EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2022

2022 No. 1232

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Levelling Up, Housing and Communities ("DLUHC") and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 This instrument amends the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146) ("the 2003 Regulations") by establishing new accounting practices in relation to the treatment of local authorities' infrastructure assets. The new accounting practice has the effect of allowing local authorities to elect to treat any component of any infrastructure which they own as having a value of nil when it is replaced. Local authorities are not required to use this accounting treatment. This accounting treatment may be applied for the preparation of all statements of accounts in respect of which a certificate of audit completion has not been issued by the auditor at the time the instrument comes into effect. The instrument will apply to statements of accounts for financial years up to and including the financial year beginning 1 April 2024.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

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 Section 21(1) of the Local Government Act 2003 ("the 2003 Act") provides that the Secretary of State may make provision about the accounting practices ("proper practices") to be followed by local authorities. Section 21(2) provides that 'proper practices' includes both enactments in legislation and codes of practice specified by the Secretary of State in legislation.

6.2 Regulation 31(a) of the 2003 Regulations specifies that the accounting practices contained in the "Code of Practice on Local Authority Accounting in the United Kingdom" ("the Code"), are to be regarded as proper practices. The code is issued by the Chartered Institute of Public Finance and Accountancy ("CIPFA"), who may amend and reissue the code from time to time.[1]

6.3 Section 21(3) of the 2003 Act provides that where there is a conflict between enactments in legislation and accounting practices in codes of practice, the legislative provisions are to be regarded as the proper practices.

6.4 This instrument provides that where a local authority replaces any component of any infrastructure asset that it owns, it may determine that the replaced component has a value of nil and therefore that there is no requirement to remove any amount from its balance sheet in respect of the disposal of that component. Where an authority does so, the instrument requires the authorities to disclose this in its statement of accounts. This instrument applies to all local authority statements of accounts in respect of which an audit certificate has not been issued as at the time the instrument comes into force, up to and including statements of accounts produced for the financial year starting on 1 April 2024. As this provision will be contained in a legislative enactment, it will override any conflicting 'accounting practice' contained in a code of practice or other document identified by the Secretary of State.

7. Policy background

What is being done and why?

7.1 This instrument inserts a new regulation 30M into the 2003 Regulations. New regulation 30M introduces an accounting treatment that applies to local authority infrastructure assets. Infrastructure assets are a class of asset held by local authorities to provide infrastructure for the delivery of public services. The Code defines infrastructure assets as "inalienable assets, expenditure on which is only recoverable by continued use of the asset created, that is there is no prospect of sale or alternative use. Examples include highways, structural maintenance of highways, footpaths, bridges, permanent ways, coastal defences, water supply and drainage systems." The definition of "infrastructure asset" in new regulation 30M is intended to align with the definition in the Code, such that the examples of infrastructure assets in the Code would also be examples of infrastructure assets under new regulation 30M.

7.2 Until 2022, the accounting treatment of infrastructure assets has not generally been an issue. There has, however, been increased scrutiny of the audits of local authority accounts in recent years, particularly on the accounting for property, plant and equipment. As a consequence, there is an increased requirement for local authorities to provide auditors with evidence in respect of infrastructure assets, specifically in terms of how the replacement of a component of an infrastructure asset is accounted for. In accordance with proper practices, when a component of an infrastructure asset is replaced, an amount representing the remaining value of the replaced component should be removed (derecognised) from the balance sheet. This may be nil if there is no residual value.

7.3 The issue is that, due to significant historical information deficits, many authorities are unable to provide sufficient evidence of the value of replaced components of infrastructure assets when they are derecognised. This is particularly the case in relation to roads. Some of these issues date back to 1994, when these assets were first brought onto local government balance sheets. Furthermore, the reporting

[1] Copies of the codes of practice and guides identified in regulation 31 may be inspected free of charge by prior appointment with DLUHC's Capital Finance and Accounting Team at 2 Marsham Street, London, SW1P 4DF.

requirements have not been consistent over time: it is only since 2010/11 that the Code has required all replacement costs to be capitalised and replaced components to be derecognised.

7.4 This issue has contributed to significant delays in the completion of local audits as both local authorities and auditors have sought a resolution. Without resolution, there is a significant risk that many local authority financial statements could be subject to qualified audit opinions in this area, whereby the auditor is unable to give an opinion that the accounts are not misstated. It is anticipated that this may also lead to delays to future audits, which engenders significant risk as timely audit is vital for providing local authorities and sector stakeholders with accurate and reliable financial information, and for ensuring that authorities' financial arrangements are transparent to the taxpayer. Further, while the government recognises the importance of auditor qualification where appropriate, it is concerned that widespread qualifications due to this issue could erode confidence in financial statements, cause reputational damage to the sector, and reduce the utility of accounts for identifying risk.

7.5 In response, CIPFA attempted to implement changes to the Code to provide a temporary dispensation on the reporting requirements for infrastructure assets. Despite every effort being made to find a solution through the Code, a solution has not been found that satisfies all stakeholders. To avoid the widespread qualification of local authority accounts for these financial years, the government is putting in place a statutory override to allow local authorities to treat the value of any replaced component of infrastructure assets as nil, without the need to provide further evidence that this is the case. This is in keeping with historic practices, where authorities derecognise infrastructure components at nil on the basis that an authority would not replace an asset unless it was at the end of its useful life. However, for reasons set out, without the statutory accounting provision there are likely to be a significant number of qualified accounts and further delays to audit completion.

7.6 This instrument also provides that local authorities are not required to restate any balances relating to previous financial years with respect to infrastructure assets. Ordinarily, authorities would be required to restate prior period balances where a material error is identified. Due to the historic information deficits described, affected authorities will be unable to do this. For absence of doubt, this is not restricted to issues or errors arising only from derecognition, as the information deficits may also result in other issues such as the way infrastructure assets have historically been depreciated. Auditors and local authorities have been clear that this provision is necessary for the instrument to be effective in mitigating the risks identified.

7.7 The government recognises that a long-term solution is needed that addresses the underlying issues. This is, however, a complex issue that will take both time and resources to fully address. Therefore, the override is provided on a temporary basis as an isolated measure to mitigate the risks of widespread accounts qualifications and delays to audit completion.

8. European Union Withdrawal and Future Relationship

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 plans to consolidate the 2003 Regulations.

10. Consultation outcome

10.1 CIPFA issued its urgent consultation on temporary changes to the code to resolve infrastructure assets reporting issues[2] on 12 May 2022, which closed on 14 June 2022; the timescale reflected the urgency of the matter. The consultation tested proposed accounting solutions to address the issues raised by auditors with respect to the derecognition of infrastructure assets. In total, 83 stakeholders responded. CIPFA's update on the response[3] notes that while there was support for a solution, there were varying views on how the Code changes should be implemented. Based on the consultation response, CIPFA developed a temporary solution with two substantive elements: the first related to the disclosure of certain balances relating to infrastructure assets and the second involved enabling authorities to derecognise replaced components of infrastructure assets at nil value. Stakeholders have agreed for the first element to be implemented through the Code, but not the second element, which is being addressed through this instrument

10.2 The government has sought views from sector stakeholders including local government audit firms and CIPFA, to draw on their specialist expertise in drafting the technical amendments and to ensure that the instrument meets its intended purposes. Those that the government has spoken to have been supportive of both the principle and form of the accounting treatment set out in this instrument.

10.3 In addition, the government conducted a survey of stakeholders to invite comments on the draft statutory instrument. There were 95 respondents, including the 5 major local authority audit firms and 85 local authorities. The responses show strong support for the accounting override and indicate that it will be effective in significantly addressing the risks of audit delay and qualification.

11. Guidance

11.1 There are no current plans for DLUHC to issue guidance on implementing these regulations

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 A full 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 DLUHC will monitor the impact of these regulations throughout the periods in which they will have effect.

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[2]CIPFA, Urgent consultation on temporary changes to the code to resolve infrastructure assets reporting issues – 12 May 2022 https://www.cipfa.org/policy-and-guidance/consultations/urgent-consultation-on-temporary-changes-to-the-code

[3]CIPFA, Update Statement on the Outcomes of Consultation on Infrastructure Asset Reporting Issues – 27 July 2022 https://www.cipfa.org/-/media/files/policy-and-guidance/cipfa-lasaac-update-on-the-consultation-on-infrastructure-assets-statement.pdf

15. Contact

15.1 Matt Hemsley at the Department for Levelling Up, Housing and Communities Telephone: 0303 444 0472 or email: matthew.hemsley@levellingup.gov.uk can be contacted with any queries regarding the instrument.

15.2 Radhika Sriskandarajah, Deputy Director for local audit, at the Department for Levelling Up, Housing and Communities can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lee Rowley MP, Minister of State for Local Government and Building Safety**,** at the Department for Levelling Up, Housing and Communities can confirm that this Explanatory Memorandum meets the required standard.