By:	Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services, Peter Oakford Interim Corporate Director Finance, John Betts Acting Chief Accountant, Joe McKay
To:	Governance & Audit Committee – 20 March 2025
Subject:	Update on the 2023-24 Statement of Accounts and preparation for 2024-25 including revised accounting policies, IFRS 16 Leases update and provisional audit timetable
Classification:	Unrestricted

Summary:

The report asks Members to:

1 - note the update on the 2023-24 Statement of Accounts

2 – approve the 2023-24 Statement of Accounts and Annual Governance Statement

3 – note the change to accounting policies for the adoption of IFRS 16 Leases

4 – note the provisional external audit timetable for the 2024-25 Statement of Accounts.

2023-24 Statement of Accounts Update

1.1 The Accounts and Audit (Amendment) Regulations 2024 require that the Local Authority publishes a note when the publication of the final financial statements have been delayed, providing an appropriate explanation. The Local Authority published its unaudited accounts on 31 May 2024, and they were approved by Governance and Audit Committee, alongside the Annual Governance Statement, on 13 December 2024.

1.2 The external auditors have indicated a delay in finalising their audit opinion, due to additional work being undertaken following an objection received, primarily regarding the Authority's arrangements for securing economy, efficiency, and effectiveness in its use of resources.

1.3 This work has now been resolved, and we envisage that the audit opinion will be finalised and the accounts signed off by the Chair of Governance & Audit Committee, the Corporate Director Finance and Grant Thornton on 20 March 2025, and there will be no need to enact any "backstop" provision.

1.4 There are no material changes to the Statement of Accounts since they were approved at Governance & Audit on 13 December 2024.

2024-25 Statement of Accounts Preparation

Section A

2 Accounting policies

2.1 The CIPFA Code of Practice requires authorities to follow International Accounting Standard 8 (IAS 8) - Accounting Policies, Changes in Accounting Estimates and Errors. Accounting policies are defined as "… the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements."

2.2 For 2024-25, there is one change to report. IFRS 16 Leases has been adopted by the public sector in 2024-25. The draft accounting policy, to be included in the 2024-25 Statement of Accounts in Note 21, is at the end of Section B.

2.3 More detail on the standard and the work undertaken to date is also provided in Section B. This includes responses to the questions that Members may wish to ask which were highlighted by Grant Thornton in their report, presented at the previous Governance & Audit meeting on 23 January 2025.

Section B

3 Background to IFRS 16

3.1 IFRS 16 is a financial reporting standard issued by the International Accounting Standards Board (IASB) that primarily deals with lease accounting. The standard is not specifically tailored for the public sector; it applies to both public and private sector entities. The standard replaces IAS 17 Leases.

3.2 IFRS 16 introduces a significant change in how leases are accounted for by lessees (defined as the entities that obtain the right to use an asset for a specific period in exchange for lease payments).

3.3 Under the previous standard (IAS 17), lessees classified leases as either operating leases or finance leases, with only finance leases being recognised on the Balance Sheet. Under the new standard (IFRS 16), most leases are now recognised on the Balance Sheet, as the distinction between operating and finance leases is removed. This means lessees are required to recognise a lease liability representing their obligation to make lease payments and a corresponding 'right-of-use' asset, reflecting their right to use the leased asset. PFI liabilities are already on the Balance Sheet but are required to be remeasured under the standard.

3.4 The introduction of IFRS 16 aims to enhance transparency and comparability in financial reporting by bringing leases onto the Balance Sheet.

3.5 The standard was issued in January 2016 and was originally planned to be adopted by local authorities in 2020-21 but was initially deferred to 2021-22. Due to the pressures on finance teams during and after Covid-19, the adoption has been deferred further to 2024-25.

3.6 The CIPFA Code of Practice contains specific guidance for local authorities which Finance have considered and incorporated into our draft Accounting Policy.

3.7 As per Note 3 our 2023-24 accounts, the accounting change will require new accounting for approximately 178 assets, of which 120 are property or land, 57 are vehicles and 1 is equipment. We estimate a right-of-use asset value and corresponding lease liability of £23.7m. This value excludes the impact of peppercorn leases (which require valuations at a cost to the Council and will increase the right-of-use asset value), the impact of PFI lease liabilities, and the impact of sub-lease arrangements. This work is being undertaken and will form part of our disclosure in the 2024-25 accounts.

4 Lease Identification

4.1 The Finance team have considered all the types of assets which are potentially relevant and have made a judgement as to which assets are within scope of IFRS 16.

4.2 Property lease agreements, residential tenancies, vehicles, and large contracts are assessed as leases for the purposes of IFRS 16. Tenancies at will (TAW) are reviewed on a case-by-case basis.

4.3 Easements, licences, licences to carry out works, agreements for a lease and office equipment (unless the individual asset value exceeds £10,000) are excluded.

4.4 The Council uses a database system (K2) to record information and store relevant documents such as title plans and lease agreements. This is the primary source of information on property leases. In addition to meetings between Finance and Infrastructure, regular lease reports are run from the K2 database to ensure up to date information is reflected in the Council's IFRS 16 accounting system, Innervision, which has been procured and implemented to complete the majority of the accounting for leases. The system creates the accounting journals which are posted into Oracle.

4.5 It is possible for lease agreements to exist as part of a wider service delivery contract. To identify these, an annual review of KCC contracts on the Kent Business Portal Contracts Register is completed to identify any assets which are used in the delivery of a contract and meet the criteria for recognition as a lease under IFRS 16. This has identified one embedded lease.

5 Exemptions

5.1 The standard excludes leases which are considered 'short term'. Short term leases are defined as leases that have a lease term of 12 months or less at the commencement date of 1 April 2024. Therefore, leases which have a lease end date of 31 March 2025 or earlier are excluded. The only exception to this is for holding over leases (see Section 6).

5.2 The standard allows authorities to elect not to apply IFRS 16 lease accounting to leases where the underlying asset is of low value. The low value exemption applies to the asset value when it is new, irrespective of its age. The assessment is made on a lease-by-lease basis, and the assessment is on an absolute basis (therefore it applies to individual assets).

5.3 To ensure consistency between capital expenditure accounting for Property, Plant & Equipment, Finance have implemented a low value exemption limit of £10,000. This ensures that the treatment of both owned and leased assets is presented in the same manner on the Balance Sheet.

5.4 Exempt leases are recognised as an expense over the lease term and are part of the Comprehensive Income & Expenditure Statement.

6 Holding Over Leases

6.1 A remaining lease term is required to calculate the lease liability under IFRS 16. For leases which are still within their lease term, the original lease dates as per the agreement can be used to determine the lease end of the lease period, subject to any additional clauses which are expected to be taken, such as an extension or break clause.

6.2 In the case of expired leases where there is a 'holding over' position usually amounting to a [legally defined] 'periodic tenancy', the remaining lease term is commonly accepted to be a rolling period equivalent to the rent payment dates (e.g. monthly, quarterly etc.) along with a statutory notice period (3 months for the tenant, minimum 6 months for the landlord). This is automatically the position with a lease that has not been contracted out of the Landlord and Tenant Act 1954 but will also be the case where a tenant has remained in occupation and continued to pay rent even if the original lease was contracted out.

6.3 For the context of IFRS 16, holding over leases occur when a tenant stays, with consent from the landlord, in occupation of a lease beyond its expiry date, without renewing or entering a new agreement. Using the notice period for these leases (which is usually around three months) would mean these leases are treated as short term (per section 5.1). However, as these agreements generally hold over for a longer period, it is more appropriate to recognise an asset and liability on the Balance Sheet.

6.4 In the absence of a lease end date, these leases will be treated as having a three-year lease term, irrespective of whether they are held by KCC or schools, to ensure a consistent and practical approach. Finance and Infrastructure colleagues considered the three years as an appropriate management planning timeframe after which it cannot be reasonably certain of business decisions in relation to these leases.

6.5 Whilst consideration is given to the broader economics of contracts, it is important to recognise that the assumed lease end date is used solely for the purposes of accounting for IFRS 16 and does not reflect the Council's commercial position nor does it represent the commercial reality of any agreement with a third party. Decisions made by the Council, or the lessor, as per the Landlord and Tenant Act 1985, could adjust this notional lease end date. In such an event, the right-of-use asset and lease liability would be adjusted for as an in-year change.

7 Incremental Borrowing Rates

7.1 On transition, the CIPFA Code of Practice requires lease liabilities to be discounted using the Council's Incremental Borrowing Rate (IBR) at 1 April 2024.

7.2 The IBR is defined in the Code of Practice as the rate of interest 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.

7.3 Both central government and NHS bodies have been prescribed a rate to use. In the absence of this for local authorities, the Public Works Loan Board (PWLB) rates as at the beginning of April 2024 have been used. These rates are appropriate, current, and auditable as historic rates are published and are consistent with the approach in many other local authorities.

7.4 PWLB rates are not available for periods over 50 years. For any leases with a remaining term of over 50 years, the 50 year rate will be used. Similarly, the rate for 1.5 – 2 years will be used for any lease with a remaining lease term below 1.5 years.

7.5 Incremental borrowing rates are updated to reflect lease modifications as outlined in the IFRS 16 CIPFA Guidance.

8 Non-Commercial Leases

8.1 Leases which are non-commercial in nature (for example a building which KCC rents at a nominal or peppercorn rate) are treated as per the Code of Practice as a donated asset. It is considered that, in substance, the agreements mean the lessor donates the asset to the lessee.

8.2 This means that lease liabilities and right-of-use assets are still calculated in the same way, but the right-of-use asset is uplifted to its fair value. Valuations have been requested for these assets from the Council's valuers, Wilks Head & Eve (WHE). The excess of the fair value over the cost of the right-of-use asset is credited as a gain in the surplus or deficit on the provision of services in the Comprehensive Income & Expenditure Statement but neutralised by statutory reversals through the Capital Adjustment Account.

9 Assessing the lease term

9.1 It is a requirement of IFRS 16 to assess the lease term where there are options to terminate or extend. Adjustments to lease terms are made based on judgements of the likelihood of the Council taking up any available options.

9.2 With the nature of services and requirements of the Council for property changing as a result of policy decisions in the Council, Finance and Infrastructure are working collaboratively to review lease options on an annual basis to ensure the most appropriate lease term is chosen, based on the likelihood we will exercise them. As this is a judgement at a fixed point in time, it is possible these options will need to be amended in the following financial year to best reflect the latest position.

10 Valuations

10.1 Valuations are not required for all right of use assets in the same way they are for freehold land & buildings. This is because the IFRS 16 guidance allows them to be measured at the value of the lease liability, adjusted for certain eligible costs & reductions, where lease terms are short enough or contain provisions for rent reviews that will regularly update amounts payable under the lease to reflect current market conditions.

10.2 However, where there are no provisions in the lease for market-based rent reviews, or these have not been undertaken, or where the reviews are at periods of more than five years then a valuation is required.

10.3 In addition, a valuation must be obtained for any right of use assets under non-commercial leases (e.g. where we are paying peppercorn rent).

10.4 This has meant that we have obtained valuations for c.100 right of use assets for land & buildings. These have been provided by our appointed external valuer.

10.5 Vehicles leases do not require valuations as there are not any significant changes to the lease terms and conditions during the lifetime of the lease agreement.

11 Lessor Accounting

11.1 The impact of lessor accounting is relatively limited compared to lessees. Whilst IFRS 16 introduces some changes for lessors, the fundamental principles of lessor accounting remain largely consistent with the previous IAS 17 standard.

11.2 Lessors must classify each lease as either a finance lease or operating lease. This classification determines how the lease is accounted for.

11.3 The main change under lessor accounting is in relation to sub-leases. When a lessor sub-leases an asset, its classification will depend to an extent on the nature of the head lease.

12 Statement of Accounts Presentation

12.1 Note 21 Leases in the Statement of Accounts will be changed to include the disclosures on lessee and lessor accounting as required in the CIPFA Code of Practice.

12.2 To clearly present the impact of IFRS 16 in the Balance Sheet, the table below shows where the assets and liabilities will be presented:

Line Description	Explanation
Right-of-use assets	This is in the long-term assets section of the balance sheet
Long-term debtors	This is in the long-term assets section of the balance sheet and represents the long-term finance lease receivable value
Short-term debtors	This is in the current assets section of the balance sheet and represents the short-term (within 12 months) finance lease receivable value
Short-term lease liability	This line already exists within the balance sheet in the current liabilities section of the balance sheet and will be updated to include the short-term (within 12 months) lease liability for all leases
Long-term lease liability	This is a new line in the long-term liabilities section of the balance sheet.

13 Grant Thornton Report

13.1 Grant Thornton presented an Audit progress report and sector update at the Governance & Audit Committee on 23 January 2025. Part of the report outlined the transition for public sector authorities to IFRS 16 Leases from 1 April 2024. The report posed seven questions for Audit Committees to consider. Each of these questions are considered in turn below.

13.2 The Finance team are engaging early with the external audit team and have provided a number of working documents to support our decision making in respect of IFRS 16, and we are grateful for this collaborative approach ahead of publishing our draft statement of accounts for 2024-25 and the main audit that follows.

13.3 ***How have we gained assurance on completeness? Have we identified all our leases, including those for a peppercorn rent?***

Extensive work has been carried out to ensure that we have captured all leases that fall under the scope of IFRS 16. A Steering Group comprising key stakeholders from Finance, Infrastructure, our wholly owned companies and Legal was established when draft guidance was first published by CIPFA.

Land and building leases, including those at a peppercorn rent, have been identified through regular reporting from the K2 property database and communication with nominated colleagues within Infrastructure.

The Chief Accountant's Team receive lease information from Directorate and Schools returns each year as part of our established year-end processes. Separately, Commercial Services, who manage the majority of our vehicle fleet, provide data at the end of the financial year.

Leases embedded within contracts have always been considered as part of the IFRIC 4 standard. KCC contracts on the Kent Business Portal Contracts Register are reviewed annually to identify any assets that are used in the delivery of a contract (see 4.5). IFRS 16 supersedes this standard, and this process has continued.

13.4 ***Have we set out threshold for low value leases?***

Yes, £10,000. Please refer to 5.2 and 5.3.

13.5 ***Have we identified all options to terminate or extend existing leases and assessed the lease term based on the likelihood we will exercise them?***

Yes, please refer to Section 9.

13.6. ***Have we reconciled our operating lease commitments as disclosed in our 31 March 2023 accounts under IAS 17 to our lease liability under IFRS 16 on 1 April 2024?***

The operating lease commitments figures in Note 21 of the 2023-24 accounts will be reconciled to the lease liability under IFRS 16 on 1 April 2024 and will form part of the disclosure note for IFRS 16 in the 2024-25 accounts.

13.7 ***How have we gained assurance that right of use assets are carried at the appropriate value at the balance sheet date?***

The CIPFA Guidance outlines those leases which require a valuation. Valuations have been commissioned as at 1 April 2024 to meet the transition requirements of the CIPFA Guidance. We have sought confirmation from the external valuer (WHE) that there has been no significant movement that would affect these valuations as at 31 March 2025.

Where the standard states that the cost model is a reliable proxy for current value, valuations have not been obtained, and the right-of-use asset value is linked to the lease liability calculation.

13.8 ***For an intermediate lessor, have we reassessed whether the leases out are finance or operating leases with reference to the terms of the head lease?***

Yes. 1 is a finance lease, the remaining 8 are operating leases.

13.9 ***Have we updated our systems to ensure that the budgetary and accounting impact of all leases is identified in a timely and effective manner?***

The necessary changes have been made to ensure the Balance Sheet reflects the new right-of-use asset and lease liability created as a result of implementing IFRS 16. Working papers have been created to ensure the correct accounting treatment is applied including the new disclosure notes required in the accounts.

The budgetary impact has been considered during the 2025-26 budget process, including amending the Capital Financing Requirement (CFR) and Minimum Revenue Provision (MRP) calculations.

Draft Accounting Policy

In 2024/25, the authority has applied IFRS 16 Leases as adopted by the Code of Accounting Practice.

The Council as Lessee

For arrangements previously accounted for as operating leases (i.e. without recognising the leased property as an asset and future rents as a liability), a right-of-use asset and a lease liability are to be brought onto the balance sheet at 1 April 2024. Leases for items of low value (under £10,000) and leases that expire within 12 months are exempt from the arrangements.

IFRS 16 has been applied retrospectively, but with the cumulative effect recognised at 1 April 2024. This means that right-of-use assets and lease liabilities have been calculated as if IFRS 16 had always applied but recognised in 2024/25 and not by adjusting prior year figures. Lease liabilities are measured at the present value of the remaining payments at 1 April 2024, discounted by the authority's incremental borrowing rate at that date. The weighted average of the incremental borrowing rates used to discount liabilities was 5.14%*. Right-of-use assets are measured at the amount of the lease liability, excluding any initial direct costs. As a practical expedient, the cost model has been used as a proxy for current value where appropriate as permitted by the Code.

Valuations are not required for all right of use assets in the same way they are for freehold land & buildings. This is because the IFRS 16 guidance allows them to be measured at the value of the lease liability, adjusted for certain eligible costs & reductions, where lease terms are short enough or contain provisions for rent reviews that will regularly update amounts payable under the lease to reflect current market conditions.

However, where there are no provisions in the lease for market-based rent reviews, or these have not been undertaken, or where the reviews are at periods of more than five years then a valuation is required.

In addition, a valuation must be obtained for any right of use assets under non-commercial leases (e.g. where we are paying peppercorn rent).

The Council as Lessor

The fundamental principles of lessor accounting remain largely consistent with the previous IAS 17 standard. Lessors must classify each lease out as either a finance lease or operating lease. This classification determines how the lease is accounted for. There is no requirement to reassess existing leases under lessor accounting for the implementation of IFRS 16.

Sub-leases

When a lessor sub-leases an asset, it must classify the sub-lease as a either a finance lease or an operating lease based on the same criteria used for the original lease. IFRS 16 requires the classification of subleases to be assessed by reference to the right-of-use asset acquired by the authority under the head lease, and not the underlying asset.

For finance leases, the lessor derecognises the leased asset and recognises a lease receivable equal to the net investment in the lease. Interest income is recognised over the lease term.

**% to be confirmed during completion of the 2024-25 accounts*

Section C

14 Draft accounts and provisional external audit timetable for 2024-25

14.1 The publication deadline for the draft (unaudited) Statement of Accounts has been changed from 31 May to 30 June for the financial years 2024-25 to 2027-28.

14.2 The audit backstop dates implemented by MHCLG require the external audit to be completed by 27 February 2026.

14.3 To achieve the deadlines above, we intend to publish the draft Statement of Accounts by 30 June 2025, with the external audit anticipated to commence in July and complete by the end of November 2025.

15 Recommendation(s)

The report asks Members to:

1 - note the update on the 2023-24 Statement of Accounts

2 – approve the 2023-24 Statement of Accounts and Annual Governance Statement

3 – note the change to accounting policies for the adoption of IFRS 16 Leases

4 – note the provisional external audit timetable for the 2024-25 Statement of Accounts.

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