

# East Herts Council Report

## Audit and Governance Committee

**Date of meeting: Tuesday 18 February 2025**

**Report by:** Councillor Carl Brittain – Executive Member for Financial Sustainability

**Report title:** Update to Accounting Policies - Capitalisation of interest

**Ward(s) affected: (All Wards);**

**Summary** – The addition of Accounting Policy (Xviii) to 2023/24 Statement of Accounts and subsequent years. This change allows for the interest incurred during construction to be capitalised.

### **RECOMMENDATIONS FOR AUDIT AND GOVERNANCE COMMITTEE:**

- a) That the Committee reviews the inclusion of a new Accounting Policy that allows the capitalisation of interest during construction.
- b) Notes the effect that this change in Accounting Policy will have on the associated values of relevant assets and the interest charged in 2023/24 to the CIES.

### **1.0 Proposal(s)**

1.1 Accounting Polices to be updated to include Note Xviii containing the following: -

#### **Capitalisation of Interest**

The Council capitalises borrowing costs incurred whilst qualifying assets are under construction. Qualifying assets are where there is a 'substantial period of time' from the first capital expenditure financed from borrowing until the asset is ready to be brought into use. A substantial period of time is considered to mean in excess of two years.

1.2 The change in accounting policy shall be applied retrospectively, as if the policy had always been applied.

1.3 The amounts that will be capitalised are noted along with the method used to calculate these amounts.

## 2.0 Background

2.1 The council has undertaken several large capital schemes over the past few years that have a combined Capital Spend of circa £93m.

2.2 The costs of these schemes have been financed in the main from Internal and External Borrowing, along with Capital Grants, Capital Disposals, and Revenue Contributions.

2.3 It is the cost of the External Borrowing during the construction phase that is being proposed to be capitalised.

2.4 The table below shows the amount of interest each asset could capitalise.

Asset	Completion	Part year interest	2021/22	2022/23	2023/24	2024/25	Total interest Capitalised
			£	£	£	£	£
Grange Paddocks (New Build)	Oct-21	6 months	2,463				2,463
Northgate End	Jun-22	2 months	5,556	32,899			38,455
Hartham Leisure Centre	Sep-23	5 months	1,037	72,200	84,809		158,046
Hertford Theatre	Aug-24	4 months	389	127,346	653,704	310,058	1,091,498
Old River Lane Development	Ongoing		165	11,828	24,768	30,385	67,146
<b>Total Borrowing Costs</b>			<b>9,610</b>	<b>244,273</b>	<b>763,282</b>	<b>340,443</b>	<b>1,357,608</b>

2.5 The accumulated value of Interest that could be capitalised up to and including 2022/23 amounts to £253,883 and a further £763,282 in 2023/24.

2.6 A total of £1,017,165 of interest will be capitalised in 2023/24. All adjustments up to and including 2023/24 will be put through the Statement of Accounts as 'in year transactions' totalling £1,017,165.

2.7 The Accumulated effect of changes in value of assets due to the capitalisation of interest will be as follows: -

- Old River Lane - £36,761
- Grange Paddocks - £2,463
- Hartham Leisure Centre - £158,047
- Northgate End - £38,455
- Hertford Theatre - £781,439

2.8 This will reduce the interest charged through the CIES in year, once the Statement of Accounts for 2023/24 has been updated to incorporate the changes, consideration will then be given to see (if appropriate) if any of this Interest can then be moved into the Interest Equalisation Reserve.

2.9 Minimum Revenue Provision charges will slightly increase each year to take into account the increase in the asset value, due to the capitalisation of Interest during construction.

### **3.0 Reason(s)**

3.1 The capitalisation of Interest during construction aligns the cost of capital to the assets being constructed.

3.2 The Interest charges incurred during the construction phase are not charged to the CIES in the year they are incurred, as the asset is not operational at that time.

3.3 Interest only becomes chargeable to the CIES when the new assets are completed and become operational.

### **4.0 Options**

- 4.1 Endorse the updates to the Accounting Policies to include the ability to capitalise interest during construction or reject the update to the Accounting Policies.

### **5.0 Risks**

5.1 The interest associated with the Assets cannot be capitalised if the Accounting Policies are not updated.

5.2 The Accounting Policies need to be updated to allow the capitalisation of interest, if not all the interest associated with the specific assets during construction would otherwise be charged to the CIES in the year they are incurred.

5.3 If the Interest is not capitalised the costs will have to be funded from reserves and will reduce them further.

## **6.0 Implications/Consultations**

6.1 Arlinclose have been asked to consider the possibility of capitalising interest costs for Assets Under Construction as part of a wider review if the Councils Minimum Revenue Provision (MRP) and associated calculations.

6.2 Where applicable reference to various accounting standards, notably International Accounting Standard 23 (IAS23) was given.

6.3 Arlinclose undertook modelling under a weighted Average Cost of Capital basis, the Council provided two alternative versions for review and consideration.

6.4 The weighted Average method would have been £48.4k more of interest than the Councils method and there are differences in each of the schemes.

6.5 The Councils method is more in line with the requirements of IAS 23 and has therefore been used.

## **Community Safety**

None arising directly from this report.

## **Data Protection**

None arising directly from this report.

### **Equalities**

None arising directly from this report.

### **Environmental Sustainability**

None arising directly from this report.

### **Financial**

All financial implications are included in the report.

### **Health and Safety**

None arising directly from this report.

### **Human Resources**

None arising directly from this report.

### **Human Rights**

None arising directly from this report.

### **Legal**

None arising directly from this report.

### **Specific Wards**

No

## **7.0 Background papers, appendices, and other relevant material**

7.1 Appendix A – Updated Accounting Policies

7.2 Appendix B – Effects of capitalisation of Interest

**Contact Member**

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