

Accounting provisions on the adoption of IFRS 16 *Leases* from 1 April 2022

INTRODUCTION AND BACKGROUND

Appendix F sets out the anticipated provisions in the 2022/23 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) for IFRS 16 *Leases*, following the decision made by CIPFA/LASAAC to defer the transition to 2022/23 to match the timeline being adopted for central government.

This appendix is issued to accompany the 2021/22 Code to provide local authority accounts preparers with advanced notification of the changes to the Code for this substantial new standard. **However, the contents of this appendix do not have the authority of the Code and early adoption of IFRS 16 is not permitted by the 2021/22 Code with the sole exception of Transport for London, to whom early adoption has also been permitted in an update to the 2019/20 and 2020/21 Codes.**

The appendix sets out the following information in respect of the future changes to the Code:

- requirements of the new standard (ie the revised Section 4.2 of the Code)
- consequential changes impacting elsewhere in the Code
- summary of changed references to accounting standards and other minor changes.

REQUIREMENTS OF THE NEW STANDARD (NOTE THESE PROVISIONS WILL ONLY APPLY FROM 1 APRIL 2022)

4.2 LEASES

4.2.1 Introduction

- 4.2.1.1** Authorities shall account for leases in accordance with IFRS 16 *Leases*, except where adaptations to fit the public sector are detailed in the Code. IPSAS 13 *Leases* is based on IAS 17 *Leases* (and does not adopt IFRS 16) and should only be considered for additional guidance where it does not contradict the provisions of IFRS 16. Transport for London is permitted, but not required, to apply the Code requirements relating to IFRS 16

implementation for the 2019/20, 2020/21 and 2021/22 financial years with a date of initial application of 1 April 2019. Early application by other local authorities is not permitted. It is anticipated that the standard will have a date of initial application of 1 April 2022.

4.2.1.2 This section of the Code shall be applied in accounting for all leases except licences of intellectual property granted by a lessor within the scope of Section 2.7 and IFRS 15 *Revenue from Contracts with Customers*, service concession arrangements within the scope of Section 4.3 of the Code and IFRIC 12 *Service Concession Arrangements*, and rights held by a lessee under licensing agreements within the scope of Section 4.5 of the Code and IAS 38 *Intangible Assets*. Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources and of biological assets within the scope of IAS 41 *Agriculture* are also excluded from the scope of this section of the Code, however these are unlikely to apply to local authorities.

4.2.1.3 A lessee may but is not required to apply this section of the Code to leases of intangible assets other than those described in paragraph 4.2.1.2. Leases relating to heritage assets are accounted for in accordance with this section of the Code subject to the specific requirements of Section 4.10 (Heritage Assets).

Adaptation for the public sector context

4.2.1.4 The following adaptations of IFRS 16 apply:

Scope

- The Code adapts IFRS 16 to remove the phrase “in exchange for consideration” from the definition of a lease. All other IFRS 16 *Leases* requirements for lease identification apply

Interpretation for the public sector context

4.2.1.5 For transition arrangements the Code applies the following interpretations:

- Authorities shall not reassess whether a contract is or contains a lease at the date of initial application, except for leases for nil consideration.
- For lessee arrangements transition will be undertaken to restate balances at the date of initial application for the cumulative effect of initial application. The option to retrospectively restate prior period comparative information is not permitted.
- For lessee arrangements the option to make adjustments on transition where the underlying asset is of low value is not permitted.
- For lessee arrangements the option to make adjustments on transition for leases where the lease term ends within 12 months is not permitted.
- For lessees, nil consideration leases are required to be identified with measurement of the right-of-use asset required, and a gain on transition recognised where applicable.
- For lessors, nil consideration finance leases are required to be identified, with the asset provided to the third party required to be derecognised, and any unguaranteed residual value recognised, where applicable.

The following interpretations of IFRS 16 apply in accounting for leases and lease type arrangements after transition to IFRS 16 *Leases*:

- The Code interprets IFRS 16 to require local authorities to apply the recognition exemption to short-term leases (see paragraph 4.2.2.32).
- The Code interprets IFRS 16 to specify in more detail the accounting requirements for leases at peppercorn or nominal lease payments, or for nil consideration by following the principles in the Code for the treatment of donated assets. Note this only applies where the substance of the transaction is that the lease donates the asset to the lessee.
- The Code interprets IFRS 16 to require that the subsequent measurement of the right-of-use asset where the underlying asset is an item of property, plant and equipment is measured in accordance with Section 4.1 of the Code (see paragraph 4.2.2.53). This includes the use of the cost model in IFRS 16 as a proxy for current value for most right-of-use assets.
- The Code interprets IFRS 16 so that housing tenancies reported within the Housing Revenue Account (HRA) are deemed to be operating leases that shall be accounted for under this section of the Code. The Code interprets IFRS 16 to confirm that operating lease disclosures for housing tenancies reported in the HRA shall not apply.

4.2.2 Accounting requirements

Definitions

- 4.2.2.1** The **commencement date of the lease** is the date on which a lessor makes an underlying asset available for use by a lessee.
- 4.2.2.2** A **contract** is an agreement between two or more parties that creates enforceable rights and obligations.
- 4.2.2.3** **Economic life** is either the period over which an asset is expected to be economically usable by one or more users; or the number of production or similar units expected to be obtained from an asset by one or more users.
- 4.2.2.4** **Effective date of the modification** is the date when both parties agree to a lease modification.
- 4.2.2.5** **Fair value** – for the purpose of applying the lessor accounting requirements of this section of the Code and IFRS 16, the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- 4.2.2.6** A **finance lease** (for lessors only) is a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.
- 4.2.2.7** **Fixed payments** are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.
- 4.2.2.8** The **inception date of the lease** is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.
- 4.2.2.9** **Initial direct costs** are the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.

- 4.2.2.10** The interest rate implicit in the lease is the rate of interest that causes the present value of:
- a) the lease payments, and
 - b) the unguaranteed residual value to equal the sum of:
 - i) the fair value of the underlying asset, and
 - ii) any initial direct costs of the lessor.
- 4.2.2.11** A **lease** is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time.
- 4.2.2.12** **Lease incentives** are payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.
- 4.2.2.13** A lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).
- 4.2.2.14** The **lease term** is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:
- a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option, and
 - b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
- 4.2.2.15** A **lessee** is an authority that obtains the right to use an underlying asset for a period of time.
- 4.2.2.16** The **lessee's incremental borrowing rate** is 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.
- 4.2.2.17** A **lessor** is an authority that provides the right to use an underlying asset for a period of time.
- 4.2.2.18** Leases for **nil consideration** are those that do not include the provision of consideration but that in all other respects meet the definition of a lease.
- 4.2.2.19** An **operating lease** (for lessors only) is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.
- 4.2.2.20** **Optional lease payments** are payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term.
- 4.2.2.21** Leases at **peppercorn or nominal lease payments** are those leases for which consideration is paid but the lease payments are substantially below market lease payments.
- 4.2.2.22** **Period of use** is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time).
- 4.2.2.23** **Residual value guarantee** is a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

4.2.2.24 The **right-of-use asset** is an asset that represents a lessee's right to use an underlying asset for the lease term.

4.2.2.25 A **short-term lease** is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

4.2.2.26 An **underlying asset** is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

4.2.2.27 **Useful life** is the period over which an asset is expected to be available for use by an authority; or the number of production or similar units expected to be obtained from an asset by an authority.

4.2.2.28 **Variable lease payments** are the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

4.2.2.29 Further definitions, including gross investment in the lease, lease payments, net investment in the lease, sublease, unearned finance income and unguaranteed residual value are contained in IFRS 16.

Removal of Housing Revenue Account tenancies from the scope of lease accounting

4.2.2.30 For the avoidance of doubt, the requirements of IFRS 16 *Leases* and this section (4.2) of the Code shall not be applied to Housing Revenue Account tenancy agreements. Housing Revenue Account tenancy agreements will be presented in accordance with the relevant sections of the Code. This includes Section 3.5 Housing Revenue Account, Section 4.1 Property, Plant and Equipment for owned social housing assets, and Section 2.7 Revenue from Contracts with Service Recipients for Housing Revenue Account tenancy agreements income.

Portfolio application

4.2.2.31 This section of the Code specifies the accounting for an individual lease. However, as a practical expedient, an authority may apply this section of the Code to a portfolio of leases with similar characteristics if the authority reasonably expects that the effects on the financial statements of applying this section of the Code to the portfolio would not differ materially from applying this section of the Code to the individual leases within that portfolio. If accounting for a portfolio, an authority shall use estimates and assumptions that reflect the size and composition of the portfolio.

Recognition exemptions

4.2.2.32 A lessee shall not apply the requirements in paragraphs 4.2.2.45 to 4.2.2.68 to short-term leases.

4.2.2.33 A lessee may elect not to apply the requirements in paragraphs 4.2.2.45 to 4.2.2.68 to leases where the underlying asset is of low value. The following apply to an authority's assessment of low value:

- a) A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, irrespective of the age of the asset being leased.

- b) The assessment of whether an underlying asset is of low value is performed on an absolute basis (therefore it applies to the individual underlying asset).
- c) Leases of low-value assets qualify as such irrespective of whether those leases are material to the lessee.
- d) The election for leases for which the underlying asset is of low value may be made on a lease-by-lease basis.
- e) The assessment of low value is not affected by the size, nature or circumstances of the lessee.
- f) An underlying asset is permitted to be treated as low value only if:
 - i) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee, and
 - ii) the underlying asset is not highly dependent on, or highly interrelated with, other assets.
- g) A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value.
- h) If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.

For further guidance in applying this paragraph (4.2.2.33) a local authority shall consider paragraphs B3 to B8 of IFRS 16.

4.2.2.34 Where a lessee holds a short-term lease or if a lessee elects not to apply the requirements in paragraphs 4.2.2.45 to 4.2.2.68 to leases for which the underlying asset is of low value, the lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

4.2.2.35 Where a lessee holds a short-term lease the lessee shall consider the lease to be a new lease for the purposes of this section of the Code if:

- a) there is a lease modification, or
- b) there is any change in the lease term.

Identifying a lease

4.2.2.36 At inception of a contract, an authority shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time (see paragraphs B9 to B31 of IFRS 16 for guidance on an assessment whether a contract is or contains a lease). Specifically to assess whether a contract is or contains a lease, an authority shall consider:

- whether the asset is explicitly or implicitly identified in a contract (see paragraph B13 of IFRS 16)
- if an asset is specified in a contract whether the supplier has a substantive right to substitute (see paragraphs B14 to B19 of IFRS 16)

- whether the asset specified in a contract is physically distinct (see paragraph B20 of IFRS 16)
- whether the customer has the right to obtain substantially all of the economic benefits and service potential from use of the asset throughout the period of use (see paragraph 4.2.2.37 and B21 to B23 of IFRS 16), and
- whether the customer has the right to direct the use of the asset throughout the period of use (B24 to B30 of IFRS 16).

4.2.2.37 To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits and service potential from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits or service potential from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realised from a commercial transaction with a third party.

4.2.2.38 An authority shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

Separating components of a contract

4.2.2.39 For a contract that is, or contains, a lease, an authority shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless it applies the practical expedient in paragraph 4.2.2.41.

Separating components of a contract – lessee

4.2.2.40 For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

4.2.2.41 As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component.

Lease term

4.2.2.42 An authority shall determine the lease term as the non-cancellable period of a lease, together with both:

- a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option, and
- b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

4.2.2.43 An authority shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:

- a) the lessee exercises an option not previously included in the authority's determination of the lease term
- b) the lessee does not exercise an option previously included in the authority's determination of the lease term
- c) an event occurs that contractually obliges the lessee to exercise an option not previously included in the entity's determination of the lease term, or
- d) an event occurs that contractually prohibits the lessee from exercising an option previously included in the authority's determination of the lease term.

Recognition – lessees

4.2.2.44 At the commencement date, a lessee shall recognise a right-of-use asset and a lease liability.

Initial measurement – lessees

Initial measurement of the right-of-use asset

4.2.2.45 At the commencement date, a lessee shall measure the right-of-use asset at cost.

4.2.2.46 The cost of the right-of-use asset shall comprise:

- a) the amount of the initial measurement of the lease liability, as described in paragraph 4.2.2.49
- b) any lease payments made at or before the commencement date, less any lease incentives received
- c) any initial direct costs incurred by the lessee, and
- d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

4.2.2.47 A lessee shall recognise the costs described in 4.2.2.46 d) as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies Section 5.1 (Inventories) to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying this section of the Code or Section 5.1 are recognised and measured applying Section 8.2 (Provisions, Contingent Liabilities and Contingent Assets).

4.2.2.48 Where a right-of-use asset is acquired at a peppercorn or for nominal lease payments, or for nil consideration, its cost shall be measured at its fair value as at the commencement date. Fair value is measured in these circumstances in accordance with the Code's provisions on donated assets in Section 2.3 and the fair value measurement requirements in Section 2.10. (Note that this only applies where in substance the lessor donates the asset to the lessee).

Initial measurement of the lease liability

4.2.2.49 At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

4.2.2.50 At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

- a) fixed payments (including in-substance fixed payments as described in paragraph B42 of IFRS 16), less any lease incentives receivable
- b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (see paragraph 28 of IFRS 16)
- c) amounts expected to be payable by the lessee under residual value guarantees
- d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs B37 to B40 of IFRS 16), and
- e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

4.2.2.51 Where a lease liability is recognised through a lease where lease payments are at a peppercorn or for nominal lease amounts, or for nil consideration, its cost shall also be recognised in accordance with paragraph 4.2.2.50. The difference (ie gain) between the fair value recognised in accordance with paragraph 4.2.2.48 and the lease liability recognised in accordance with paragraphs 4.2.2.49 to 4.2.2.50 is recognised in the surplus or deficit on the provision of services. This treatment follows the treatment for donated assets in accordance with Section 2.3 of the Code. (Note that this only applies where in substance the lessor donates the asset to the lessee.)

Subsequent measurement

Subsequent measurement of the right-of-use asset

4.2.2.52 After the commencement date a lessee shall measure the right-of-use asset in accordance with Section 4.1 for property, plant and equipment at current value in accordance with the following:

- a) On an asset-by-asset basis, for right-of-use assets that are classified to be measured at current value per Section 4.1, as a practical expedient the cost model in b) shall be used as a proxy for current value unless inappropriate, in which case paragraph c) applies.
- b) Where a cost model is appropriate, a lessee shall measure the right-of-use asset at cost as defined in this section of the Code:
 - i) less any accumulated depreciation and any accumulated impairment losses, and
 - ii) adjusted for any remeasurement of the lease liability specified in paragraph 4.2.2.56 c).

Note that the latter adjustment would follow the same accounting treatment (including the statutory accounting requirements) as subsequent expenditure (ie additions to cost) on owned assets under Section 4.1 of the Code.

- iii) adjusted for any changes in the estimated costs of dismantling, removal or restoration as specified in paragraph 4.2.2.46 d) and 4.2.2.47.
- c) For some right-of-use assets the use of the cost model in b) as a proxy for current value will be inappropriate. This is anticipated to be the case where both of the following conditions are met:
 - i) a longer-term lease has no provisions to update lease payments for market conditions (such as rent reviews), or there is a significant period of time between those updates, and
 - ii) the fair value or current value in existing use of the underlying asset is likely to fluctuate significantly due to changes in market prices. This is more likely to be the case with property assets
- d) Following the transitional arrangements specified in paragraph 4.2.2.103, the lease asset will be transferred at its carrying amount for finance leases that commenced prior to the date of initial application ie 1 April 2022. From that date such right-of-use assets may continue to be measured in accordance with the revaluation provisions in Section 4.1.
- e) For the avoidance of doubt a local authority with property, plant and equipment right-of-use assets that are measured using valuation shall apply the requirements of Section 4.1 regarding remeasurement.

4.2.2.53 Where an authority determines that a previously revalued right-of-use asset meets the criteria permitting use of the cost model as proxy, if the authority applies the cost model as proxy the cost model shall meet the requirements of paragraph 4.2.2.52 b).

4.2.2.54 If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the useful life of the underlying asset. Otherwise the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. A lessee shall apply the requirements of Section 4.7 to determine whether the right-of-use asset is impaired.

4.2.2.55 If a lessee applies the fair value model in Section 4.4 of the Code and IAS 40 *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in Section 4.4 of the Code. Note that Section 4.4 of the Code anticipates that the fair value model is applied in all but exceptional circumstances (see Section 4.4).

Subsequent measurement of the lease liability

- 4.2.2.56** After the commencement date, a lessee shall measure the lease liability by:
- a) increasing the carrying amount to reflect interest on the lease liability
 - b) reducing the carrying amount to reflect the lease payments made, and

- c) remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 4.2.2.59 to 4.2.2.64, and 40 to 43 of IFRS 16 or to reflect revised in-substance fixed lease payments (see paragraph B42 of IFRS 16).

4.2.2.57 Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 4.2.2.49, or if applicable the revised discount rate described in paragraph 41 of IFRS 16, paragraph 43 of IFRS 16 or paragraph 4.2.2.63 c).

4.2.2.58 After the commencement date, a lessee shall recognise in surplus or deficit on the provision of services, unless the costs are included in the carrying amount of another asset applying other sections of the Code, both:

- a) interest on the lease liability, and
- b) variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.

Reassessment of the lease liability

4.2.2.59 After the commencement date, a lessee shall apply paragraphs 40 to 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. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognise any remaining amount of the remeasurement in the surplus or deficit on the provision of services.

4.2.2.60 A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate if either:

- a) there is a change in the lease term, as described in paragraphs 20 of IFRS 16 and 4.2.2.43; a lessee shall determine the revised lease payments on the basis of the revised lease term, or
- b) there is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 20 of IFRS 16 and 4.2.2.43 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.

In applying this paragraph (4.2.2.60), a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.

4.2.2.61 A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:

- a) there is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.

- b) there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (ie when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.

In applying this paragraph (4.2.2.61), a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.

Lease modifications

4.2.2.62 A lessee shall account for a lease modification as a separate lease if both:

- a) the modification increases the scope of the lease by adding the right to use one or more underlying assets
- b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

4.2.2.63 For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:

- a) allocate the consideration in the modified contract applying paragraphs 4.2.2.40 and paragraphs 14 and 16 of IFRS 16
- b) determine the lease term of the modified lease applying paragraphs 4.2.2.42 and paragraph 19 of IFRS 16, and
- c) remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.

4.2.2.64 For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:

- a) decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease; the lessee shall recognise in surplus or deficit on the provision of services any gain or loss relating to the partial or full termination of the lease
- b) making a corresponding adjustment to the right-of-use asset for all other lease modifications.

Presentation

4.2.2.65 A lessee shall either present in the Balance Sheet, or disclose in the notes:

- a) right-of-use assets separately from other assets – if a lessee does not present right-of-use assets separately in the Balance Sheet the lessee shall:

- i) include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned, and
 - ii) disclose which line items in the Balance Sheet include those right-of-use assets.
- b) lease liabilities separately from other liabilities – if the lessee does not present lease liabilities separately in the Balance Sheet, the lessee shall disclose which line items in the Balance Sheet include those liabilities.

4.2.2.66 The requirement in paragraph 4.2.2.65 a) does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the Balance Sheet within the investment property line item.

4.2.2.67 The depreciation charge for the right-of-use asset is recognised in the gross expenditure, gross income and net expenditure of continuing operations. Interest expense on the lease liability shall be recognised in financing and investment income and expenditure in the Comprehensive Income and Expenditure Statement.

4.2.2.68 In the Cash Flow Statement, a lessee shall classify:

- a) cash payments for the principal portion of the lease liability within financing activities
- b) cash payments for the interest portion of the lease liability applying the requirements in IAS 7 *Statement of Cash Flows* for interest paid, and
- c) short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Classification of leases – lessors

4.2.2.69 A lessor shall classify each of its leases as either an operating lease or a finance lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

4.2.2.70 Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

4.2.2.71 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- a) the lease transfers ownership of the underlying asset to the lessee by the end of the lease term
- b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised
- c) the lease term is for the major part of the economic life of the underlying asset even if title is not transferred

- d) at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset, and
- e) the underlying asset is of such a specialised nature that only the lessee can use it without major modifications.

Where leases of assets are provided on non-commercial terms, ie for nominal or at peppercorn rents or lease payments, or for nil consideration, authorities will need to consider the substance of the transaction. CIPFA/LASAAC is of the view that it is likely that the situation set out at point d) above will not apply to an authority's analysis of the classification of the lease where lease payments are nominal or at a peppercorn, or for nil consideration. Note that this exception is only relevant for transactions on non-commercial terms and would not be relevant, for example, where lease arrangements also include a substantial payment (ie a lease premium). As a part of the authority's analysis of the accounting treatment of the non-commercial lease it will need to consider whether there are other transactions or arrangements involving the parties that need to be taken into account to determine the overall substance of the arrangement.

4.2.2.72 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
- b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee
- c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

4.2.2.73 In classifying a sublease, an intermediate lessor shall classify the sublease as a finance lease or an operating lease as follows:

- a) if the head lease is a short-term lease that the authority, as a lessee, has accounted for applying paragraph 4.2.2.32 (short-term leases), the sublease shall be classified as an operating lease.
- b) otherwise, the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease).

Separating the components of a contract – lessors

4.2.2.74 For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying paragraphs 2.7.2.36 to 2.7.2.39 of the Code and 73 to 90 of IFRS 15.

Finance leases – lessors

Recognition

4.2.2.75 At the commencement date, a lessor shall recognise assets held under a finance lease in its Balance Sheet and present them as a receivable at an amount equal to the net investment in the lease.

Initial measurement

4.2.2.76 The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease. Initial direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term.

4.2.2.77 At the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the lessee's right to use the underlying asset during the lease term that are not received at the commencement date:

- a) fixed payments (including in-substance fixed payments as described in paragraph B42 of IFRS 16), less any lease incentives payable
- b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date
- c) any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee
- d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraph B37 of IFRS 16), and
- e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Subsequent measurement – lessors

4.2.2.78 A lessor shall recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

4.2.2.79 A lessor shall apply the lease payments relating to the period against the gross investment in the lease to reduce both the principal and the unearned finance income. A lessor shall apply the derecognition and impairment requirements in Section 7.2.9 of the Code and IFRS 9 to the net investment in the lease. A lessor shall review regularly estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the income allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.

Lease modifications – lessors

4.2.2.80 A lessor shall account for a modification to a finance lease as a separate lease if both:

- a) the modification increases the scope of the lease by adding the right to use one or more underlying assets, and
- b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

- 4.2.2.81** For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:
- a) if the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:
 - i) account for the lease modification as a new lease from the effective date of the modification; and
 - ii) measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
 - b) otherwise the lessor shall apply the requirements of IFRS 9 as specified in Chapter 7 of this Code.

Operating leases – lessors

Recognition and measurement

- 4.2.2.82** A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished. Costs, including depreciation, incurred in earning the lease income are recognised as an expense.
- 4.2.2.83** A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.
- 4.2.2.84** The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

Lease modifications

- 4.2.2.85** A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Sale and leaseback transactions

- 4.2.2.86** If an authority (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 4.2.2.87 to 4.2.2.91.

Assessing whether the transfer of the asset is a sale

- 4.2.2.87** An authority shall apply the requirements for determining when a performance obligation is satisfied in Section 2.7 of the Code and IFRS 15 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the asset is a sale

- 4.2.2.88** If the transfer of an asset by the seller-lessee satisfies the requirements of Section 2.7 of the Code and IFRS 15 to be accounted for as a sale of the asset:

- a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor
- b) the buyer-lessor shall account for the purchase of the asset applying the relevant sections of the Code (eg Sections 4.1, 4.2 and 4.3), and for the lease by applying the lessor accounting requirements in this section of the Code.

4.2.2.89 If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an authority shall make the following adjustments to measure the sale proceeds at fair value:

- a) Any below-market terms shall be accounted for as a prepayment of lease payments.
- b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

4.2.2.90 The authority shall measure any potential adjustment required by paragraph 4.2.2.89 on the basis of the more readily determinable of:

- a) the difference between the fair value of the consideration for the sale and the fair value of the asset
- b) the difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the asset is not a sale

4.2.2.91 If the transfer of an asset by the seller-lessee does not satisfy the requirements of Section 2.7 and IFRS 15 to be accounted for as a sale of the asset:

- a) The seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying Chapter 7 of the Code and IFRS 9.
- b) The buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying Chapter 7 of the Code and IFRS 9.

Transition

4.2.2.92 An authority shall apply this section of the Code and IFRS 16 for annual reporting periods beginning on or after 1 April 2022. Where Transport for London utilise the option allowed for early adoption in 2019/20, 2020/21 and 2021/22 Transport for London will apply this section of the Code and IFRS 16 for annual reporting periods beginning on or after 1 April 2019, using a transition date of 1 April 2019. No other bodies reporting under the Code are permitted to adopt IFRS 16 for 2019/20, 2020/21 or 2021/22.

Definition of a lease

4.2.2.93 As a practical expedient, an authority shall not reassess whether a contract is, or contains, a lease at 1 April 2022 except in relation to leases for nil consideration. Instead, the authority is required:

- a) to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 *Leases* and IFRIC 4 *Determining whether an Arrangement contains a Lease* as adopted by the 2021/22 Code. The authority shall apply the transition requirements in paragraphs 4.2.2.95 to 4.2.2.111 to those leases.
- b) not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

4.2.2.94 An authority shall disclose the fact that it has applied the practical expedient in paragraph 4.2.2.93 and apply the practical expedient to all of its contracts. This disclosure should only be a brief statement to that effect and should not be onerous. As a result, the authority shall apply the requirements in paragraphs 4.2.2.36 to 4.2.2.38 only to contracts entered into (or changed) on or after 1 April 2022, or those for nil consideration.

Lessees

4.2.2.95 A lessee shall apply IFRS 16 as adopted by this section of the Code to its leases, retrospectively with the cumulative effect of initially applying IFRS 16 recognised at 1 April 2022 in accordance with paragraphs 4.2.2.96 to 4.2.2.105.

4.2.2.96 The lessee shall not restate comparative information. The lessee shall recognise the cumulative effect of initially applying IFRS 16 as adopted by the Code as an adjustment to the opening balance of reserves at 1 April 2022.

Leases for nil consideration not previously recognised as leases

4.2.2.97 The lessee shall:

- a) Recognise a right-of-use asset at 1 April 2022 for leases for nil consideration, measuring the right-of-use asset at fair value at the date of initial application. Where fair value cannot be obtained at a cost that is commensurate with the benefits to users of the financial statements, current value shall be used as a proxy.
- b) For right-of-use assets for nil consideration any gain on transition shall be recognised as a donated asset in accordance with Section 2.3 of the Code and IPSAS 23 as an adjustment to opening balances.
- c) Apply Section 4.7 to those right-of-use assets at the date of initial application.
- d) Apply paragraphs 4.2.2.100 a) (low value underlying asset exemption) and 4.2.2.102 (treatment where the lease term ends within 12 months).

4.2.2.98 The lessee may apply paragraph 4.2.2.101 (optional practical expedients).

Leases previously classified as operating leases

4.2.2.99 The lessee shall:

- a) Recognise a lease liability at 1 April 2022 for leases previously classified as an operating lease applying IAS 17. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.
- b) Recognise a right-of-use asset at 1 April 2022 for leases previously classified as an operating lease applying IAS 17. The lessee shall measure the right-of-use asset at an

amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet immediately before 1 April 2022. For right-of-use assets for peppercorn or nominal lease payments a right-of-use asset shall be recognised at fair value on 1 April 2022 with any gain, being the difference between that fair value and the lease liability, recognised as a donated asset in accordance with Section 2.3 of the Code and IPSAS 23 as an adjustment to opening balances.

- c) Apply Section 4.7 to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph 4.2.2.100 b).

4.2.2.100 Notwithstanding the requirements in paragraph 4.2.2.99, for leases previously classified as operating leases applying IAS 17, a lessee:

- a) Shall not make any adjustments on transition for leases for which the underlying asset is of low value (as described in 4.2.2.33 and paragraphs B3 to B8 of IFRS 16) that will be accounted for applying paragraph 4.2.2.34. The lessee shall account for those leases applying this section of the Code from 1 April 2022.
- b) Is not required to make any adjustments on transition for leases previously accounted for as investment property using the fair value model in Section 4.4 of the Code and IAS 40 *Investment Property*. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying Section 4.4 of the Code and IFRS 16 from 1 April 2022.
- c) Shall measure the right-of-use asset at fair value at the date of 1 April 2022 for leases previously accounted for as operating leases applying IAS 17 and that will be accounted for as investment property using the fair value model in Section 4.4 and IAS 40 from 1 April 2022. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying Section 4.4 and IAS 40 and IFRS 16 from 1 April 2022.

4.2.2.101 A lessee may use one or more of the following practical expedients when applying this standard retrospectively to leases previously classified as operating leases applying IAS 17. A lessee is permitted to apply these practical expedients on a lease-by-lease basis:

- a) A lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).
- b) A lessee may rely on its assessment of whether leases are onerous applying Section 8.2 of the Code and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* immediately before 1 April 2022 as an alternative to performing an impairment review. If a lessee chooses this practical expedient, the lessee shall adjust the right-of-use asset at 1 April 2022 by the amount of any provision for onerous leases recognised in the Balance Sheet immediately before 1 April 2022.
- c) A lessee may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

4.2.2.102 A lessee shall not apply the requirements in paragraph 4.2.2.99 to leases for which the lease term ends within 12 months of the date of initial application. A lessee shall:

- a) account for those leases in the same way as short-term leases as described in paragraph 4.2.2.34, and
- b) include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the 1 April 2022.

Leases previously classified as finance leases

4.2.2.103 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 1 April 2022 shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying IAS 17⁶⁴. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying IFRS 16 from 1 April 2022.

Disclosure

4.2.2.104 The lessee shall disclose the following information about initial application:

- a) the title – IFRS 16 *Leases*
- b) confirmation that the change in accounting policy is made in accordance with the transitional provisions in the Code for the adoption of IFRS 16
- c) the nature of the change in accounting policy
- d) a description of the transitional provisions
- e) the weighted average lessee's incremental borrowing rate applied to lease liabilities recognised in the Balance Sheet at 1 April 2022
- f) an explanation of any difference between:
 - i) operating lease commitments disclosed applying IAS 17 at the end of the annual reporting period immediately preceding 1 April 2022 date of initial application, discounted using the incremental borrowing rate at 1 April 2022 as described in paragraph 4.2.2.99 a)
 - ii) lease liabilities recognised in the Balance Sheet at 1 April 2022.

4.2.2.105 If a lessee uses one or more of the specified practical expedients in paragraphs 4.2.2.101, it shall disclose that fact and shall disclose the practical expedient required by paragraph 4.2.2.102 (treatment where the lease term ends within 12 months).

Lessors

4.2.2.106 Except as described in paragraph 4.2.2.107 or 4.2.2.108, a lessor is not required to make any adjustments on transition for leases in which it is a lessor and shall account for those leases applying IFRS 16 as adopted by the Code from 1 April 2022.

64. Finance lease assets valued at current value during 2021/22 and where the right-of-use asset continues to be carried at current value during 2022/23 will carry forward the existing revaluation reserve balances applicable and these will be adjusted in the event of a revaluation of the right-of-use asset after transition. Finance lease assets valued at current value during 2021/22 and where, after transition, the right-of-use asset is measured at cost as proxy for current value will require any revaluation reserve balance to be written out.

4.2.2.107 An intermediate lessor shall:

- a) reassess subleases that were classified as operating leases applying IAS 17 and are ongoing at 1 April 2022, to determine whether each sublease should be classified as an operating lease or a finance lease applying IFRS 16. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date
- b) for subleases that were classified as operating leases applying IAS 17 but finance leases applying IFRS 16, account for the sublease as a new finance lease entered into at 1 April 2022.

4.2.2.108 Where an authority is party to a lease for nil consideration, as defined in paragraph 4.2.2.18, in which it is acting as lessor and the lease is classified as a finance lease, it will derecognise the asset being provided to the third party, and recognise any unguaranteed residual value, in accordance with the requirements of IFRS 16 as specified in the Code. The lessor shall not restate comparative information. The lessor shall recognise the effect as an adjustment to the opening balance of reserves at 1 April 2022.

Sale and leaseback transactions before 1 April 2022

4.2.2.109 An authority shall not reassess sale and leaseback transactions entered into before 1 April 2022 to determine whether the transfer of the underlying asset satisfies the requirements in Section 2.7 of the Code and IFRS 15 to be accounted for as a sale.

4.2.2.110 If a sale and leaseback transaction was accounted for as a sale and a finance lease applying IAS 17, the seller-lessee shall:

- a) account for the leaseback in the same way as it accounts for any other finance lease that exists at 1 April 2022, and
- b) continue to amortise any gain on sale over the lease term.

4.2.2.111 If a sale and leaseback transaction was accounted for as a sale and operating lease applying IAS 17, the seller-lessee shall

- a) account for the leaseback in the same way as it accounts for any other operating lease that exists at 1 April 2022, and
- b) adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the Balance Sheet immediately before 1 April 2022.

4.2.3 Statutory accounting requirements

4.2.3.1 There are no statutory accounting requirements in respect of operating leases (for lessors) other than those in relation to those leases reclassified on transition to IFRS (see below).

Assets held by an authority (as a lessee) under a lease

4.2.3.2 Depreciation, impairment and gains or losses on revaluation charged to the surplus or deficit on the provision of services are not proper charges to the General Fund (see part 2 of Appendix B for the legislative basis). Such amounts shall be transferred to the capital adjustment account and reported in the Movement in Reserves Statement.

4.2.3.3 England: The Housing Revenue Account shall be charged with depreciation. However, depreciation charged to the surplus or deficit on the provision of services in the Housing Revenue Account in England shall be charged in accordance with the requirements of the *Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017*.

4.2.3.4 Minimum revenue provision (England, Northern Ireland and Wales) and the repayment of the liability (Scotland) are proper charges to the General Fund, but do not appear in the Comprehensive Income and Expenditure Statement. Such amounts shall be transferred from the capital adjustment account and reported in the Movement in Reserves Statement. The amounts of minimum revenue provision or repayment of the liability to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance (see part 2 of Appendix B for the legislative basis).

4.2.3.5 Gains and losses on the disposal of an investment property held under a lease are subject to the statutory accounting requirements set out in Section 4.4.3 of the Code.

Assets disposed of by means of a finance lease (local authority as lessor)

4.2.3.6 Gains and losses on the disposal of property, plant or equipment by way of a finance lease are subject to the statutory accounting requirements set out in Section 4.1.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

4.2.3.7 Gains and losses on the disposal of an intangible asset by way of a finance lease are subject to the statutory accounting requirements set out in Section 4.5.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

4.2.3.8 Gains and losses on the disposal of an investment property by way of a finance lease are subject to the statutory accounting requirements set out in Section 4.4.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

4.2.3.9 A sale and leaseback arrangement that results in a finance lease is not a disposal for the purposes of this section of the Code.

4.2.3.10 Amounts received as part of the repayment of a finance lease that reduce the lessee's obligation are classed as capital receipts (see part 2 of Appendix B for the legislative basis). In Scotland, capital receipts fall to be defined in accordance with proper accounting practice. Authorities shall recognise the capital receipt by debiting the capital adjustment account and crediting the capital receipts reserve or (in Scotland) a statutory capital fund or capital grants and receipts unapplied account.

Leases reclassified on transition to IFRS (authority is lessor)

4.2.3.11 In England and Wales, income received under a lease that was reclassified on transition to IFRS continues to be treated as either a capital receipt or as revenue income according to its status prior to reclassification (see part 2 of Appendix B for the legislative basis).

4.2.3.12 Where a lease has been reclassified as a finance lease on transition to IFRS, income received under the lease shall continue to be treated as revenue income. An authority shall transfer the capital receipt to the General Fund and report the transaction in the Movement in Reserves Statement.

4.2.3.13 Where a lease has been reclassified as an operating lease on transition to IFRS, any income that would, prior to the reclassification, have been treated as a capital receipt shall be transferred from the General Fund to the capital receipts reserve, and the transfer shall be reported in the Movement in Reserves Statement.

4.2.3.14 In Scotland, no statutory guidance was issued on transition to IFRS so authorities shall account for all income received from leases in line with classification of the leases under the Code.

4.2.3.15 In Northern Ireland, where an operating lease has been reclassified as a finance lease on transition to IFRS, income received under the lease shall continue to be treated as revenue income. An authority shall transfer the capital receipt to the General Fund and report the transaction in the Movement in Reserves Statement.

Leases with peppercorn or nominal payments, or for nil consideration

4.2.3.16 The gain recognised in the Comprehensive Income and Expenditure Statement on entry into a lease with peppercorn or nominal lease payments, or for nil consideration, is not a proper charge to the General Fund. In accordance with statutory provisions such amounts shall be transferred to the capital adjustment account.

4.2.4 Disclosure requirements

4.2.4.1 Disclosure of accounting policies in relation to leases is required, where these accounting policies are significant to the authority's financial statements (see Section 3.4 of the Code).

Lessee disclosures

4.2.4.2 The objective of the disclosures is for lessees to disclose information in the notes that, together with the information provided in the Balance Sheet, Comprehensive Income and Expenditure Statement and Cash Flow Statement, gives 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.

4.2.4.3 Having regard to paragraph 3.4.2.27 of the Presentation of Financial Statements section of the Code, which permits authorities not to provide a specific disclosure if information is not material, authorities (acting as lessees and/or lessors) shall disclose information about leases in a single note or a separate section of the financial statements in addition to meeting the requirements of IFRS 7 *Financial Instruments: Disclosures* (see Chapter 7). However a lessee need not duplicate information that is already presented elsewhere in the financial statements provided there is appropriate cross referencing.

4.2.4.4 A lessee shall disclose the following amounts for the reporting period:

- a) depreciation charge for right-of-use assets by class of underlying asset
- b) interest expense on lease liabilities
- c) the expense relating to short-term leases accounted for applying paragraph 4.2.2.34; this expense need not include the expense relating to leases with a lease term of one month or less

- d) the expense relating to leases of low-value assets accounted for applying paragraphs 4.2.2.33 and 4.2.2.34; this expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 4.2.4.4.c)
- e) the expense relating to variable lease payments not included in the measurement of lease liabilities
- f) income from subleasing right-of-use assets
- g) total cash outflow for leases
- h) additions to right-of-use assets
- i) gains or losses arising from sale and leaseback transactions, and
- j) the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.

4.2.4.5 A lessee shall provide the disclosures specified in paragraph 4.2.4.4 in a tabular format, unless another format is more appropriate. The amounts disclosed shall include costs that a lessee has included in the carrying amount of another asset during the reporting period.

4.2.4.6 A lessee shall disclose, subject to the application of paragraphs 2.1.2.14 to 2.1.2.17 to ensure that material information is not obscured, the amount of its lease commitments for short-term leases accounted for applying paragraph 4.2.2.34 if the portfolio of short-term leases to which it is committed at the end of the reporting period is dissimilar to the portfolio of short-term leases to which the short-term lease expense disclosed applying paragraph 4.2.4.4.c) relates.

4.2.4.7 If the right-of-use assets meet the definition of investment property, a lessee shall apply the disclosure requirements in IAS 40. In that case, a lessee is not required to provide the disclosures in paragraph 4.2.4.4 a), f), h) or j) for those right-of-use assets.

4.2.4.8 If a lessee measures right-of-use assets at revalued amounts applying IAS 16, the lessee shall disclose, subject to the application of paragraphs 2.1.2.14 to 2.1.2.17 to ensure that material information is not obscured, the information required by paragraph 4.1.4.3 4) for those right-of-use assets.

4.2.4.9 A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 7.3.3.21 and B11 of IFRS 7 *Financial Instruments: Disclosures* separately from the maturity analyses of other financial liabilities.

4.2.4.10 In addition to the disclosures required in paragraphs 4.2.4.4 to 4.2.4.9, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 4.2.4.2 (as described in paragraph B48 of IFRS 16). This additional information may include, but is not limited to, information that helps users of financial statements to assess:

- a) the nature of the lessee's leasing activities
- b) future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities; this includes exposure arising from:
 - i) variable lease payments (as described in paragraph B49 of IFRS 16)
 - ii) extension options and termination options (as described in paragraph B50 of IFRS 16)

- iii) residual value guarantees (as described in paragraph B51 of IFRS 16), and
- iv) leases not yet commenced to which the lessee is committed
- c) restrictions or covenants imposed by leases, and
- d) sale and leaseback transactions (as described in paragraph B52 of IFRS 16).

4.2.4.11 A lessee that accounts for leases of low-value assets applying paragraph 4.2.2.34 shall disclose that fact.

Lessor disclosures

4.2.4.12 The objective of the disclosures is for lessors to disclose information in the notes that, together with the information provided in the Balance Sheet, Comprehensive Income and Expenditure Statement and Cash Flow Statement, gives 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 lessor.

4.2.4.13 A lessor shall disclose the following amounts for the reporting period:

- a) for finance leases:
 - i) selling profit or loss
 - ii) finance income on the net investment in the lease, and
 - iii) income relating to variable lease payments not included in the measurement of the net investment in the lease
- b) for operating leases, lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.

4.2.4.14 A lessor shall provide the disclosures specified in paragraph 4.2.4.13 in a tabular format, unless another format is more appropriate.

4.2.4.15 A lessor shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 4.2.4.12. This additional information includes, but is not limited to, information that helps users of financial statements to assess:

- a) the nature of the lessor's leasing activities, and:
- b) how the lessor manages the risk associated with any rights it retains in underlying assets. In particular, a lessor shall disclose its risk management strategy for the rights it retains in underlying assets, including any means by which the lessor reduces that risk. Such means may include, for example, buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits.

Finance leases

4.2.4.16 A lessor shall provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases.

4.2.4.17 A lessor shall disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted lease payments to the net investment in the lease. The reconciliation shall

identify the unearned finance income relating to the lease payments receivable and any discounted unguaranteed residual value.

Operating leases

- 4.24.18** For items of property, plant and equipment subject to an operating lease, a lessor shall apply the disclosure requirements of Section 4.1. In applying the disclosure requirements in Section 4.1, a lessor shall disaggregate each class of property, plant and equipment into assets subject to operating leases and assets not subject to operating leases. Accordingly, a lessor shall provide the disclosures required by IAS 16 for assets subject to an operating lease (by class of underlying asset) separately from owned assets held and used by the lessor.
- 4.24.19** A lessor shall apply the disclosure requirements in Section 4.4 (Investment Property), Section 4.5 (Intangible Assets) and Section 4.7 (Impairment of Assets) for assets subject to operating leases.
- 4.24.20** A lessor shall disclose a maturity analysis of lease payments, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

4.2.5 Statutory disclosure requirements

- 4.25.1** There are no statutory disclosures required in relation to leases.

4.2.6 Changes since the 2021/22 Code

- 4.26.1** The Leases section of the 2022/23 Code has been fully revised to adopt the provisions of IFRS 16.

CONSEQUENTIAL CHANGES TO OTHER CHAPTERS AND SECTIONS OF THE CODE

In addition to the main provisions on leases reflected in the new Section 4.2 the following consequential changes to the other chapters or sections of the 2022/23 Code are set out below. Commentary on the changes is presented in italic font.

CHAPTER 2. CONCEPTS AND PRINCIPLES

2.1 CONCEPTS

2.1.2 Accounting requirements

Measurement bases to be applied

Paragraph 2.1.2.64 – *In the table of measurement bases to be applied the text for investment property is amended as follows:*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see

Section 2.10). As a non-financial asset an investment property shall be measured at highest and best use. The fair value of investment property held under a lease is the fair value of the right-of-use asset (see Sections 4.2 and 4.4).

2.3 GOVERNMENT AND NON-GOVERNMENT GRANTS

2.3.2 Accounting requirements

Definitions

...

2.3.2.2 Donated assets are assets (including some heritage assets and right-of-use assets) transferred at nil value or acquired at less than fair value.

Two additional paragraphs are to be inserted after 2.3.2.16 as follows:

Recognition and presentation – grants and contributions

...

2.3.2.17 Leases with payments at peppercorn or nominal consideration that are provided at substantially below market terms, and leases for nil consideration, shall be accounted for as follows:

- a) The portion of the lease that is payable, if any, along with any interest payments, is an exchange transaction and is accounted for in accordance with Section 4.2 (Leases).
- b) An authority shall recognise the difference between the consideration (lease payments) and the fair value of the lease on initial recognition (see Section 4.2) as non-exchange revenue and this should be accounted for in accordance with this section of the Code and IPSAS 23.
- c) Leases with payments at peppercorn or nominal consideration, or for nil consideration, should be accounted for in the same way as other donated assets.

(Note that this only applies where in substance the lessor donates the asset to the lessee.)

Transition

2.3.2.18 The transitional provisions in Section 4.2 are also applicable to the measurement of the right-of-use assets held by a lessee for a peppercorn or nominal lease payment, or for nil consideration.

CHAPTER 4. NON-CURRENT ASSETS

4.1 PROPERTY, PLANT AND EQUIPMENT

4.1.1 Introduction

The section on property, plant and equipment would need to be amended to reflect the requirements of IFRS 16 relating to right-of-use assets, amending the text as follows:

...

4.1.14 Where property, plant and equipment are held under a lease, the treatment of the right-of-use asset shall follow Section 4.2 in terms of recognition (also see IFRS 16); however, in such cases, other aspects of the accounting treatment for these assets, including depreciation, are prescribed in this section. Similarly, property, plant and equipment acquired under service concession arrangement (PFI/PPP) schemes shall follow Section 4.3 of the Code in terms of recognition, but subsequent measurement requirements for property, plant and equipment held under service concession arrangements including depreciation are prescribed in this section.

4.3 SERVICE CONCESSION ARRANGEMENTS: LOCAL AUTHORITY AS GRANTOR

4.3.2 Accounting arrangements

An additional Annex has been added to the 2022/23 Code in respect of subsequent measurement of service concession arrangement liabilities. The existing Annex has been renamed Annex A with the following references and wording amended:

...

4.3.2.7 Where the control tests described in paragraphs 4.3.2.5 and 4.3.2.6 above are not both met, this section of the Code does not apply as the transactions are outside its scope. Annex A to this section of the Code sets out the accounting arrangements in these cases.

...

4.3.2.20 Where a service concession arrangement can be separated into a service element and a construction element, the service element shall be expensed as incurred, and the construction element accounted for as specified below and applying Annex B to this section. A contract may be separable in a variety of circumstances; see paragraph 4.3.2.13.

4.3.2.21 Subsequent to initial recognition, the service concession arrangement liability shall be measured following the principles set out in this section. The liability shall be reported as a financial liability but shall be measured applying this section of the Code including Annex B, not Chapter 7 of the Code (Financial Instruments).

...

4.3.2.23 Scheduled payments under the arrangement shall be allocated between a) operating costs to reflect the service element of the arrangement, b) repayment of the liability, and c) an imputed finance charge (based on the interest rate implicit in the contract). Where it is not possible to determine the rate implicit in the contract, the authority shall use its cost of capital rate (including inflation). It is expected that this situation would be rare. The liability shall be measured as a financial instrument based on elements b) and c) of the scheduled payments above, using the measurement requirements specified in Annex B to this section.

...

4.3.2.25 By definition, where a PPP or PFI arrangement can be separated into construction and service elements, the payments for each element will be readily identifiable. The service element shall be charged as expenditure as incurred. The construction element shall be allocated into

an element relating to the repayment of the liability and an interest (finance charge) element in accordance with the arrangements detailed in Annex B. The interest element shall be charged to the surplus or deficit on the provision of services as incurred, with the balance of the payment used to adjust the outstanding liability on the Balance Sheet.

The new Annex B to Section 4.3 reads as follows:

ANNEX B TO SECTION 4.3: SUBSEQUENT MEASUREMENT OF SERVICE CONCESSION ARRANGEMENT LIABILITY

- B.1** The measurement of the liability related to a service concession arrangement is to be consistent with the previous requirements applying up to 31 March 2021. For the subsequent measurement of the liability those requirements applied the IAS 17 *Leases* specification in relation to a finance lease liability accounted for by a lessee. Since IAS 17 *Leases* has been withdrawn, the following text, based on IAS 17, provides the specification for service concession arrangement liability subsequent measurement for financial years starting on or after 1 April 2022.
- B.2** Amounts that are directly chargeable as expenses to the surplus or deficit on the provision of services, such as operating costs, shall be deducted from the unitary payment for each year. The residual amount of unitary payment for each year shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.
- B.3** In practice, in allocating the finance charge to periods during the term, an authority as grantor may use some form of approximation to simplify the calculation.

4.4 INVESTMENT PROPERTY

4.4.2 Accounting requirements

...

Definitions

- 4.4.2.3 Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see Section 2.10). The fair value of investment property held under a lease is the fair value of the right-of-use asset.

...

- 4.4.2.5 Owner-occupied property** is property held (by the owner or by the lessee as a right-of-use asset) for use in the delivery of services or production of goods or for administrative purposes.

Classification

Paragraphs 4.4.2.6 to 4.4.2.8 of the 2021/22 Code have been replaced by the following two paragraphs in the 2022/23 Code:

- 4.4.2.6** Owned owner-occupied property shall be accounted for as property, plant and equipment (see Section 4.1 of the Code and IAS 16 *Property, Plant and Equipment*). IFRS 16 applies to owner-occupied property held by a lessee as a right-of-use asset. Investment property that subsequently meets the criteria within Section 4.9 of the Code to be classified as held for sale shall continue to be accounted for as investment property, but may be reported separately as investment property held for sale.
- 4.4.2.7** Where an authority leases property to a subsidiary, the property is accounted for as an investment property in the authority's accounts if it meets the definition in paragraph 4.4.2.4. The property is not accounted for as an investment property in the group accounts, because from the group perspective the property is owner-occupied.

Recognition and measurement

Paragraphs 4.4.2.9 to 4.4.2.13 of the 2021/22 Code have been replaced by the following eight paragraphs in the 2022/23 Code:

- 4.4.2.8** An owned investment property shall be recognised as an asset when, and only when:
- it is probable that the future economic benefits that are associated with the investment property will flow to the authority, and
 - the cost or fair value of the investment property can be measured reliably.
- 4.4.2.9** An investment property held by a lessee as a right-of-use asset shall be recognised in accordance with IFRS 16 as specified in Section 4.2 of this Code.
- 4.4.2.10** An authority shall evaluate the costs of an investment property when they are incurred. The costs include acquisition costs and costs incurred subsequently to add to, replace part of or service an investment property, but do not include day-to-day repairs and maintenance. Where part of an investment property is replaced, an authority shall recognise in the carrying value of the investment property the cost of the replacement; the carrying amount of those parts that are replaced is derecognised.
- 4.4.2.11** Investment property shall be measured initially at cost. The cost of an investment property includes its purchase price, transaction costs and directly attributable expenditure. Where an investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition. Where an investment property is acquired in exchange for a non-monetary asset, the cost of the investment property is its fair value at the time of the exchange, or, where this cannot be reliably determined, the carrying amount of the asset given up.
- 4.4.2.12** An investment property held by a lessee as a right-of-use asset shall be measured initially at its cost in accordance with IFRS 16 as specified in Section 4.2 of this Code.
- 4.4.2.13** After initial recognition, investment property shall be measured at fair value. The use of the cost model allowed under IAS 40 is not permitted, except where paragraph 4.4.2.15 applies. A gain or loss arising from a change in the fair value of investment property shall be recognised in surplus or deficit on the provision of services for the period in which it arises. The fair value of investment property shall reflect market conditions at the end of the reporting period. An investment property under construction shall be measured at fair value

once an authority is able to measure reliably the fair value of the investment property, and at cost before that date. Investment properties held at fair value are not depreciated.

4.4.2.14 When a lessee uses the fair value model to measure an investment property that is held as a right-of-use asset, it shall measure the right-of-use asset, and not the underlying property, at fair value.

4.4.2.15 Exceptionally, there may be evidence when an authority first acquires an investment property (or the property first becomes an investment property following a change of use) that the fair value of the investment property is not reliably measurable on a continuing basis. In such cases, an authority shall account for that property using the cost model in IAS 16 and Section 4.1 of the Code (ie the investment property is depreciated over its useful life). The residual value of the investment property shall be assumed to be zero.

Transfers

Paragraph 4.4.2.14 of the 2021/22 Code has been renumbered as follows:

4.4.2.16 IAS 40 details the accounting arrangements that apply where assets are reclassified as investment property or are reclassified from investment property. Where such reclassifications take place, authorities shall follow the accounting arrangements set out in paragraphs 57 to 65 of IAS 40.

Disposals

Paragraphs 4.4.2.15 and 4.4.2.16 of the 2021/22 Code have been renumbered as follows:

4.4.2.17 An investment property shall be derecognised on disposal (by sale or by entering into a finance lease) or when the investment property is permanently withdrawn from use and no future economic benefits or service potential are expected from its disposal. Gains or losses arising from the retirement or disposal of investment property shall be recognised in surplus or deficit on the provision of services (unless IFRS 16 and Section 4.2 of the Code requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

4.4.2.18 Compensation from third parties for investment property that becomes impaired, lost or is given up is recognised in surplus or deficit on the provision of services when it becomes receivable.

4.4.4 Disclosure requirements

...

Paragraph 4.4.4.2 of the 2021/22 Code is amended in the 2022/23 Code to remove the first bullet point so it now reads as set out below:

4.4.4.2 Having regard to paragraph 3.4.2.27 of the Presentation of Financial Statements section of the Code, which permits authorities not to provide a specific disclosure if information is not material, authorities shall disclose the following notes in relation to investment property:

- 1) the amounts recognised in the Comprehensive Income and Expenditure Statement for:
 - a) rental income from investment property
 - b) direct operating expenses (including repairs and maintenance) arising from investment property

where these amounts are not disclosed on the face of the Comprehensive Income and Expenditure Statement

- 2) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal
- 3) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements
- 4) a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:
 - a) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised in the carrying amount of an asset
 - b) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Section 4.9 of the Code and other disposals
 - c) net gains or losses from fair value adjustments
 - d) transfers to and from inventories and owner-occupied property, and
 - e) other changes.

Investment property that meets the criteria to be classified as held for sale under IFRS 5 may be reported separately as investment property held for sale, usually within current assets. In addition, the disclosures required by Section 4.9 of the Code are also required in respect of investment property that meets the criteria to be classified as held for sale.

...

The references to operating leases and finance leases of investment property in the disclosure requirements for investment property set out in paragraph 4.4.4.4 would need to be removed as this distinction is no longer relevant, amending the text as follows:

4.4.4.4 The disclosures above apply in addition to those applicable to leases (see Section 4.2 of the Code). In accordance with the Code's provisions on leases (see Section 4.2 of the Code) the owner of an investment property shall provide lessors' disclosures about leases into which it has entered. An authority that holds an investment property under a lease shall provide lessees' disclosures for any leases into which it has entered.

4.8 BORROWING COSTS

4.8.2 Accounting requirements

...

4.8.2.4 Borrowing costs may include:

- interest expense calculated using the effective interest method, and
- interest charges in respect of lease liabilities recognised or measured in accordance with Section 4.2.

4.10 HERITAGE ASSETS

4.10.2 Accounting requirements

...

- 4.10.23** The term ‘heritage asset’ is used in this section of the Code to refer to both tangible heritage assets and intangible heritage assets, including heritage right-of-use assets arising from lease arrangements as specified in Section 4.2.

CHAPTER 7. FINANCIAL INSTRUMENTS

7.3 FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION REQUIREMENTS

7.3.2 Significance of financial instruments for financial position and performance

...

- 7.3.2.20** Disclosures of fair value are not required:

- a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables
- b) for a contract containing a discretionary participation feature (as described in IFRS 4 *Insurance Contracts*) if the fair value of that feature cannot be measured reliably, or
- c) for lease liabilities.

TABLE OF CHANGED REFERENCES TO ACCOUNTING STANDARDS AND OTHER MINOR CHANGES

In addition to the consequential amendments set out in the preceding pages the following minor amendments and references to accounting standards in the 2021/22 Code will be amended as follows in the 2022/23 Code:

2021/22 Code paragraph	Existing Code text	Revised 2022/23 Code text
2.10.2.15 b)	and IAS 17 <i>Leases</i>	and IFRS 16 <i>Leases</i>
3.4.2.72 Financing Activities c)	finance leases	leases
3.4.2.76 Financing Activities c)	finance lease	lease
4.1.2.27	finance lease	lease
4.1.2.27	also see IAS 17	also see IFRS 16
4.1.4.3 5)	finance leases	leases
4.3.2.34	IAS 17	IFRS 16
4.3.2.36	IAS 17	IFRS 16
Annex to section 4.3 A2	IAS 17	IFRS 16
4.4.2.15	IAS 17	IFRS 16
4.5.1.3	IAS 17	IFRS 16
7.2.9.17 b)	IAS 17	IFRS 16

