

# REPORT

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Committee CIPFA/LASAAC LOCAL AUTHORITY SORP BOARD

Venue Robert Street, London

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Subject Leases Section of Draft IFRS-Based Code

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## 1. INTRODUCTION

- 1.1. At its meeting held on 15 April 2008, CIPFA/LASAAC agreed the format and structure of the IFRS-based Code of Practice.
- 1.2. This report considers the leases section of the draft IFRS-based Code of Practice on Local Authority Accounting, and CIPFA/LASAAC is asked to approve the section or suggest amendments.

## 2. SUMMARY OF COMPLIANCE WITH STANDARDS / IMPACT

IFRS Compliance / Adaptations	Full compliance, no adaptations (subject to consideration of paragraph 3.8)
IPSASB Compliance / Adaptations	Full compliance, no adaptations (subject to consideration of paragraph 3.8)
i-FReM Compliance / Adaptations	Full compliance, no adaptations (subject to consideration of paragraph 3.8)
Changes to SORP	Yes (detailed in paragraphs 3.2 and 3.3)
Impact on Taxation	On transition and for lessors (see paragraphs 3.6 – 3.7)

## 3. DRAFT CODE

- 3.1. The accounting requirements for leases are detailed in *IAS 17 Leases*. *IPSAS 13 Leases* is based on *IAS 17* and introduces no additional requirements, although it provides additional guidance on issues that might arise in the public sector.

- 3.2. Many of the requirements are similar to those previously included in the SORP, following *SSAP 21 Accounting for leases and hire purchase contracts*. Changes to the requirements are summarised below:
- Leases of property are accounted for as a lease of land and a lease of buildings, and are classified separately; this can result in a lease of property being accounted for partly as an operating lease and partly as a finance lease. Under the existing SORP, leases of property are classified as a single lease. This requirement is expected to result in some leases being partially reclassified on transition to the IFRS based Code.
  - One of the factors that indicates a lease is a finance lease is if “the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset”. Under the SORP (and *SSAP 21*), “substantially all” was quantified as “normally 90% or more”. This quantitative test does not apply under *IAS 17*.
  - Under *IAS 17*, finance income is calculated so as to produce a constant periodic rate of return on the net investment. Under the SORP, the finance income is calculated so as to give a constant periodic rate of return on the net cash investment. This difference in treatment may lead to income being recognised in different periods.
- 3.3. The draft Code also covers two areas not previously dealt with in the SORP:
- Following *IAS 17*, the Code requires initial direct costs to be added to the carrying amount of the asset in some circumstances. This is a permitted (but not required) option under *SSAP 21*.
  - Following *IAS 17*, the Code specifies the accounting treatment for sale and leaseback transactions. The current accounting treatment is set out in *SSAP 21*. The requirements of *IAS 17* are consistent with those of *SSAP 21*.
- 3.4. The draft Code does not identify any areas where the requirements of *IAS 17* should be varied. This is consistent with the current SORP, which adopts *SSAP 21* in full.
- 3.5. The draft section of the Code covering leases is included as Appendix A.
- 3.6. The draft section of the Code covering the transition arrangements for leases is included as Appendix B. It should be noted that the transitional arrangements may have implications for the General Fund and Council Tax, especially where an authority is acting as a lessor. These arise because of the interaction of the accounting arrangements and regulations regarding capital financing and capital receipts. The implications will be raised with CLG and the devolved administrations so that they can consider whether this would be an appropriate area for regulation.
- 3.7. At the time of writing the transition arrangements, it was not clear whether finance leases in Scotland are accounted for through the Loans Fund or not, nor whether practice in the past has been consistent. As a result, some further development of this section may be required once the situation has been clarified.
- 3.8. A significant volume of work may be required to review all existing property leases and separate the land and buildings elements prior to transition. CIPFA/LASAAC may therefore wish to consider if this is an appropriate use of authorities resources, or whether it would be appropriate to adapt *IAS 17* in relation to existing leases to reduce this burden. *IAS 17* states that where the lease payments cannot be

allocated reliably between the land and buildings elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease. One possible adaptation would be for the Code to state that, for leases in existence at transition, the land and property elements did not need to be separated where it was obvious that both elements would be operating leases. This would allow resources to be concentrated on reviewing leases where a revised accounting treatment was more likely to occur. The draft section of the Code covering the lease transition arrangements does not currently include this modification.

4. RECOMMENDATION

**CIPFA/LASAAC is asked to approve the leases section of the IFRS-based Code of Practice on Local Authority Accounting, or comment on areas where further analysis or changes are requested.**

**CIPFA/LASAAC is asked to consider whether an adaptation of IAS 17 in relation to leases in existence at transition would be appropriate, and if so, the form of that adaptation.**