

EXPLANATORY MEMORANDUM TO
THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING)
(ENGLAND) (AMENDMENT) REGULATIONS 2008

2008 No. 414

1. This explanatory memorandum has been prepared by the Department for Communities and Local Government and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (“the 2008 Regulations”) make a number of technical amendments to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146) (“the 2003 Regulations”). The 2003 Regulations set out detailed provisions in relation to local authority finances, including the spending of capital receipts, the way that local authorities account for debt and accounting practices generally.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 The 2008 Regulations make a number of technical amendments to the 2003 Regulations. With the exception of the amendment made by regulation 3, the amendments will apply to the local authority financial year which ends on 31st March 2008 and to subsequent years.

4.2 Regulation 3 of the 2008 Regulations inserts a new regulation 7A into the 2003 Regulations, to provide that sums received by local authorities in respect of the redemption on maturity of bonds held by them shall be treated as capital receipts. Capital receipts are defined in section 9 of the Local Government Act 2003 (“the 2003 Act”), which includes a power for the Secretary of State to extend that definition by regulations. The uses to which capital receipts may be put are set out in the 2003 Regulations (under section 11 of the 2003 Act). The new regulation will apply in relation to financial years beginning on or after 1st April 2008.

4.3 Regulation 4 of the 2008 Regulations amends the provisions of the 2003 Regulations which deal with “minimum revenue provision” (“MRP”). Under regulation 27 of the 2003 Regulations, local authorities must make MRP to cover the cost of repaying the principal sum of loans they have entered into. Regulation 4 replaces the detailed calculations for making this provision which are contained in regulation 28 of the 2003 Regulations with a requirement that local authorities make such MRP as they consider prudent. (They will also retain their existing

discretion to make additional voluntary revenue provision.) This requirement will be supplemented by guidance issued under section 21 of the 2003 Act. New regulation 29 of the 2003 Regulations provides that where in a previous year a local authority has made less MRP than it should have under the previous provisions -

- if it has not corrected the provision, it shall not do so; and
- if it has corrected the provision, it may record a credit in a revenue account of the same value as the correction.

4.4 Regulation 5 of the 2008 Regulations amends regulation 30C of the 2003 Regulations to correct a minor drafting error. Regulation 30C includes provision on the accounting practices to be followed where a local authority repays a loan early and an early repayment penalty is payable or an early repayment discount is available. The way that these consequences are described is amended by regulation 5 to reflect similar provisions in regulation 30B.

4.5 Regulation 6 of the 2008 Regulations inserts new regulations 30E and 30F in to the 2003 Regulations. The new regulations give local authorities some flexibility about the way they account for interest rates on “stepped interest rate loans” and financial guarantees given by them which were entered into before 9th November 2007 (see paragraph 7.8 below). The special feature of a stepped interest rate loan is that the rate of interest is very low for an initial period (usually of several years) and then increases in one or more steps. Local authorities will, if they chose, be able to base the revenue charge in respect of such loans on the actual amount of annual interest payable, rather than having to follow new accounting standards introduced for the financial year ending on 31st March 2008. In the case of financial guarantees, local authorities will be given the option of accounting for these transactions in accordance with the accounting standards which applied in the financial year that ended on 31st March 2007 rather than the standards introduced for the financial year ending on 31st March 2008.

5. Territorial Extent and Application

5.1 This instrument applies to England only.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

Capital receipts (regulation 3)

7.1 Local authorities have wide freedom to invest surplus funds. But the 2003 Regulations steer them away from more speculative options. This disincentive is achieved by regulation 25(1)(d) which defines the acquisition of “share capital and loan capital” in companies as capital expenditure. It means that investing in the shares or corporate bonds of individual companies reduces authorities’ future

spending power. The disincentive is enhanced because the disposal of such investments on the open market will generate a “capital receipt”, which means that the cash may be used only for capital spending (and not for possibly more urgent revenue needs). However, it is not clear from the 2003 Regulations how to treat the proceeds which arise when a corporate bond which has reached maturity is redeemed by the company that issued it (rather than being sold on the open market). New regulation 7A of the 2003 Regulations makes clear that such bond redemption payments are capital receipts. The change comes into force on 1st April 2008.

Revenue provision: determination of minimum revenue provision (regulation 4(1))

- 7.2 Regulation 27 of the 2003 Regulations requires authorities to make annual provision out of their revenue resources to repay their debts and meet other kinds of credit liability – Minimum Revenue Provision (“MRP”). Regulation 28 then specifies how the amount of MRP is to be determined.
- 7.3 Regulation 28 provides highly complex formulae for calculating MRP. The amendment made by regulation 4(1) of the 2008 Regulations simplifies the MRP regime. The formulae are replaced with a duty to make such MRP as the authority considers to be prudent. In parallel, guidance is being issued under section 21(1A) of the 2003 Act on how to determine the level of prudent provision; authorities are required by section 21(1B) to have regard to this guidance. This will give authorities significant discretion in determining their MRP, but as a safeguard the guidance recommends that they submit an annual statement to their full council on their proposed methods of doing so.

Revenue provision: past deficiencies in minimum revenue provision (regulation 4(2))

- 7.4 When the “prudential” capital finance system (Part 1 of the 2003 Act) was introduced, the MRP regime was also revised. In connection with this transition, authorities’ external auditors undertook checks on the correctness of the MRP made in earlier years under the former capital finance system. In some cases, auditors concluded that their authorities had made significantly less MRP than was required and asked the authorities to rectify the past deficits by making extra revenue provision now. In some cases the amounts are significant and would not easily be affordable within revenue budgets. The new regulation is designed to assist such authorities and works in two ways. Where extra provision has not yet been made, the regulation requires the incorrect calculations made in the past to be treated as correct, so that no extra provision is now needed. Where authorities have already made the extra revenue provision required by auditors, the regulation will enable them to treat their revenue balances as increased by the same amount (thus neutralising the provision). Local authorities wishing to do this must do so before the beginning of the financial year which starts on 1st April 2010.

Early repayment of loans (regulation 5)

- 7.5 Recent major changes in accounting standards for financial instruments have potentially adverse effects on the revenue resources of some authorities.

Amendments to the 2003 Regulations brought into force in April 2007 by the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2007¹ began to tackle this problem by modifying the effects of the new accounting procedures on the amounts which actually have to be charged to a revenue account. However, regulation 30C, which deals with premiums and discounts arising after 31st March 2007, contained some minor drafting errors which the new amendment puts right.

Loans and guarantees (regulation 6)

- 7.6 The recent changes in accounting standards mentioned above have two further adverse effects. The first relates to a borrowing option used by numerous authorities, known as a *stepped interest rate loan*, under which the rate of interest is very low for an initial period and then increases in one or more steps. Where authorities are already party to such agreements and have up until now been charging only the actual low interest amount to revenue, the new accounting standards require additional amounts to be charged now, resulting in a substantial revenue charge in the financial year ending on 31st March 2008. The 2008 Regulations insert new regulation 30E into the 2003 Regulations to protect authorities from this impact. It ensures that the charge to the revenue account in the financial year ending on 31st March 2008 and subsequent years need not be based on the new accounting standard but may be equal to the amount of interest actually payable on the loan in the year.
- 7.7 The second type of transaction where action is needed is the *financial guarantee* which authorities sometimes give to lenders on behalf of local organisations whose activities they wish to support. The authority will only have to make a payment in the event of actual default, but under the new accounting rules, a charge representing the fair value of the guarantee will be required from the outset, and an adjustment may be required in the financial year ending on 31st March 2008 in relation to existing guarantees. New regulation 30F will provide that, in respect of existing guarantees, the charge to the revenue account for each year the risk being guaranteed subsists may be determined in accordance with the less stringent proper practices applicable during the financial year which ended on 31st March 2007, rather than the new accounting rules.
- 7.8 Both regulations 30E and 30F apply only to transactions entered into by authorities by 8th November 2007, the day the consultation on the draft Regulations began (see paragraph 7.9 below); future transactions undertaken in full knowledge of the new accounting standards should be subject to those standards.

Consultation Process

- 7.9 The 2008 Regulations were developed in close liaison with representatives of the Local Government Association (“LGA”), London Councils (formerly the Association of London Government), the Audit Commission and CIPFA (the Chartered Institute of Public Finance and Accountancy). Draft Regulations were

¹ S.I. 2007/573

issued for consultation by e-mail on 8th November 2007 to all English local authorities and other interested parties. Responses were requested by 21st December 2007, in accordance with the informal agreement with the LGA that consultation periods for technical material of this kind need not exceed 6 weeks. Over one hundred responses were submitted and all were considered carefully (including the few received after the deadline). The great majority of comments were supportive and there were several constructive technical suggestions. The Department met the LGA, London Councils, Audit Commission and CIPFA on 15th January 2008 to discuss possible changes to reflect comments received. A summary of the consultation responses and the decisions taken in the light of them is on the CLG website.

8. Impact

8.1 An Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

9. Contact

Trevor Emmott at the Department for Communities and Local Government, telephone 020 7944 4226 or e-mail trevor.emmott@communities.gsi.gov.uk, can answer any queries regarding the instrument.