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IFRS 16 LEASES- VIEW FROM WELSH GOVERNMENT HSS

Introduction

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IFRS 16 Re-cap

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- IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces the previous Standards IAS 17 *Leases* and related IFRIC and SIC Interpretations.
- IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.
- IFRS 16 introduces a single lessee accounting model that will provide greater transparency of a lessee's financial leverage and capital employed
- IFRS 16 requires a lessee to recognise assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value.

IFRS 16 Re-cap

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- A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.
- As a consequence, a lessee also recognises depreciation of the right-of-use asset and interest on the lease liability, and classifies cash repayments of the lease liability into a principal portion and an interest portion and presents them in the statement of cash flows applying IAS 7 *Statement of Cash Flows*.
- IFRS 16 also contains disclosure requirements for lessees. Lessees will need to apply judgement in deciding upon the information to disclose in order to meet the objective of providing a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee.

Recognition exemptions

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IFRS 16 provides two optional recognition and measurement exemptions:

- **Short-term leases** are defined in IFRS 16 as having a lease term of 12 months or less, after the assessment of any options. Any lease with a purchase option cannot qualify as a short-term lease. The recognition and measurement exemption for short-term leases in IFRS 16 is made by class of underlying asset.
- In addition to the recognition and measurement exemption for short-term leases, IFRS 16 also provides a recognition exemption for leases of **low-value underlying assets.**

Definition of a lease

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- IFRS 16 defines a lease as a contract that '*conveys the right to control the use of an identified asset for a period of time in exchange for consideration*.' This definition applies both to lessees and lessors.
- IFRS 16 requires entities to use the definition of a lease guidance to assess all contracts entered into after the date of initial application. However, on transition, the FReM requires entities to carry forward the assessments that were made in accordance with the requirements in IAS 17 and IFRIC 4 regarding whether contracts are, or contain, leases. Therefore, the guidance in IFRS 16 on the definition of a lease is only relevant for contracts that are entered into, or amended, after the date of initial application.

FReM adaptations to lease definition

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FReM makes two adaptations to the definition of a lease in IFRS 16 for the public sector.

Intra-UK government agreements

- Public sector adaptation: The definition of a contract (and therefore, of a lease) is expanded to include intra-UK government agreements that are not legally enforceable.

Lease-like agreements with nil consideration

- The definition of a lease in IFRS 16 contains a requirement that the right to use an asset be conveyed in exchange for consideration. However, in the public sector there are arrangements in which the right to use an asset is conveyed freely.
- The adaptations around peppercorn leases mean that arrangements with nil consideration can qualify as leases if they meet the definition of a lease in every other aspect. These types of arrangements exist in the public sector and are very similar to donated assets.

Transition Arrangements

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Entities must have made certain key assessments by 1 April 2022 including:

- identifying and locating all lease contracts, along with implementing a process for entering those leases into their accounting system;
- determining methodologies for separating lease and service components, if necessary;
- determining how to communicate and educate all relevant stakeholders as to the impact of IFRS 16, including commercial, legal and finance teams;
- considering which disclosure requirements are material, and where the necessary information is held to provide sufficient disclosures to meet the disclosure requirements.

Lessee Accounting – Initial Measurement

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Lease term

- When initially measuring right-of-use assets and lease liabilities, an entity will need to determine the lease term. IFRS 16 defines the lease term as the non-cancellable period for which a lessee has the right to use an underlying asset, together with both i) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and ii) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

Lease payments

- IFRS 16 requires the right-of-use asset, and the lease liability, to be initially measured at the present value of unavoidable future lease payments. The following payments are included in the initial measurement of the right-of-use asset and lease liability:

    - fixed payments (including in-substance fixed payments)
    - variable lease payments that depend on an index or a rate (for example, payments linked to a consumer price index or market rental rates)
    - amounts expected to be payable by the lessee under residual value guarantees
    - the exercise price of a purchase option if the lessee is reasonably certain to exercise that option
    - payments of penalties for terminating the lease, if the lease term reflects the lessee exercising a termination option.

Lessee Accounting – Initial Measurement

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Discount rate

- IFRS 16 requires the lease liability to be discounted using the rate implicit in the lease, or where this is not readily determined, the lessee's incremental rate of borrowing. The incremental rate of borrowing is defined as the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Lessee disclosures

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Quantitative disclosures related to the right-of-use asset

- additions to right-of-use assets
- the carrying amount of right-of-use assets at the end of the reporting period by class of underlying assets
- IFRS 16 requires right-of-use assets to be presented separately from other assets in the statement of financial position, or disclosed in the notes to the statement of financial position with a statement of which line item includes right-of-use assets

Lessee disclosures

Quantitative disclosures related to the lease liability

- IFRS 16 requires an entity to disclose a maturity analysis of lease liabilities. This requires an entity to use judgement in determining which time bands should be disclosed in order to provide the most useful information to users of the financial statements. An entity should consider the specific features of its lease portfolio, especially typical lease terms, when making this judgement, along with its existing IFRS 7 disclosures.

Quantitative disclosures related to elements recognised in the SoCNE

- IFRS 16 also requires the following quantitative disclosures for those elements not captured in the measurement of the right-of-use asset or lease liability, but instead recognised in the Statement of Comprehensive Net Expenditure:
- depreciation charge for right-of-use assets by class of underlying asset
- interest expense on lease liabilities
- the expense related to short-term leases (excluding leases with a lease term of one month or less)
- the amount of lease commitments for short-term leases, if the portfolio of short-term leases an entity is committed to at the end of the reporting period is dissimilar to the portfolio of leases for which the short-term lease expense disclosure described above is made
- the expense related to leases of low-value assets for which the recognition and measurement exemption is applied (excluding short-term leases of low-value assets)
- the expense related to variable lease payments not included in the measurement of lease liabilities

IFRS 16 and Budgets

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- Introduction of IFRS 16 means that the budgeting treatment for leases will also change.

Leases will score in the public sector to:

- Capital DEL for the Right of Use Asset
- Interest charge to the Revenue DEL
- Depreciation charges to the Ring Fenced DEL Revenue budgets
- For budgeting purposes, IFRS 16 will also apply from 1st April 2022

Financial Implications

2020-21 NHS Wales Accounts

- Finance lease obligations £2.683 million
- Operating Leases –payments recognised as an expense £42.844 million
- Total future minimum lease payments £159.759 million

September 2021 capital resource requirement estimate

NHS Wales Summary 2022-23 to 2024-25 IFRS 16 Capital Requirement					
		2022-23	2023-24	2024-25	
		£000	£000	£000	
TOTAL		83,609	14,654	17,581	

Welsh Government plans

- Continue to work with Capital TAG to introduce the standard
- Quinquennial NHS Estate revaluation 1 April 2022
- Estimates of the capital charges for 2022 and beyond
- In line with IAS 8 – introduce a note in the 2021-22 Annual Accounts to estimate the impact of introducing IFRS 16
- Prepare draft 2022-23 accounts formats to show what the Right of Use Asset presentation will look like
- Update the Finance Lease and Operating lease supporting note and the relevant accounting policies to reflect the new standard
- Introduce a separate agreement process for inter NHS lease agreements outside the main debtor / creditor agreements process for 2022-23 accounts
- Review Capital Resource Limit
- Liaise with HMT to clarify the budgeting and funding mechanisms for NHS bodies to claim their capital funding allocations
- Re-writing the Capital Accounting Manual for 2022-23 updating it to replace all IAS 17 references and replace with IFRS 16 and its relevant requirements