EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2019

2019 No. 396

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 technical amendments define the investments that shall not be treated as capital expenditure within local authority accounts. They also amend the categories of local authority investments in relation to which fluctuations in fair value are subject to specific accounting treatment.

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 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.

6.2 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.

6.3 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. It also has a specific power to provide through regulations which expenditure of local authorities is, or is not, accounted for as capital expenditure.

6.4 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (the "2003 Regulations") make provision for capital finance and accounts under Part 1 of the Local Government Act 2003 ("the 2003 Act"). Regulation 25 of the 2003 Regulations provide for expenditure which is, and which is not, to be treated as capital expenditure for the purposes of Chapter 1 of Part 1 of the 2003 Act. Since 2004, regulation 25 has excluded local authority investments in money market funds from treatment as capital expenditure in local authority accounts. Regulation 30K of the 2003 Regulation provides for specific accounting treatment for fair value gains and losses of local authority investments in pooled investment funds, including money market funds.

7. Policy background

What is being done and why?

7.1 Including this instrument, there have been two changes to the 2003 Regulations which have made amendments relating to the appropriate accounting treatment of investments held by local authorities. The most recent change was done through the 2018 EU Exit Regulations. This was subject to the European Union (Withdrawal) Act because it addressed deficiencies within the statute book arising from the withdrawal of the United Kingdom from the European Union. In the context of the 2003 Regulations, this included removing the reference to an EU directive within the definition of "money market fund", as this would otherwise have excluded all UK money market funds from treatment as revenue expenditure after the UK's departure from the EU once the EU directive no longer applied to them. However, we also needed to update the definition of a 'money market fund' independently of the need to remove the reference to the EU Directive. It was the latter update that has led to this instrument being laid following the insertion of the new definition of "money market fund" by the 2018 EU Exit Regulations. This instrument ensures that certain local authority investments are subject to appropriate accounting treatment. This is explained in more detail from paragraph 7.2 onwards

7.2 **Definition of Relevant Investments to be Treated as Revenue Expenditure under Section 25:** Section 16(2) of the Local Government Act 2003 ("the 2003 Act") empowers the Secretary of State to override normal accounting practices and vary which expenditure meets the definition of capital expenditure. Section 25 of the 2003 Regulations specifies expenditure which, under this power, local authorities must class as capital expenditure. Paragraph (3) of regulation 25 specifies a subset of specific expenditure that 'shall not be treated as being capital expenditure by virtue of this regulation'. Included in this sub paragraph are several types of investments which local authorities use for treasury management purposes. The definition of a money market fund, one of the investments that is listed, needed updating and this was done through *The Local Government (Miscellaneous Amendments) (EU Exit) Regulations 2018 (*"the 2018 EU Exit Regulations"). However, this update will narrow what investments are classified as revenue expenditure when the instrument comes into force.

7.3 This Statutory Instrument therefore makes further technical amendments to the 2003 Regulations to ensure that the types of investments that were previously treated as revenue expenditure continue to be counted as such when the 2018 EU Exit Regulations come into force. In some cases, this will be for a time limited period to reflect the temporary arrangements that have been put in place by HM Treasury with regards to these investments.

7.4 If an amendment is not made, these investments will be classified as capital expenditure which would result in an unintended accounting transfer from revenue to capital resource. This is because local authorities would have to classify the investment as a capital receipt when they redeemed the investment. Section 11 of the 2003 Act enables provisions to be made about the use of capital receipts and these are to be found in regulation 23 of the 2003 Regulations. This regulation sets out the finite number of ways in which capital receipts can be used, including to meet capital expenditure or to repay loan capital. As a consequence, these investments would no longer be suitable for purposes relating to treasury management and this would be likely to result in a large scale disinvestment of these funds when the definition changes.

7.5 This instrument also amended the 2003 Regulations to ensure that unit trusts, authorised contractual schemes and open-ended investment companies are categorised as revenue expenditure in local authority accounts whether they are UK or EEA funds. As well as this, there is an update to a reference to the statutory regime relating to Real Estate Investment Trusts (REITs).

7.6 In addition, we have amended Regulation 30K to include investments that fall under the current definition of a money market fund but will not when the 2018 EU Exit Regulations replaces that definition. This will ensure that the full range of intended investments are included in the Regulation that requires local authorities to reverse out fair value gains and losses of pooled investment funds.

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 We have not widely consulted on these changes as they largely represent technical amendments to ensure there is no shift in the overall policy position. We have sought the views of a number of sector stakeholders with specialist expertise throughout the process of drafting these technical changes to ensure that the instrument meets the intended purpose of consistently defining relevant investments as revenue expenditure.

11. Guidance

11.1 No formal guidance will be issued by MHCLG on implementing these Regulations. The purpose of the instrument is to ensure that legislation remains consistent with the continued policy intention of expenditure that should be treated as revenue in the accounts of local authorities.

11.2 The 2003 Regulations will differ in presentation. This is because previously ‘money market funds’ were described. In the update, we define relevant UCITS as well. To ensure that our definitions are technically accurate we have revised the definitions.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

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 The 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.