Agenda Item: 7

Meeting of:	**Governance and Audit Committee**
Date of Meeting:	**Thursday, 23 September 2021**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	**Implementation of the International Financial Reporting Standard for Leasing (IFRS 16)**
Purpose of Report:	To present to those charged with governance the implications and considerations of a new International Financial Reporting Standard for Leases (IFRS 16)
Report Owner:	Report of the Managing Director
Responsible Officer:	Section 151 Officer
Elected Member and Officer Consultation:	None
Policy Framework:	The proposals in this report are in accordance with Policy Framework and Budget

Executive Summary:

- From 1st April 2022, a new International Financial Reporting Standard, IFRS 16 Leases, is coming into effect.

This means that any operating lease agreements (new and existing) will now create a new debt in the Councils accounts, over the life of the lease and a corresponding asset. There is no impact of this change on the bottom line of the Council's accounts, however a number of technical changes will be required including the inclusion of all new leases as capital expenditure in the Council's accounts and taking account of the Council's lease liabilities as debt when preparing the Council's Treasury Management Strategy.

Recommendation

1. That the contents of this report are noted by the Audit Committee.

Reason for Recommendation

1. To ensure that the members of the Governance and Audit Committee, as those charged with governance are aware of the standard and have considered the implications of the new leasing standard.

1. Background

1.1 From 1st April 2022, a new International Financial Reporting Standard, IFRS 16 Leases, is coming into effect. IFRS 16 introduces a new 'Right of Use' asset class to the balance sheet, and also recognises the corresponding lease liability. This applies to all leases - property, vehicles and equipment.

1.2 The Council is required to prepare a full impact assessment for implementation of IFRS 16 by 31st March 2022.

1.3 IFRS 16 was primarily intended to address contradictions in the private sector e.g. British Airways had no planes on their balance sheet, and more importantly, were not recognising the significant corresponding committed lease liability (in order that the company could continue in business).

1.4 IFRS 16 also has implications for the public sector. Whilst finance leases are already accounted for as an asset and corresponding lease liability, from 1st April 2022, any operating leasing commitments must also be accounted for on the balance sheet. The Council currently has no finance leases in its accounts.

1.5 This means that any operating lease agreements (new and existing) now create a new debt in the Councils accounts, over the life of the lease. This has financial implications for the Councils Treasury Management Strategy, the Capital Programme, and the Financial Statements. Under IFRS 16, all leases are now classified as capital expenditure, and must be included in the Capital Programme (requiring Cabinet approval or potentially a delegated approval). This new standard will include leases arranged by schools.

1.6 The standard also considers 'Embedded Leases' which exist if there is an explicit or implicit identified asset in the contract and the customer controls the use of the asset, in order to continue the service. Work is currently underway to identify these leases.

2. Key Issues for Consideration

2.1 When a lease contract is signed, this effectively commits the Council to debt in exchange for the control of an asset for a fixed period of time, therefore it is important that the correct 'value for money' procedures are undertaken and the correct approvals are in place for the value of the lease agreement.

2.2 Under the new standard this lease will require a budget in the Capital programme for the total value of the leased asset, therefore contracts previously paid through revenue will now need to be included in the capital programme at their total cost over the life of the scheme and funded through the creation of a debt, which is equivalent to the total lease liability except where they fall into the exceptions outlined in paragraphs 2.9 and 2.10 below.

2.3 This is a significant change to the current approach, and it may be that the Council has some lease agreements that have not had such an approval in place in the past, the risk is that these agreements may not have been correctly assessed for cost and perhaps do not present the best value for money to the Council.

2.4 To support this change we propose to introduce a new procurement process for leasing from 1st April 2022, and to record all new lease agreements in a database. No budget holders must enter into any new leasing contract without the appropriate authorisation (a new procedure is currently being compiled which will need to be agreed with internal and external audit, legal and procurement). We will seek to capture leasing information required at the point of procurement which will assist in gathering the data required and also consideration of the total cost of this approach. It is intended that information on leasing will also be collated from the procurement contract register. If a lease arrangement is identified that must be accounted for in accordance with the new standard the expenditure will need to be included in the capital programme at its total cost equivalent to the right of use of the asset. The expenditure will be funded by a corresponding lease liability.

2.5 During 2020/21 the Accountancy team has worked with their colleagues in Estates, Legal and Procurement as well as budget holders across the Council to identify a long list of possible leases across the Council. The list is a combination of known significant leased assets such as Hen Goleg or Victoria School, smaller leases of office equipment and vehicles across the Council but particularly in schools and possible embedded leases in contracts where the Council effectively has control of and sole use of the asset due to the nature of the service provision.

2.6 During this period the Accountancy team also had an initial meeting with colleagues from other neighbouring local authorities to discuss next steps, identify best practice and try and ensure consistency of approach.

2.7 Further work is now required to establish Policies and Procedures to assess existing leases and review new proposed leases for Value for Money so that the correct approvals can be put in place. The Council will need to engage an external valuer to provide an assessment of value for the known property leases. The Council will also need to establish any legal agreements that contain the right to use an asset and assess the arrangement against three key tests.

2.8 As the Council has limited time to implement the standard it will need to bring in additional expertise. Theta Consultancy have been recommended by the Councils Treasury Management advisers and have experience supporting the Private Sector in the implementation of the lease standard and are also supporting other Local Authorities in the implementation of this standard. We hope to utilise their knowledge in compiling documentation to support the Council's low value policy, policies for assessing embedded leases particularly in respect of areas such as Social Services and Waste Management.

2.9 Under the standard, the Council is able to set a de minimis policy to exclude smaller office furniture type leases from the technical accounting requirements and a draft of our proposal is included at Appendix 1 to this report. We will be required to include a disclosure of the value of leases falling under this policy within the Council's Statement of Accounts. The standard specifies that vehicles are not intended to be included in any low value exemption so any vehicle leases will automatically need to be included in the new lease approval arrangements.

2.10 The standard also makes provision to exclude any leases than run for less than 12 months or that have less than 12 months remaining on 1st April 2022. The Council will also be required to disclose the value and number of leases that fall into this category as part of the Statement of Accounts. As part of considering whether lease arrangements should be included in the exemption, the Council needs to consider what the intention is rather than just the legal form of the lease arrangement, so if the lease arrangement has previously been allowed to run on and/or there is no alternative provision for this asset or service then the lease should be accounted for on this basis. This poses some difficulties when calculating and accounting for lease arrangements, but does more accurately reflect the Council's exposure to debt and asset base.

2.11 In order to establish a value for the existing lease assets and liabilities Accountancy has split the leases into five broad categories which are as follows.

Category	Examples	Next Steps
Known leased assets	Victoria School, Hen Goleg, Llandow Waste Site, Vale Enterprise Centre	Request valuation for these sites from the External valuer. Prepare finance lease calculations for each asset.

Possible embedded lease assets	Some Waste Management arrangements, some residential care and supported accommodation arrangements.	Review each case in more detail and prepare a proposed treatment. Discuss treatment with other Councils to ensure consistency of approach. Submit paper to external Audit for review. Establish values and prepare finance lease calculations as appropriate.
Peppercorn Leases	Any land or property lease where the Council receives the right to use an asset for a nil or peppercorn consideration.	Request valuation for these sites from the External valuer. Prepare finance lease calculations for each asset.
Leases expected to fall within de minimis policy	Small office equipment items such as photocopiers, shredders and franking machines. Small ICT and communication equipment such as mobile phones, laptops and tablets. Other small equipment such as water coolers, hand dryers. Vehicles would always be treated as non exempt in line with the expectations of the standard.	Agree de minimis policy with external audit. Establish where these leases are held and gather data on the costs/ term of the lease. Calculate lease costs for inclusion in low value disclosure in the accounts.
Leases expected to fall within less than 12 months exemption.	Any lease that runs for less than 12 months or has less than 12 months remaining where we do not intend to extend the lease.	Establish where these leases are held and gather data on the costs/ term of the lease. Calculate lease costs for inclusion in leases with less

		than 12 months remaining disclosure in the accounts.

2.12 Based on the work carried out to date we intend to have values for known leases of significant assets to give an indication of the materiality of the changes to the Council's balance sheet for the introduction of the standard in April 2022.

2.13 Due to the emerging nature of the embedded category of potential leases and the difficulty in establishing values for the associated lease assets it is expected that this part of the preparation for the introduction of the standard will need to continue in 2021/22 and into 2022/23.

2.14 Work to establish the data required for low value and short-term leases is ongoing, and due to the nature and frequency of these lease arrangements will need to be regularly updated.

3. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

3.1 The Council's budget and therefore its expenditure is incurred in order to achieve its corporate priorities as set out in the Corporate Plan 2020-2025 through the 4 well-being outcomes.

4. Resources and Legal Considerations

Financial

4.1 The adoption of the standard will not have a bottom line effect on the Statement of Accounts however it will increase the assets and liabilities of the Council which will have implications for the Council’s Capital Financing Requirement and Treasury Management Indicators.

4.2 The Council will incur one off additional costs for preparation of adopting the standards due to the need to procure expert advice on the implementation of the standard and valuation of leased assets.

Employment

4.3 None as a direct consequence of this report.

Legal (Including Equalities)

4.4 The legal department will be consulted on the development of a new procedure for procuring leases going forward.

5. Background Papers

None

Appendix 1

Leasing Low Value Recognition Exemption Policy

Under the standard there is an exemption in place for items of low value, it is down to individual authorities to set a local policy to define what local value is in practice.

The starting point for the Council is the capital de minimis limit of £10,000.

The CIPFA leasing briefing 2 states that.

The application guidance in IFRS 16 provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones. It also comments that leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.

From our initial high level review in line with the expectations low value items would represent the following.

- Small office equipment items such as photocopiers, shredders and franking machines.
- Furniture.
- Small items of medical equipment such as hoists and wheelchairs.
- Small ICT and communication equipment such as mobile phones, laptops and tablets.
- Other small equipment such as water coolers, hand dryers.
- Vehicles would always be treated as non exempt in line with the expectations of the standard.