Audit and Standards Committee

20 March 2025

Warwickshire County Council – Annual Refresh of Accounting Policies 2024/25

Recommendations

That the Audit and Standards Committee:

1. Approves the use of the accounting policies in **Appendix A** as the basis of the preparation of the 2024/25 Warwickshire County Council Statement of Accounts;

2. Notes the specific changes to the accounting policy for Leases due to the implementation of the new leases standard “IFRS 16 - Leases” adopted from 1 April 2024 in line with requirements of the CIPFA Code of Practice on Local Authority Accounting; and

3. Delegates authority to the Executive Director of Resources to make any further amendments to the accounting policies during production of the draft Statement of Accounts as are required.

1. Purpose of the Report

1.1. As a local authority, we are required to comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Local Authority Accounting (the Code) when preparing our annual Statement of Accounts.

1.2. As part of its remit, in recommending the annual Statement of Accounts to Council for approval, the Audit and Standards Committee is also required to approve accounting policies on which the financial statements are based, and the approach adopted by the Authority in complying with accounting requirements. It is therefore best practice where there has been a potentially material change in accounting policy that the Audit and Standards Committee is able to consider and approve accounting policy changes before they are implemented as part of the year end accounts production process.

1.3. Also, the external auditors will report to the Audit and Standards Committee their views on the acceptability of our accounting policies and, as there has been a change, they will comment on it in their formal reporting to the Committee after the conclusion of the audit process. This reinforces why it is best practice that the Audit and Standards Committee should be aware of and approve any changes to accounting policies prior to producing the draft Statement of Accounts and the external auditors issuing their Audit Findings Report.

1.4. Consequently, this report outlines the new requirements for reporting leases under IFRS 16, adopted on 1 April 2024, and seeks agreement to the wording of the accounting policy and the Council's proposed approach to meeting the new standard on which the Statement of Accounts for 2024/25 and future years will be prepared.

1.5. The report also more generally seeks the agreement of the Audit and Standards Committee to the full suite of accounting policies attached as **Appendix A** which will be used as the basis for the preparation of the Warwickshire County Council Statement of Accounts for 2024/25 and future years.

1.6. The Audit and Standards Committee is also asked to delegate to the Executive Director for Resources (as s.151 officer) any further amendments to the accounting policies as may be required during the closedown process and production of the draft Statement of Accounts. Any amendments to the attached policies will be reported to the committee alongside the audited accounts in November 2025.

2. IFRS16 - Leases

<u>Overview of Lease Accounting</u>

2.1. Under the previous standard "IAS 17 - Leases" there are two types of leases that organisations can enter into to obtain access to the assets they need to undertake their operations. These are finance leases and operating leases and the accounting treatment for each is different. Finance leases are effectively accounted for as acquisitions (with the asset recognised on the balance sheet, together with a liability to pay for the asset acquired). In contrast, operating leases are treated as 'pay as you go' arrangements, with rental payments charged to the revenue account over the term of the lease.

2.2. The 2008 financial crisis raised concerns about transparency of information which was ‘off-balance sheet’ per IAS17. A particular concern was that for a lot of organisations there was no balance sheet recognition of leased assets or any consequent liabilities for lessees (the body using the asset) where they were classified as ‘operating leases’. This significantly limited insight into the exposure organisations had to these kinds of liabilities.

2.3. In response to this, a new standard ‘IFRS 16 – Leases’ was issued by the International Accounting Standards Board (IASB) in 2016. Its main impact is to remove (for lessees) the traditional distinction between finance leases and operating leases. IFRS 16 requires all substantial leases to be accounted for using the ‘acquisition approach’, recognising the rights acquired to use an asset. This effectively means that for all substantial leases the lessee has to account for them as an acquisition and, therefore, account for the assets and liabilities on the Council’s balance sheet.

2.4. IFRS16 was initially intended to be adopted for local government within the CIPFA Code in the 2020/21 financial year. However, due to COVID-19 and timeliness of subsequent accounts production and audit completion across the local government sector, implementation for local government has been deferred nationally to the 2024/25 financial year, with an effective date of 1 April 2024.

Requirements of IFRS16

2.5. IFRS 16 requires all lessee leases (with exemptions noted in paragraph 2.9) to effectively be accounted for as finance leases, recognising the rights to use an asset; i.e. accounted for as though the Authority had purchased the asset, with a corresponding liability representing the remaining lease payments. These changes from IFRS16 do not apply where WCC is acting as the lessor, which will continue to be accounted for using the previous rules under IAS17.

2.6. From 2024/25, our proposed approach to determining the <u>initial</u> value of the asset will be to use the ‘cost model’ which in effect equates the value of the leased asset as the sum of the remaining principal repayments within the lease contract.

2.7. This approach works for all assets except where assets are leased for a concessionary or nil consideration. Assets from such arrangements will instead need to be recognised at ‘Fair Value’, but with no associated liability. The determination of ‘Fair Value’ will be undertaken as part of the Council’s independent asset valuation contract.

2.8. After the initial recognition of leased assets on the Council's balance sheet the assets will be revalued and accounted for in accordance with the Council's current accounting and valuation policies for property, plant and equipment assets.

2.9. There are some exemptions for lessees from applying this standard, which reduce the burden of number assets required to be recognised. These are:

1) Short term leases - defined as those with a lease term of 12 months or less at the date of their initial recognition;

2) Leases where the value of the asset that the lease relates to is low - defined as those where the value of the asset is less than £10,000. The Code and IFRS16 allows organisations to determine a monetary amount that would constitute low value and £10,000 has been deemed to be a suitable figure for WCC; and

3) Leased intangible assets (non-physical) will be excluded from the scope of our adoption of IFRS 16. This is an optional exemption under IFRS 16. WCC does not currently lease, or plan to lease, any intangible assets of significant value and therefore inclusion of intangible assets would not be an effective additional allocation of resources.

2.10. Leases falling under the above exemptions will continue to be accounted for in the same way as operating leases were under IAS 17. No assets and liabilities will be recognised and the annual payment will be expensed in year to the revenue account.

<u>Depreciation and Minimum Revenue Provision (MRP)</u>

2.11. As part of our current accounting policies we make an annual charge to revenue for the use of assets through our depreciation policy. Our depreciation policy is that assets are depreciated on a straight-line basis over their useful life. These proposals do not change this policy other than the requirement within IFRS16 to depreciate leased assets on a straight-line basis using the lower of the remaining useful life of the asset or the remaining years on the lease liability.

2.12. Also, by following the proper accounting processes, the introduction of increased numbers of finance leases onto the balance sheet will increase the level of capital spend to be financed i.e. the Capital Financing Requirement. Without any other change this would increase the Minimum Revenue

Provision (MRP) set aside as part of annual budget setting to repay debt, as leases are considered a form of debt. However, the Council is already making lease rental payments for these assets and therefore an adjustment will be made to avoid budgets having to be set aside to fund the assets twice. The adjustment will be equal to the principal element of the lease payment so providing for a “net nil” effect on the revenue budget.

WCC’s 2024/25 Accounting Policy for Leases

2.13. The proposed accounting policy drafted in respect of leases that will be in place for the 2024/25 Statement of Accounts is as follows:

Leases

We have adopted the new leases standard “IFRS 16: Leases” from 1 April 2024, in accordance with the CIPFA Code of Practice, which mandates the implementation from that date.

<u>*As lessee:*</u>

We have formal arrangements where as “lessee”, we obtain the right of use in relation to assets which we do not own outright. We include the value of the leased assets on our balance sheet as part of overall PPE [Property, Plant Equipment]. We recognise a lease liability on the balance sheet which represents the net present value of our obligations to make payments in respect of the leased assets.

Under the IFRS 16 - Leases accounting standard, there are a number of scope exemptions applied to lease arrangements with specific circumstances. We apply:

- *Short-life exemption: Lease arrangements with a term of 12 months or less.*
- *Low value exemption: Lease arrangements relating to an asset with a low value. We apply a threshold of £10,000 on the “as new” value of an asset.*
- *Intangible asset exemption: We opt to exclude intangible assets from the scope of leased assets.*

The exemptions are applied in order to reduce the administrative burden on reporting lease arrangements within the accounts and ensure efficiency in providing valuable information to the reader of the accounts.

A lease period is defined as the non-cancellable period of a lease, plus periods covered by options to extent that reasonably certain to exercise.

We have two different types of "lessee" lease arrangements. Concessionary leases, where we make no or negligible annual payments for the rights to use an asset. We also have non-concessionary leases where we make annual payments at market value for the rights to use the asset.

Concessionary leases:

With concessionary leases, there is no lease liability present on the balance sheet as we have no obligations in respect of future payments. The asset is brought into PPE at the fair value as deemed by our expert valuer. The addition to PPE is treated as per a donated asset. The value of the asset is initially recognised as "donation and grant income" within the CIES [Comprehensive Income and Expenditure Account]. There is no impact to the general fund as the adjustment in the Movement in Reserves Statement reverses the impact to the Capital Adjustment Account. Following recognition, the asset is depreciated like regular PPE and subjected to annual revaluation. At the end of the lease term the asset is derecognised from the balance sheet.

Non-Concessionary leases:

With non-concessionary leases, a lease liability is recognised on the balance sheet at the time that the asset is recognised. The value of the lease liability is calculated as the net present value of future lease payments – this being the amount of future payments we are contractually obliged to make, discounted to the date of recognition. As the payments are on a market value basis, the future economic inflows expected from possessing the asset are taken to be the same value as the liability calculated. Therefore, the asset and liability recognised are of equal value.

The asset is not subject to revaluation each year but is depreciated over the shorter of the remaining lease term and its remaining useful economic life. The treatment of depreciation is in line with owned assets. The asset value is amended to reflect any change in circumstances (e.g. rent review implemented or extension of lease arrangement) which will also alter the value of the lease liability. At the end of the lease term, the asset will be fully depreciated and have zero net book value. The asset is derecognised on cessation of the lease.

When lease payments are made, the payments are assigned to two elements. An amount pertaining to the annual unwinding of the discount factor applied is *charged as a finance cost to finance and investment income and expenditure in the CIES. The remainder of the payment reduces the principle of the lease liability and is reduced from the value of the lease liability held on the balance sheet. The payment relating to principle is subsequently charged to MRP as a Movement in Reserves Statement adjustment which is treated in line with MRP charged on owned assets.*

<u>As lessor:</u>

Under IFRS 16: Leases, where WCC is the lessor, the concept of operating and finance lease remains.

Operating leases:
Where we grant an operating lease over an item of property, plant or equipment, the asset is retained on our Balance Sheet and the rental income is credited to the CIES as it is due. We do not disclose contingent rents as they are not material to the financial statements.

Finance leases:
Where we grant a finance lease over a property or item of plant or equipment, the asset is removed from the Balance Sheet and replaced by a lease receivable. The lease receivable reflects the future amounts to be received as part of the lease arrangement. This is recorded as the net present value of future lease payments to be received. An amount pertaining to the annual unwinding of the discount factor applied is credited as a finance income to finance and investment income and expenditure in the CIES. Payments received by the lessee are recognised in cash and reduce the amount held as lease receivable.

<u>Impact on the Financial Statements in 2024/25</u>

2.14. Our records show that we lease at around 60 land and building assets that will be classified as right-of-use assets plus 17 larger vehicles and pieces of equipment where the exemptions per Paragraph 2.9 do not apply. These assets will be accounted for within the Property, Plant and Equipment line on the Balance Sheet. Work is still on-going to quantify the effect of this change.

2.15. The implementation of the new accounting standard will not require the authority to restate the 2023/24 Statement of Accounts on an IFRS16 compliant basis. Instead, we will make opening balance adjustments on 1 April 2024 for the 2024/25 accounts.

2.16. The application of IFRS16 will have an impact on various parts of the 2024/25 Financial Statements in terms of both the presentation of the accounts and additional disclosure notes. As well as the opening balance adjustments the elements we will need to disclose are:

Balance Sheet

- Right-of-use assets included on the balance sheet as part of the Property Plant and Equipment line with a reconciling disclosure note;
- Lease liabilities as a separate line on the balance sheet or within other liabilities with a reconciling disclosure note;

CIES and Movement in Reserves Statement

- Depreciation of right of use assets within the relevant service expenditure line in the net cost of services;
- Finance cost on right-of-use assets;
- MRP on right-of-use assets;

Cashflow Statement

- Total cash outflow for leases;

Notes to the Statement of Accounts

- Carrying amount of right-of-use assets by class of asset;
- Financial liability and maturity disclosures;
- The nature of leasing activities; and
- Leases signed but not yet commenced.

3. Financial Implications

3.1. There will be no direct financial impact for the Council as a result of the introduction of the new accounting standard for leasing.

3.2. There will be an additional resource commitment initially to create and then maintain a Council leasing register. This is currently being managed from within existing resources.

3.3. IFRS16 will increase the number of assets on our balance sheet required to be valued at Fair Value on an annual basis, this increase may impact on the contract cost to procure independent valuations of our assets.

4. Environmental Implications

4.1. None.

5. Background Papers

5.1. None.

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