PROPOSED CHANGES TO ACCOUNTING POLICIES WDA/19/25

Recommendation

That Members:

1. accepts the proposed revision to the Minimum Revenue Provision Policy outlined in section 3 and Appendix 1;

2. accepts the proposed revision to the Depreciation Policy outlined in section 4; and

3. accepts the proposed amendments pertaining to the implementation of Internation Financial Reporting Standard (IFRS) 16 at Section 5.

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PROPOSED CHANGES TO ACCOUNTING POLICIES
WDA/19/25

Report of the Director of Finance

1. Purpose of the Report

1.1 To approve the proposed amendment to the following accounting policies:

a) Minimum Revenue Provision (MRP) Policy
b) Depreciation Policy
c) Accounting for leases under International Financial Reporting Standard (IFRS) 16

2. Background

2.1 The Statement of Accounts summarises the Authority's transactions for the financial year and its position at the year end. The Authority is required to prepare an annual Statement of Accounts by the Accounts and Audit (England) Regulations 2015, which require it to be prepared in accordance with proper accounting practices. These practices comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 and the Service Reporting Code of Practice 2019/20, supported by International Financial Reporting Standards (IFRS) and statutory guidance issued under section 12 of the Local Government Act 2003.

2.2 In preparing the accounts the Authority takes into account any changes in codes of practice and reporting standards, together with best practice adopted by other local authorities.

2.3 This report was considered by the Audit & Governance Committee on 27th May 2025 and the recommendations commended for approval by the Authority.

3. Minimum Revenue Provision (MRP) Regulations and Revised MRP Policy

3.1 The Authority has undertaken, in conjunction with Treasury Management Advisors, a review of how Minimum Revenue Provision is calculated and charged to the revenue budget. In line with statutory guidance, the review was to ensure that MRP continues to be charged in a prudent manner.

3.2 The main recommendations of the review were:

- To move to the Annuity Method (from the straight-line/reducing balance method) using the PWLB Certainty Rate over the life of assets;

- To make MRP over the life of assets for Public Private Partnership (PPP) schemes (rather than the life of each PPP contract); and
- To make provision for £36m of Capital Financing Requirement (CFR) built up between 2008 and 2017 for which no provision is currently being made.

3.3 The Annuity Method will mean that relatively less MRP will be made in the earlier years and greater amounts in the later years, compared to the straight-line method. Although the annuity method results in short term savings and long-term costs, officers believe this method is prudent, as it produces a smoother profile of costs over the life of assets. This is because interest costs are greater in the early years and less in the later years and means that total financing costs will fall to the Authority at an equal rate over the life of assets. This methodology also better reflects the time value of money.

3.4 MRP is currently made on PPP contracts on a straight-line basis over the life of each PPP contract. The rate is calculated from the interest rate implicit in each PPP contract. Where the Authority expects to continue to own or retain service benefit from PPP assets after the end of the contract, it is proposed to make MRP over the remaining life of the asset. This will make the policy more consistent with the policy adopted on the Authority's other assets.

3.5 As the changes in MRP policy will result - in the short term – less money being set aside to repay debt; this will result in increased interest costs over the lifetime of assets if the savings in the early years are spent on day-to-day expenditure rather than used to build up revenue reserves. The change in policy will impact on the 2024/25 financial outturn and the future years' implications will be factored into the Medium-Term Financial Plan (MTFP) presented to the Authority for approval in February 2026.

3.6 Further details, including the revised policy, are provided at Appendix 1, with Arlingclose's report included at Annex (i) to that appendix.

3.7 On 10 April 2024, amended legislation and revised statutory guidance were published on Minimum Revenue Provision (MRP). The majority of the changes take effect from the 2025/26 financial year, although there is a requirement that for capital loans given on or after 7 May 2024, sufficient MRP must be charged so that the outstanding CFR in respect of the loan is no higher than the principal outstanding less the Expected Credit Loss (ECL) charge for that loan.

3.8 The regulations also require that local authorities cannot exclude any amount of their Capital Financing Requirement (CFR) from their MRP calculation unless by an exception set out in law. This means that £36m of CFR built up between 2008 and 2017 upon which no MRP is currently charged, will be subject to MRP from 2024/25 onwards.

4. <u>Depreciation</u>

4.1 The useful life of land, buildings and plant shall generally be assumed to be 30 years at the date of recognition except for Right-of-Use Assets (RoUA) and PPP Assets.

4.2 For RoUA’s the useful life shall be the term of the lease.

4.3 For PPP assets, these will be depreciated over contract length plus any expectation of useful life at the end of the contract. This is to bring the current depreciation of the assets in relation to Gillmoss and RRC in line with conditions in the contracts that require them to have a remaining useful life of 5 years at the end of the contract.

4.4 The useful life of IT assets shall be four years

4.5 The useful life of assets will be reviewed along with the triennial revaluation of assets and any changes should be made to reflect the condition of the asset and any changes to their expected use.

5. <u>Amendments pertaining to the implementation of IFRS-16</u>

5.1 Under IFRS 16, there is no distinction between operating and finance leases. So, the Operating and Finance Lease section shall be replaced with a section on Leases with the below text.

As per the requirement of IFRS 16, contracts that have an underlying asset require the recognition of a Right of Use Asset and a Lease liability. Except where the underlying asset is of low value and/or for a lease term of less than 12 months. In determining low value the Authority will apply a low value limit of £5,000.

5.2 The Lease Liability shall be recognised at commencement date at present value of lease payments not paid at that date - discounted at rate implicit in lease (if readily determinable) or lessee’s incremental borrowing rate (The Authority will use the PWLB annuity rates available at date of recognition as its incremental borrowing rate).

5.3 RoUAs shall be recognised as the initial lease liability and include adjustments for: -

- Lease payments made before commencement dates,
- Lease incentives received,
- Lessee’s initial direct costs,
- Dismantling, removal or restoration costs.

5.4 For leases deemed non-commercial, where lease payments are peppercorn, at nominal amount or where there is nil consideration, the lease liability will be calculated as per the above and RoUA shall be recognised at Fair Value.

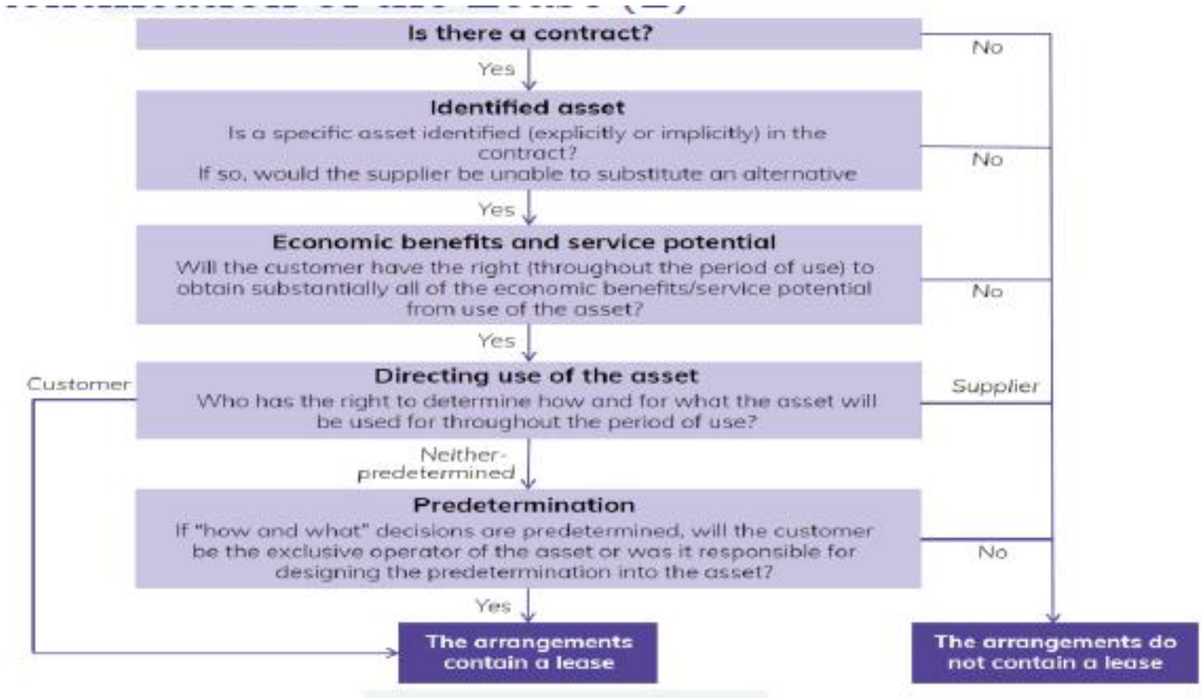
5.5 The changes will have an impact on the significant provisions the Authority currently makes in respect of its PPP liabilities. The Authority commissioned Arlingclose to assist in assessing the financial implications and the associated report and recommendations included at Annex (ii) to Appendix 1.

Update to Capital Expenditure Procedure and Procurement Processes

5.6 With the changes to IFRS-16 this now means that any contracts entered relating to assets could potentially be counted as capital expenditure and will therefore impact the Authority’s CFR and Prudential indicators.

5.7 The procurement process will be updated to include a method for determining leases that will need to be recognised, provided it doesn’t meet the exemption criteria (Asset in question being of low value or a lease for less than 12 months).

5.8 The below flow chart is suggested by CIPFA to ascertain whether a contract is a lease and so mean that it will need to be recognised in accordance with IFRS-16.



6. Risk Implications

6.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and accounting policies are not adopted and followed. The Authority has followed good practice in this respect, taking external advice where appropriate.

6.2 The change in MRP policy will result in savings in the short term but increased charges in later years in respect of the current levels of Authority debt. The risk of the Authority not being able to finance increased charges in later years will be mitigated by:

- The savings will be used to increase the level of earmarked reserves and provisions rather than fund increased expenditure or a reduction in levy charges; and
- The impact in later years will be mitigated by reduced charges in respect of new borrowing the Authority makes in order to fund capital expenditure over the next decade.

6.3 Through the consideration and approval of the Treasury Management Strategy Statement, the Minimum Revenue Provision Policy, the Annual Investment Strategy and the Treasury Management and Prudential Indicators, the Authority has governance procedures in place to ensure the risks are managed.

7. HR Implications

7.1 There are no HR implications associate with this report.

8. Environmental Implications

8.1 There are no environmental implications associated with this report.

9. Financial Implications

9.1 The financial implications are contained within this report.

10. Legal Implications

10.1 The proposals have been the subject of review by Finance Officers and the Council's Treasury Management advisers in order to ensure compliance with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and statutory guidance on the Minimum Revenue Provision. Officers are satisfied that the recommended proposals would not be in breach of those regulations or statutory guidance.

11. Conclusion

11.1 Members are asked to consider and approve the proposals outlined in this report together with the MRP Policy contained within Appendix 1.

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The background documents to this report are open to inspection in accordance with Section 100D of The Local Government Act 1972.

Appendices

Appendix 1: Revised Annual Minimum Revenue Provision Statement 2024/25