IAS 17 mandated that a finance lease was recognised at an amount equal to the fair value of the leased property or if lower the present value of the minimum lease payments. **Such a “cap” no longer exists.**

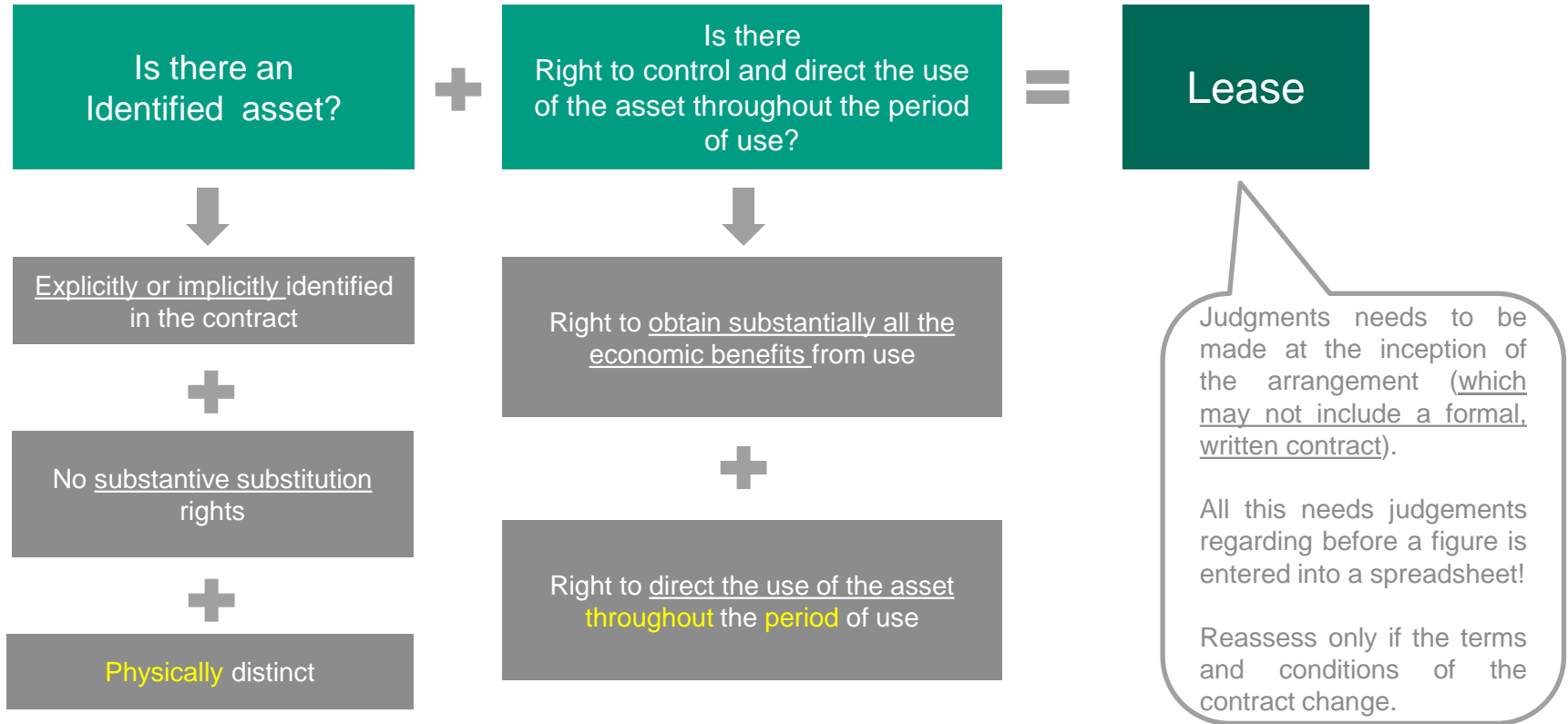
Sublease



An intermediate lessor must classify the sublease as a finance lease or an operating lease as follows:

- If the head lease is a short-term lease that the entity, as a lessee, has accounted for by recognising the lease payments as an expense, the sublease must be classified as an operating lease.
- Otherwise, the sublease must be classified by reference to the right-of-use asset arising from the head lease, **rather than** by reference to the economic useful life of the underlying asset
- **ON TRANSITION ALL SUBLEASES THAT ARE OPERATING LEASES MUST BE REASSESSED**

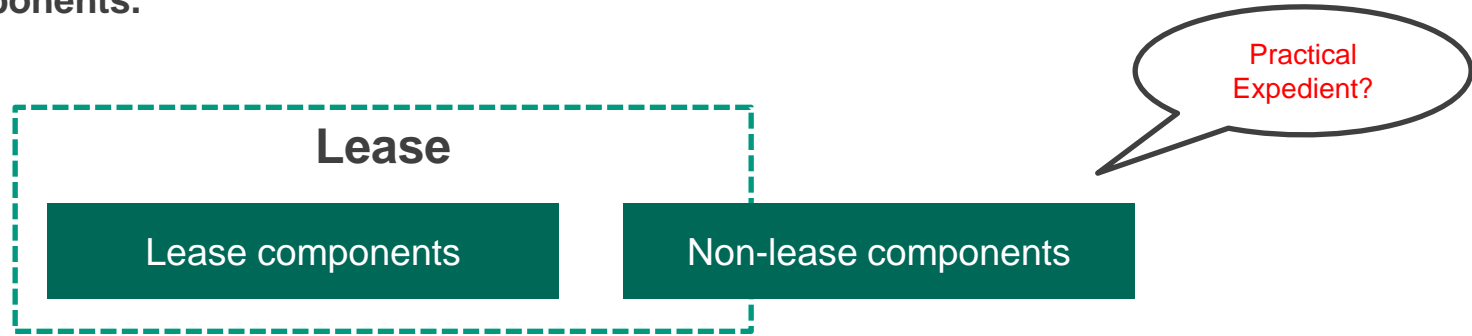
Steps to Identifying a lease under IFRS 16



Lease and non-lease components

Contracts may contain both a **lease and non-lease component**.

The new standard requires lessees and lessors to **separate the lease and non-lease components**.

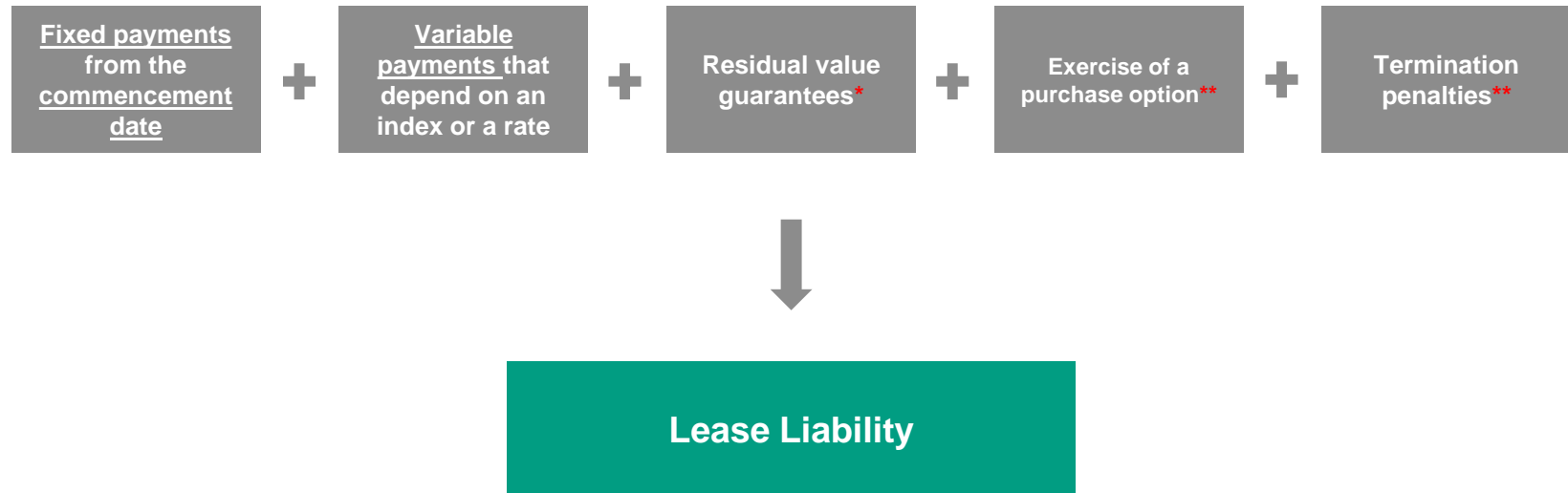


Lessees are required to separate the lease and non-lease components unless the **practical expedient** is applied. IFRS 16 permits lessees to account for all components of a lease as part of a lease arrangement.

Measurement of the lease liability

The lessee must recognise a lease liability on the commencement date of a lease, i.e. the date on which the lessor makes an underlying asset available for use by a lessee.

The lease liability is made up of the present value of the following:

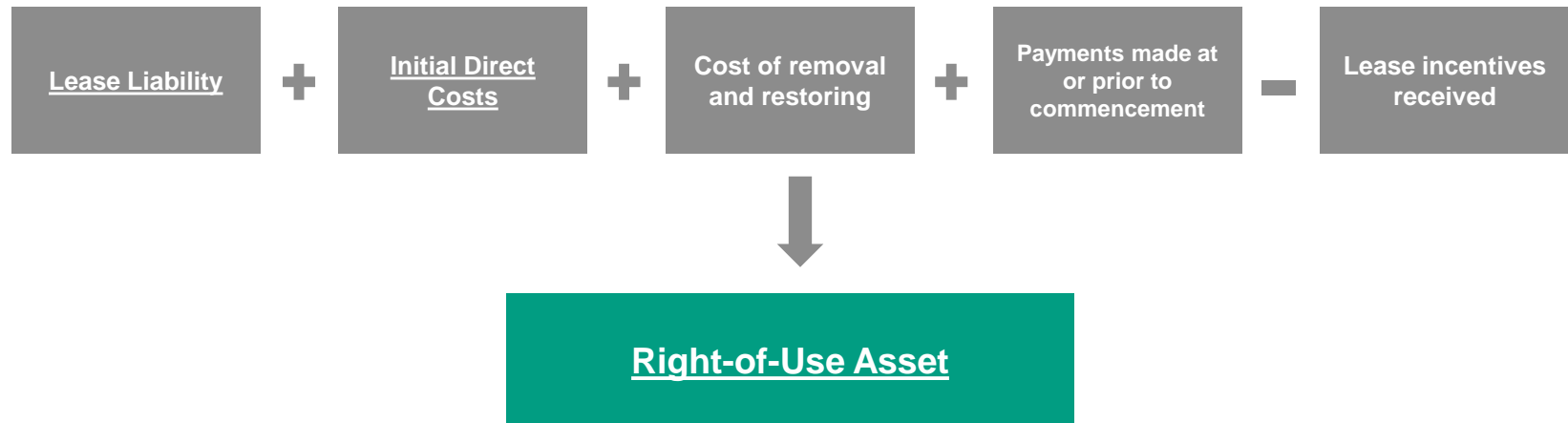


* If included in the contractual terms and conditions

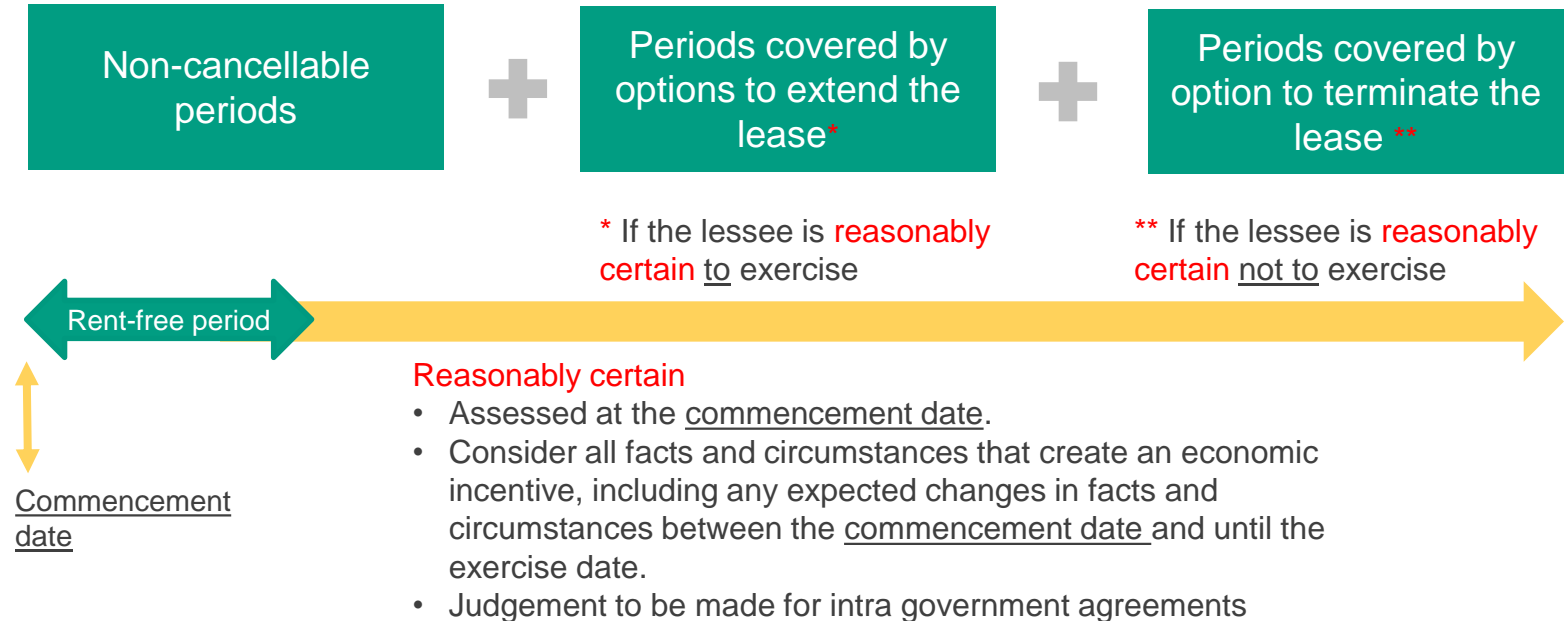
** If lessee is reasonably certain to exercise the option

Measurement of the right-of-use asset

The lessee must also recognise a right-of-use asset. This asset comprises:



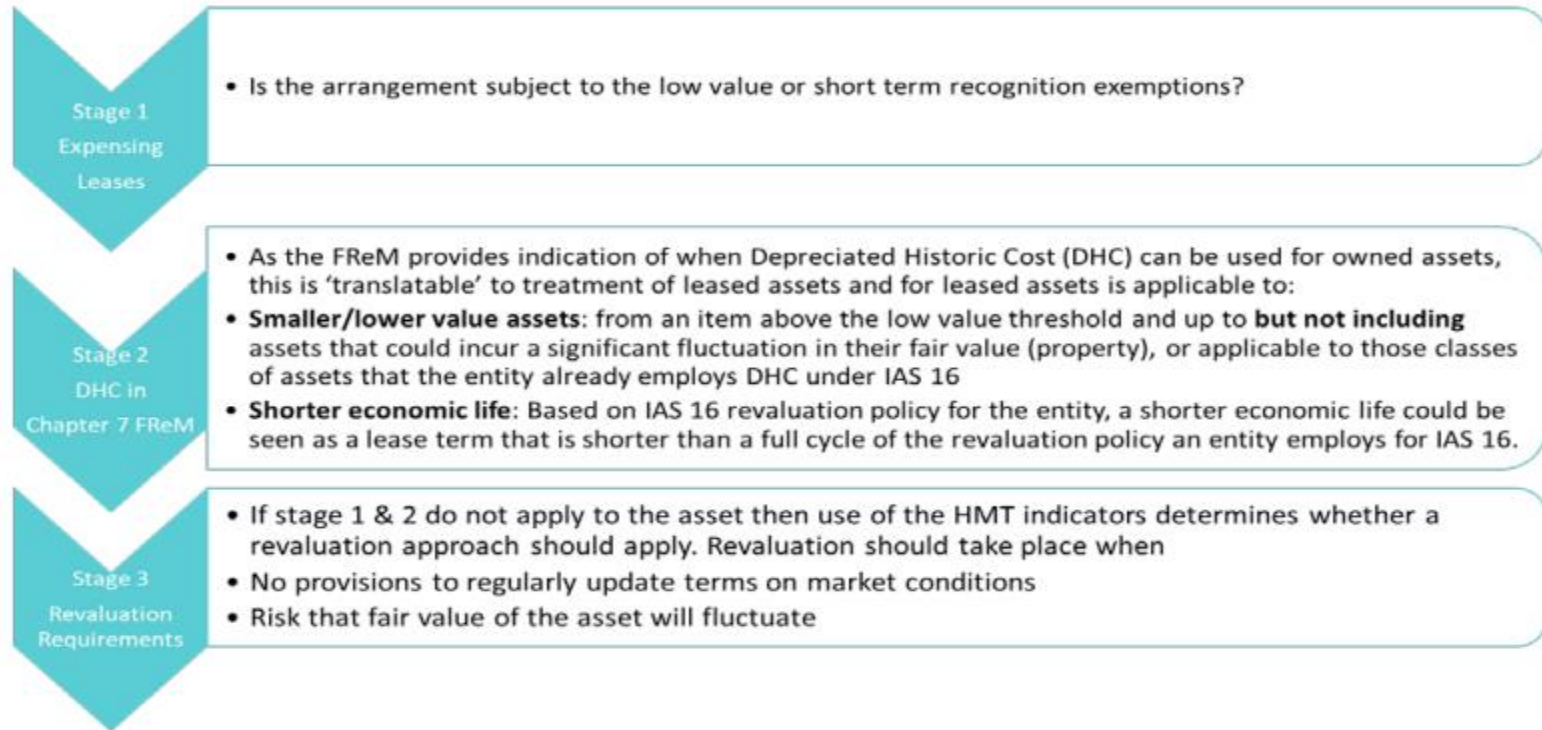
Judgements galore under IFRS 16... Lease term



Using Hindsight on Transition is Mandated!

To Revalue or not Revalue...

Figure 1: Steps to revaluation approach





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How the standard will impact the budgets

Budgeting: Transition to IFRS 16

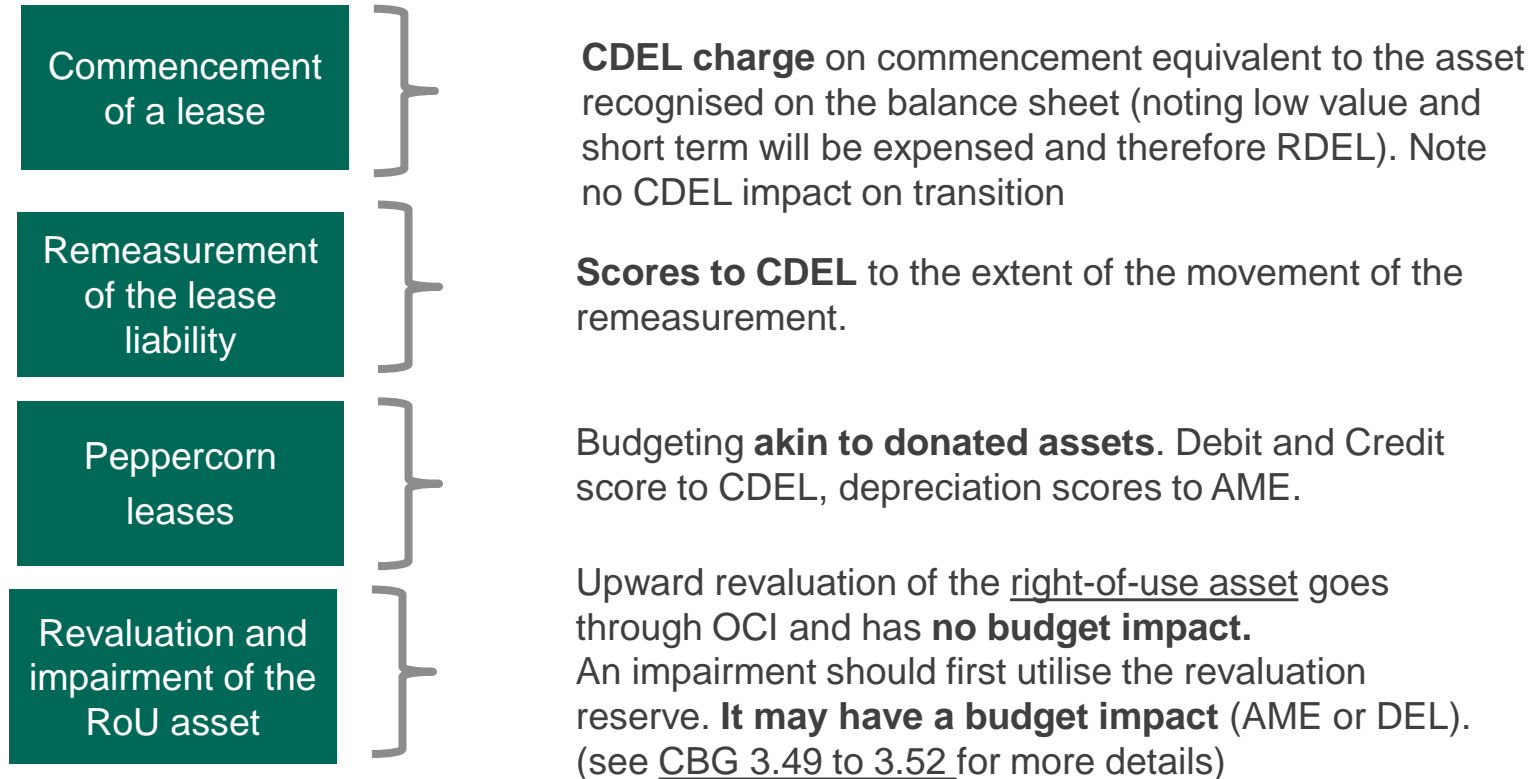
On transition to IFRS 16, it is mandated that all FReM bodies retrospectively apply the standard with the cumulative effect recognised as an adjustment to opening balances (cumulative catch-up). No budget entry should be made for the cumulative catch-up adjustment to accounts. Instead, for budgeting, the cumulative catch-up is ignored and no Prior Period Adjustment (PPA) is required.

Cumulative	Recognise asset	
IFRS 16 - on balance sheet lease	Yr 3	Depreciate asset
		Interest
	Yr 4	Cash paid
Depreciate asset		
Interest		
	Cash paid	

Accounting					
P&L		BS			
Income	Expense	Assets	Cash	Liab	Equity
		16		(16.0)	
	8	(8)			
	0.2			(0.2)	
			(8.15)	8.15	
	8	(8)			
	0.1			(0.1)	
			(8.15)	8.15	
0	16.3	0	(16.3)	0	0

Budgeting			
Asset (CDEL)	Ringfenced RDEL	Working capital (non budget)	Interest/impairment /other (RDEL)
	8		0.2
		7.95	
	8		0.1
		8.05	
0	16	16	0.3

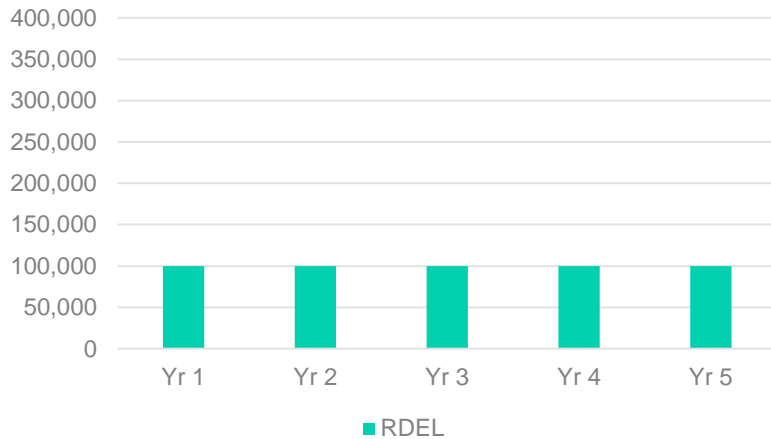
IFRS 16 has significant budgeting impacts:



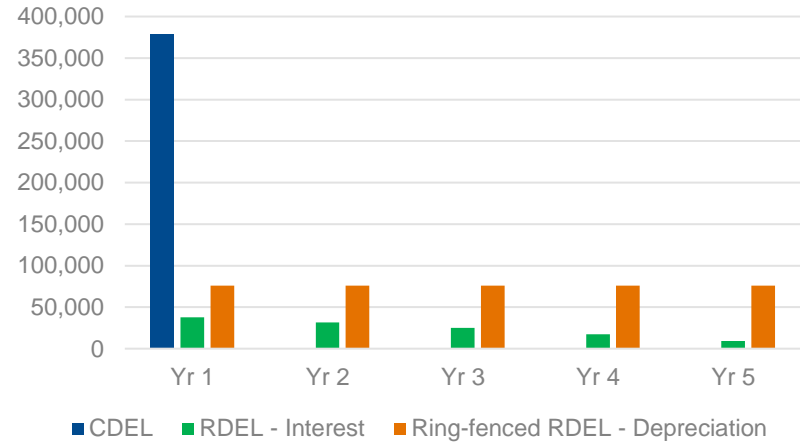
Budgeting: Example New Lease

The impact IFRS 16 will have on budgets can be demonstrated through an example.

IAS 17 – Operating Lease



IFRS 16



Implication: CDEL requirement for new leases + RDEL is front-loaded



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Update on Public Sector Approach to IFRS 16

IFRS 16 to be applied in 2022-23

The effective date across the public sector is 1 April 2022 (aside from those already applying the Standard). No further delays or deferrals...

Note the timelines for activities as it stands in NHSE and NHSI financial reporting area

Harnessing Cop 26 credentials, most materials and requirements for entities regarding IFRS 16 have been out for a while and DHSC, NHSE and NHSI will be recycling all off this (albeit with minor refinements).

Key preparatory work that needs to be progressed regarding;


- Entity understanding multi disciplinary impact of Standard
- Developing materially complete information, estimates and judgements
- Be aware of all HM Treasury adaptations and interpretations – they haven't materially changed over the past 2 years
- Business planning that will inform implementation for 2022-23
- Active management of lease information and impacts on accounts and budgets
- DHSC, NHSE and NHSI updated guidance and implementation timetables published and updated accordingly

IFRS 16 to be applied in 2022-23

The principles behind the Main Estimate data collection – from HMT’s perspective

Central Government IFRS 16 refresher training Need help? | Lea

IFRS 16 budgeting - process



- SR21 is being conducted on an IAS 17 basis, although departments have been asked for an estimate of CDEL costs to help with HMT's planning
- Budgets will be adjusted for IFRS 16 via a technical reclassification exercise ahead of Main Estimates 2022/23. This will involve completing a return for HMT containing the type of information below, which will go through a process of checks and agreement.

Main reclassification changes
Surrender RDEL for lease expense on IAS 17 basis
Request CDEL for new leases & relevant changes to existing leases
Request Ringfenced RDEL for depreciation
Request RDEL for interest
Request net CDEL for Public Corporation leases
Request other budgetary changes e.g. AME for peppercorn lease depreciation/ market value impairments/ capitalised dilapidation provisions

HM Treasury 15

Measurement of a lease liability and VAT...

The Financial Reporting Advisory Board agreed entities should ...

Apply IFRIC 21

Omitting irrecoverable VAT from lease payments has been built into the accounting policy of the DHSC Group's approach to IFRS 16.

For consistency of approach to IFRS 16 this also applies to the low value threshold which is £5k excluding irrecoverable VAT also

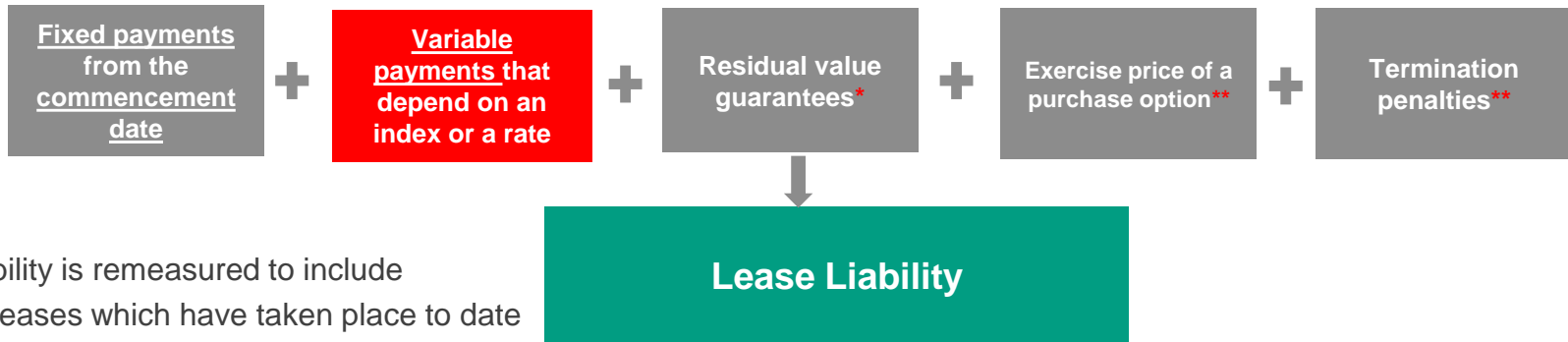
Entities need to ensure this approach to irrecoverable VAT is reflected in systems and processes;

- to ensure irrecoverable VAT is separately recorded
- to ensure financial management processes (business case development) disaggregate costs and budget currencies appropriately

Measurement of a lease liability and PFI... Apply IFRS 16 from 1 April 22

Currently the imputed PFI liability is measured under an IAS 17 style approach. As such contingent rents are expensed. Per FRM, liability recognised for the capital value. Service and interest elements of unitary payments expensed annually.

Once IAS 17 is superseded by IFRS 16 the lease liability will require remeasurement when lease payments change to reflect movement in an index or rate.



Estimated future increases are not included!

Measurement of a lease liability and PFI... IFRS 16

An example from the draft HMT guidance helps demonstrate the difference of approach

Service and interest charges continue to be expensed and indexation tied to these would equally be expensed.

Clear there is an ongoing requirement to remeasure the PFI liability when payments Impacted by a change in rate or index

2.4 For example, if the PPP contract terms were “annual capital repayments of £1000 (plus interest & service charge), increasing annually by CPI”:

Year + example CPI	IAS 17 approach	IFRS 16 approach
Y1 – CPI 3% Increase £1000 x 3% = £1030	Payments of £1000 p/a included in future lease liability. Expense £30 as contingent rent.	Payments of £1000 p/a <u>were</u> included in future lease liability. Remeasure future lease liability (including for Y1) to include payments of £1030 p/a.
Y2 – CPI 2% Increase £1030 x 2% = £1051	Payments of £1000 p/a included in future lease liability. Expense £51 as contingent rent.	Payments of £1030 p/a were included in future lease liability. Remeasure future lease liability (including for Y2) to include payments of £1051 p/a.
Y3 – CPI 4% Increase £1051 x 4% = £1093	Payments of £1000 p/a included in future lease liability. Expense £93 as contingent rent.	Payments of £1051 p/a were included in future lease liability. Remeasure future lease liability (including for Y2) to include payments of £1093 p/a.

Measurement of a lease liability and PFI... IFRS 16

Other things that need to be considered;

- Indexation floors – fixed annual uplifts are in substance fixed payments.
- Transition – HMT considering approach to transition - is there anything more they want entities to do than roll forward PFI liability as a finance lease would (IFRS 16 C11)?
- Timelines for guidance – Input to HMT guidance to assist finalisation
- DHSC and NHSE and NHSI to consider further contextualisation of HMT guidance for Group bodies.



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IFRS 16

Practical challenges

Practical Challenges: Overview

Additional cost of assets ownership

IFRS 16 will increase the amount of fixed assets an organisation will need to maintain information regarding to inform valuation assessments for instance (revaluation or impairment)

Completeness of data

Obtaining and assessing all of the relevant data. Completeness of the lease registers. Assets records will require greater level of detail.

Estimates and judgments

Separating lease and non-lease components, consideration of extension and termination options. IFRS 16 requires an abundance of judgements to be made!

Practical Challenges: Overview

Group consolidations
and eliminations

Lack of symmetry between lessee and lessor accounting will require complex group adjustment on consolidation.

Judgments around
existing
arrangements

Lack of documentation in some cases will require judgments as to what existing arrangements represent and what accounting treatment is appropriate.

Lease Management

After the initial implementation the entities will have to continue maintaining control of the lease arrangements. Regular reassessment reviews etc.

Practical Challenges: Addressing any issues

There are many colleagues within the DHSC group as well as outside of it who can assist you with challenges and issues you come across when implementing the new Standard.



Further Guidance

Standard [“IFRS 16 Leases”](#) available of IAS Plus website

[DHSC “Group Accounting Manual IFRS 16 Supplement”](#)

[“Financial Reporting Manual \(FReM\) 2020-21”](#)

[“FReM IFRS 16 Leases Application Guidance”](#)

[“IFRS 16 Supplementary Budgeting Guidance”](#)

[“IFRS 16 implementation area”](#)

IFRS 16 materials available on the [Government Finance Function portal](#) including Technical Accounting Centre of Excellence materials

All major accountancy bodies have published a wealth of information (not necessarily adapted or interpreted for the public sector – but always informative)