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CIPFA Bulletin 20 – IFRS 16 transition clarifications

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CIPFA issues bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code), the Service Reporting Code of Practice (SeRCOP) and the Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but they are not prescriptive and do not have the formal status of the Code, SeRCOP or the Prudential Code.

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CIPFA Bulletin 20 – IFRS 16 transition clarifications

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IFRS 16 considerations in relation to assets held by police and crime commissioners and used by chief constables

Background

1. The Police Reform and Social Responsibility Act 2011 provided for the introduction of police and crime commissioners and chief constables as separate legal entities (corporations sole) while also providing flexibility to put in place local arrangements as to how responsibilities and delegations would be managed between the police and crime commissioner and the chief constable in their local areas. The accounts of these bodies need to reflect their local arrangements.

2. To assist police bodies in England and Wales with their accounting arrangements under the new provisions, LAAP Bulletin 95 was issued in December 2012 and LAAP Bulletin 98A was issued in March 2014.

3. LAAP Bulletin 98A was framed in terms of Code requirements reflecting IAS 17 *Leases*. The Code for 2024/25 fully implements IFRS 16 *Leases* and no longer includes provisions based on IAS 17 *Leases*. The requirements of IAS 17 are no longer relevant.

4. CIPFA has been asked whether arrangements under which chief constables use the assets of police and crime commissioners should be considered to be leases under IFRS 16, and whether a right-of-use asset should then be recognised.

5. In each case, preparers need to consider the substance of the arrangement in determining the accounting treatment, having regard to the requirements of IFRS 16 as set out in the Code, including the requirements on transition.

Requirements on transition

6. Paragraph 4.2.1.5 of the Code specifies that on transition, there shall be no reassessment of whether a contract is or contains a lease at the date of initial application, except for leases for nil consideration.

7. Having regard to the above:
    - where there are existing contractual arrangements at non-zero consideration, these will be treated as leases in those cases where the contract has been previously assessed as containing a lease, or

    - where there are arrangements for nil consideration under which chief constables use the assets of police and crime commissioners, an assessment will be required of whether this represents a lease.

Assessment of whether there is a lease

8. Key matters for police and crime commissioners and chief constables to consider are whether there is a contractual arrangement and whether access to the asset arises from the contractual arrangement.

The existence of a contract giving rise to a lease

9. Paragraph 4.2.2.11 of the Code sets out the IFRS 16 definition of a lease, which is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time. If there is no contract, there is no lease from the perspective of IFRS 16 or the Code.

10. The FReM has adapted IFRS 16 to expand the definition of a contract to include intra-UK government arrangements where non-performance may not be enforceable by law. The Code has not made this adaptation, as unlike central government departments, local authorities are separate legal entities.

11. Paragraph 4.2.2.2 of the Code sets out the IFRS 16 definition of a contract, which is an agreement between two or more parties that creates enforceable rights and obligations. Therefore:

    - if there are no enforceable rights and obligations, there is no contract and therefore no lease from the perspective of IFRS 16 or the Code

    - if there are enforceable rights and obligations but they arise from other factors than the agreement, then there is also no contract and no lease from the perspective of IFRS 16 or the Code.

12. Once it has been determined that there is a contract, paragraphs 4.2.2.36 and 4.2.2.37 set out the factors that need to be considered to determine that a contract contains a lease. A contract is or contains a lease if it conveys the right to control the use of an identified asset for a period of time. In order to control the use of an identified asset, a customer is required to have the right to obtain substantially all the economic benefits and service potential from use of the asset throughout the period of use.

Accounting required if a nil consideration lease is identified

13. The treatment of a nil consideration lease depends on whether an asset has, in effect, been donated by the lessor to the lessee.

14. Where this is the case, the Code interprets IFRS 16 to specify treatment following the principles in the Code for the treatment of donated assets. Under these circumstances, paragraphs 4.2.1.5 and 4.2.2.48 of the Code specify that:

    - lessees must measure the right-of-use asset at fair value and recognise a gain on transition where applicable

- lessors must derecognise the asset provided to the third party, with any unguaranteed residual value recognised, where applicable.

15. Where no asset has been donated, the balances and transactions are taken at current value rather than fair value, and there is no effect on the financial statements.

Service concession arrangements

16. CIPFA has been made aware of potential differences in how the *Code of Practice on Local Authority Accounting in the United Kingdom 2024/25* (the Code) is being interpreted in relation to accounting for remeasurement of service concession arrangements on transition to IFRS 16. This bulletin clarifies CIPFA/LASAAC's intended interpretation of the Code requirements.

17. Paragraph 4.3.2.44 of the Code requires changes relating to the measurement of service concession arrangements liabilities in accordance with the measurement requirements for the lease liability in Section 4.2 and IFRS 16 to follow the transition requirements for lease liabilities in Section 4.2.

18. Service concession arrangement liabilities were treated in the same way as finance leases under IAS 17. Therefore, similar arrangements to those in paragraph 4.2.2.104 setting out the requirements on transition for leases that were classified as finance leases applying IAS 17 would apply to liabilities under service concession arrangements on transition to IFRS 16.

19. Paragraph 4.2.2.104 of the Code states:

> *For leases that were classified as finance leases applying IAS 17, the carrying amount of the right-of-use asset and the lease liability at the date of initial application (except for Transport for London, this will either be 1 April 2022 or 1 April 2023) shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying IAS 17. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying IFRS 16 from the date of initial application.*

20. However, paragraph 4.3.2.44 of the Code specifies a departure from this approach for service concession arrangements where the contract provides for variable payments that depend on an index or a rate:

> *In such cases, the balance should be adjusted on the date of initial application to reflect the carrying amount of the liability which would have been calculated as the closing balance in the previous reporting year, based on the index or rate applied to variable payments in the previous reporting year.*

21. Therefore, paragraphs 4.2.2.104 and 4.3.2.44 require service concession arrangement assets and liabilities to be accounted for applying IFRS 16 from the date of initial application. For service concession arrangements, remeasurement does not wait until the next change in payments, but instead a remeasurement is required on the date of

initial application (1 April) to reflect the carrying amount of the liability, which would have been calculated as the closing balance in the previous reporting year.

22. Paragraph 4.3.2.21 of the Code requires measurement of the service concession liability to follow the principles set out in Section 4.2 for the arrangements for measurement of the lease liability. Paragraph 4.2.2.59 of the Code states:

> *After the commencement date, a lessee shall apply paragraphs 40–43 of IFRS 16 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.*

23. Paragraphs G79–G86 in Module 4 of the *Code of Practice on Local Authority Accounting in The United Kingdom: Guidance Notes for Practitioners 2024/25 Accounts* provide guidance on the accounting requirements for the transition from IAS 17 to IFRS 16 for service concession arrangements. The accounting entries for remeasurement of service concession liabilities on the date of initial application are:

DR	Property, plant and equipment
CR	Liabilities

Where the increase in the carrying amount means there is a risk of material misstatement of the current value of the asset, a new valuation of the asset may be required. The accounting entries for this will be in accordance with a conventional revaluation under Section 4.1 of the Code – ie if there is a reduction in the current value of the asset, an adjustment to reduce the revaluation gains previously accumulated in the revaluation reserve for the asset will be required. However, where there are no accumulated gains or they are insufficient to cover the full amount of the adjustment, a charge will be made to the relevant service line(s) in the Comprehensive Income and Expenditure Statement (CIES):

DR	Revaluation reserve and/or CIES – relevant service line
CR	Property, plant and equipment

If the debit was made to the CIES, as a write-down in the value of the item of property, plant and equipment, the impact of the debit on the General Fund balance will need to be neutralised by a transfer to the capital adjustment account:

DR	Capital adjustment account
CR	General Fund balance (Movement in Reserves Statement)

24. Some authorities will have service concession arrangements without an asset on the Balance Sheet. For example, many authorities entered into PFI contracts for the building of new schools that were subsequently transferred to academy trusts. In such instances, it may be reasonable to apply statutory arrangements for expenditure on an asset not owned by the authority and treat the increase in the liability as revenue expenditure funded from capital under statute.

The accounting entries would then be:

DR	Comprehensive Income and Expenditure Statement (cost of services)
CR	Liabilities
DR	Capital adjustment account
CR	General Fund balance (Movement in Reserves Statement)