EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2018

2018 No. 1207

1. Introduction

1.1 This explanatory memorandum has been prepared by the Ministry of Housing Communities and Local Government and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations make amendments to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146) ("the 2003 Regulations"). The amendments suspend two aspects of normal accountancy practices that apply to all local authorities, on a temporary basis. Introducing these changes will ensure that local authorities' finances are not adversely impacted as a result of the accounting practices in question.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales.

4.2 The territorial application of this instrument is England only.

5. European Convention on Human Rights

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

6. Legislative Context

6.1 Part 1 of the Local Government Act 2003 sets the legal framework within which local government may undertake capital expenditure and central Government may regulate that activity. Amongst other matters, Part 1 creates powers to make provision about the use of capital receipts and the accounting practices to be followed by local authorities in regulations. These provisions have been set out in the 2003 Regulations.

6.2 The Ministry of Housing, Communities and Local Government has policy responsibility for local authority accounting. In practice, under regulation 31(a) of

2003 Regulations the Chartered Institute of Public Finance and Accountancy (CIPFA) has responsibility for setting 'proper practices' for local authority accounting.

6.3 Under the 2003 Regulations, local authorities must follow CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom, as amended or reissued in every financial year.

6.4 The Government can modify local authorities' duties to follow the proper practices set out in the Code on Local Authority Accounting, by including specific provisions in the 2003 Regulations.

7. Policy background

What is being done and why

7.1 **Back payments following unequal pay:** New regulation 30AA re-introduces the accounting treatment which applied to equal pay claim liabilities under regulation 30A of the 2003 Regulations, which ceased to have effect on 1 April 2018. It gives local authorities the ability to defer charging liabilities for back payments following unequal pay to a revenue account until the date in which the payment must be made. Without this provision a local authority, under standard accounting practices, must make appropriate provision for a probable future liability relating to equal pay when it first becomes aware that the liability is probable and can be reasonably estimated. This is a revenue cost and therefore has implications for whether an authority will meet the balanced budget requirement that local authorities are required, through legislation, to balance each year.

7.2 Unequal pay claims could lead to a large, unbudgeted for expense which could have to be resourced through reserves even though the physical payment would not occur at that time. Therefore, we are introducing new regulation 30AA to ensure that local authorities are appropriately supported. We are also updating regulation 23 which permits capital receipts to be used for back payment purposes set out in regulation 30AA.

7.3 **Fair value gains and losses on pooled investment funds:** New regulation 30K applies to certain financial assets that are measured at fair value through profit or loss as a result of International Financial Reporting Standards (IFRS) 9, meaning all gains and losses that result from a change in fair value need to be recognised in the revenue account in the year that they occur. CIPFA's code on local authority accounting requires all local authorities to apply IFRS 9 in full. The regulation mandates local authorities to charge gains and losses resulting from unrealised fair value movements relating to pooled investment funds that under IFRS 9 must be recognised in profit or loss, therefore impacting on the revenue account, into a separate reserve account which cannot be used for any other purpose under these Regulations. This will be done via an accounting adjustment entry. This will ensure that the gains and losses resulting from fluctuations in fair value do not impact the revenue account each year. Under proper accounting practices a gain or loss is realised at the point a holding in a pooled investment fund is impaired or sold or otherwise disposed of. The Regulations require that when a gain or loss is realised it must be recognised in the revenue account in the year that it occurs.

7.4 The regulations do not apply to any investment in a pooled investment fund made by and accounted for in the pension fund of a pension fund administering authority. This is because pension funds hold pooled investment assets to generate capital gains, rather than for treasury management purposes and fluctuations in fair value do not impact on the revenue account used to finance services for local residents.

7.5 The use of a separate reserve account will ensure that there is transparency regarding the amount of unrealised gains and losses on pooled investment funds. This will be in place for five years to allow local authorities time to ensure that the accounting standard can be appropriately managed by the local authority without potentially adverse impacts on the revenue account.

7.6 It is appropriate that the effect of this provision is temporary since as, in the medium term, local authorities should comply with proper accounting practices that have been put in place to ensure that organisations appropriately report on risk. However, in the short term if the regulation were not introduced it would add volatility to the revenue positions of local authorities because of an accounting requirement. This could result in impacts such as local authorities increasing council tax, cutting service provision or using reserves to mitigate the gains and losses resulting from fair value movements.

7.7 Investment in pooled funds is common practice in the local authority sector and will often form part of their treasury management procedures. Therefore, there will be a financial impact on the sector which the regulation seeks to mitigate. The introduction of this regulation is also supported by a Public Accounts Committee recommendation published in Financial Sustainability of Local Authorities on 4th July 2018.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act

9. Consolidation

9.1 There are no current plans to consolidate the 2003 Regulations.

10. Consultation outcome

10.1 A link to the Government response to the consultation can be found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754743/Pooled_investment_funds_consultation_response.pdf

10.2 A public consultation was launched on 25th July 2018 and ran to 28th September 2018. In that time we received 107 responses from a variety of sources, mostly from local authorities. Responses were also received from treasury management advisors, the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Local Government Association (LGA). The consultation contained eight questions which listed the Government’s proposals. Respondents were asked if they agreed or disagreed with the proposals, where they disagreed we asked for reasons why and other proposals that we should consider.

10.3 The majority of respondents agreed with the proposals set out in the consultation with the exception of one proposal relating to the proposed time limited nature of the fair value treatment of pooled investment funds. Around 90% of respondents did not think that proper practices should ever be implemented which is a view that contrasts to our approach of effectively postponing the impact that the accounting standard will have on local authority finances. Having considered this we have decided to issue the regulation for five years. This is an extension from the three years that was proposed in the consultation. This will allow local authorities more time to take appropriate actions to mitigate the impact that IFRS 9 will have in relation to pooled investment funds. However, it is appropriate for proper practices to take effect in the medium term. This is because, in the course of normal operations, it is important local authorities fully comply with the new financial standard which has been put in place to ensure that organisations give appropriate consideration to reporting on risk. A permanent deviation from normal accounting practices would also add another level of complexity to local government accounts.

11. Guidance

11.1 No formal guidance will be issued by MHCLG on implementing these Regulations. CIPFA's code of practice for local authority accounting sets out the requirements for local authorities to fully comply with IFRS9 and new regulation 30K will set out how local authorities will account for the relevant instruments during the specified period.

12. Impact

12.1 There is no significant impact on business, charities or voluntary bodies as a direct implication of these Regulations.

12.2 There is no significant impact on the public sector due to these Regulations, although significant impacts of changes in accountancy practice will be averted by them. As a result of these Regulations, gains and losses resulting from fair value movements will be recorded in a reserve account that cannot be used for funding purposes, therefore meaning that usable reserves can be used for purposes relating to the provision of services rather than mitigating the unrealised gains and losses experienced from fair value movements on pooled investment funds. The amendments made by this statutory instrument to the 2003 Regulations have been put in place on a temporary basis to ensure that local authorities are given the appropriate time to transition to the newly adopted financial standard and therefore mitigate the impact that they would have experienced if that override to normal accounting practices were not provided in 2018/19. In the medium term local authorities should comply with this new accounting standard which has been implemented to ensure that entities appropriately recognise the risks attached to financial instruments.

12.3 An Impact Assessment has not been prepared for this instrument because there will not be an impact on business as a result of these changes.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 MHCLG will monitor the impacts these Regulations have throughout the periods within which they will have effect.

15. Contact

15.1 Gareth Caller/Geoffrey Whitby at the Ministry of Housing, Communities and Local Government Telephone: 0303 444 4300/0303 444 2607 or email: gareth.caller@communities.gov.uk/geoffrey.whitby@communities.gov.uk can be contacted with any queries regarding the instrument.

15.2 Katy Baldwin, Deputy Director for Local Government Finance Strategy, Revenue and Capital at the Ministry of Housing, Communities and Local Government can confirm that this Explanatory Memorandum meets the required standard.

15.3 Rishi Sunak at the Ministry of Housing, Communities and Local Government can confirm that this Explanatory Memorandum meets the required standard.