EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2009

2009 No. 321

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. Purpose of the instrument

2.1 These Regulations amend the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146) ("the 2003 Regulations"). Principally, they will allow a local authority which has recorded an impairment in its accounts in relation to certain types of investment relief from the financial effects of that impairment by temporarily offsetting it with a corresponding credit.

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

3.1 None.

4. Legislative Context

4.1 Local authorities are required to prepare their accounts in accordance with proper practices. "Proper practices" is defined in section 21 of the Local Government Act 2003 ("the 2003 Act") as accounting practices which the local authority is required to follow by virtue of any enactment or those contained in a code of practice identified by the Secretary of State in regulations. Regulation 31(a) of the 2003 Regulations identifies *A Statement of Recommended Practice: Code of Practice on Local Authority Accounting in the United Kingdom*, commonly referred to as "the SORP", as containing proper practices. In the event of a conflict between the accounting practices set out in an enactment and the SORP, those set out in the enactment shall be regarded as proper practices.

4.2 In certain circumstances, the SORP requires local authorities to recognise an impairment in their accounts in relation to an investment. In very broad terms, this means that the local authority's accounts must recognise that it is unlikely all or part of the investment will be recovered or yield the return expected. Also in very broad terms, the effect of the impairment is to treat the investment or return (or relevant part of it) as already having been lost.

4.3 These Regulations insert a new regulation 30G into the 2003 Regulations which will allow local authorities to temporarily offset the effects of having to recognise an impairment in their accounts, by allowing them to record a credit of up to a corresponding amount in their accounts. The accounts will continue

to show the impairment – so that it is clear the authority has had to recognise it – but the financial impact will be offset.

4.4 A local authority can only take the benefit of these arrangements in certain circumstances. The first of these is that the investment in respect of which the impairment is recognised must be an investment in a bank. The second is that the event[1] which gave rise to the impairment being recognised must have happened in the period commencing on 1st April 2008 and ending on 26th November 2008.

4.5 New regulation 30G also makes provision for any credit recorded under it to be reduced in a number of circumstances. To the extent that the credit is not reversed by such reductions, it must be fully reversed in the local authority's accounts for the financial year which will begin on 1st April 2010. The effect of this is that the financial effects of the impairment will be fully felt in that financial year, if not before.

4.6 Unrelated to new regulation 30G, these Regulations also make a minor amendment to regulation 31(c) of the 2003 Regulations to reflect the fact that the code of practice prescribed under section 21 of the 2003 Act in relation to parish councils has been renamed.

5. Territorial Extent and Application

5.1 This instrument applies to England.

6. European Convention on Human Rights

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

7. Policy background

- ***What is being done and why***

7.1 Local authorities have wide freedom to invest surplus funds. In autumn 2008 a number of Icelandic banks went into administration and many local authorities had deposits in those banks. While those deposits are at risk, they are not lost and it is not yet clear how much money will be recovered. On 26th November 2008, John Healey MP, Minister for Local Government, announced that the Government proposed to make Regulations which would, exceptionally, allow local authorities with funds invested in Icelandic banks to postpone the financial impact required by normal accounting practice.

7.2 Local authorities are required to set their budgets prior to the start of each financial year. These Regulations will give local authorities more time before they need to consider the impact of possible losses on their budgets and

[1] The term "event" is used in the SORP in the explanation of when local authorities should recognise an impairment in their accounts. The SORP also includes a non-exhaustive list of events that provide objective evidence of impairment.

council tax levels. Where the provisions of these Regulations are taken advantage of there will not be any impact on budgets or council tax for the financial year 2009/10 as a result of the possible losses. Instead, these Regulations will enable decisions on accounting for any losses to be delayed from the financial year 2008/09 until 2010/11.

7.3 These Regulations apply only to the principal amount of sums invested in banks. They do not enable local authorities to delay dealing in their accounts with immediate losses of interest of those investments. This issue was raised in consultation on the Regulations (see paragraph 8) and is dealt with further in the informal commentary on the Regulations published by the Department for Communities and Local Government (see paragraph 9).

- ***Consolidation***

7.4 The accounting arrangements permitted by new regulation 30G of the 2003 Regulations are self contained within that regulation and are time limited. For that reason, the Department does not intend to consolidate the 2003 Regulations at this stage.

8. Consultation outcome

8.1 These Regulations were developed in close liaison with CIPFA (the Chartered Institute of Public Finance and Accountancy), which has published parallel guidance on the associated accounting treatment (see paragraph 9.2 below).

8.2 Draft Regulations were issued for consultation by e-mail on 10th December 2008 to all English local authorities and other interested parties. Responses were requested by 23rd January 2009, in accordance with the informal agreement with the Local Government Association that consultation periods for technical material of this kind need not exceed 6 weeks. A copy of the consultation document is available at www.local.communities.gov.uk/finance/capital/index.htm.

8.3 Over thirty responses were submitted and all were considered carefully (including the few received after the deadline). A summary has been published on the Department's website alongside the consultation document. The great majority of comments were supportive. The main issue raised was that proposed new regulation 30G did not cover the loss of interest. The consultation document however made clear that the new regulation is not intended to enable local authorities to delay dealing with the immediate loss of interest on investments. The consultation document also made clear that authorities will not be able to rely on new regulation 30G to avoid the impact of any loss of interest on the investment for the period up to 31st March 2010 and that local authorities will need to take account of such losses in settling their budgets for the financial year 2009/10. Having considered the responses received, the Department has maintained its position. The aim of the new regulation is solely to avoid the need for local authorities to budget for the one-off loss of the principal investment, the value of which, at the moment, cannot be estimated. The loss of annual interest can however be estimated now

and the process of charging it to the revenue account should not be deferred to future years.

9. Guidance

9.1 The Department will provide an informal commentary to accompany the Regulations, which will be available on the local authority capital finance pages of the Department's website (www.local.communities.gov.uk/finance/Capital.htm).

9.2 Local authorities should also consider these Regulations alongside guidance recently issued by CIPFA's Local Authority Accounting Panel on the accounting treatment of possible investment losses and on the specific accounting implications of the Regulations. CIPFA has published this guidance on its website (www.cipfa.org.uk/pt/laap.cfm) and has also ensured that local authorities have been notified of it.

10. Impact

10.1 No impact on business, charities or voluntary bodies is foreseen.

10.2 The impact on the public sector is that the Regulations will allow local authorities to delay dealing with the impact of possible losses of deposits invested in Icelandic banks.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 These Regulations will give local authorities more time before they need to consider the impact on their budget and council tax levels of possible losses on deposits invested in Icelandic banks. The Department intends to review the situation in autumn 2009.

13. Contact

Sarah Blackman at the Department for Communities and Local Government, telephone 020 7944 4234 or e-mail sarah.blackman@communities.gsi.gov.uk, can answer any queries regarding the instrument.