EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2020

2020 No. 1212

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 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' schools budget deficits. The new accounting practice has the effect of separating schools budget deficits from local authorities' wider finances for a period of three financial years. This instrument applies only to accounts produced by local authorities relating to the financial years beginning on 1st April 2020, 1st April 2021 and 1st April 2022.

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 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, in particular with respect to the

charging of expenditure to a revenue account.[1] 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", 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.

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, that the legislative provisions are to be regarded as the proper practices.

6.4 This instrument provides that where a local authority has a deficit on its school budget relating to its accounts for a financial year beginning on 1st April 2020, 1st April 2021 or 1st April 2022, that it must not charge the amount of that deficit to a revenue account. The local authority must record any such deficit in a separate account established solely for the purpose of recording deficits relating to its schools budget. 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 30L into the 2003 Regulations. New regulation 30L introduces an accounting treatment that applies to deficits relating to schools budget expenditure[2] by local authorities. Deficits arise where schools budget expenditure exceeds that of the available funding provided through the Dedicated Schools Grant[3] (DSG). Where this has occurred in prior financial years, many local authorities have carried an accumulated deficit position into future financial years by holding these deficits separately from their wider finances (general fund[4]), thereby ensuring the deficits do not place pressure on their ability to delivery other services. However, in 2019, concerns were raised that accounting practices did not permit deficits to be offset by a local authority's general fund, as there was no statutory basis to hold them separately. The view shared by Government and the sector was that the deficits should not place pressure on resources required for other essential services, nor place pressure on an authority's reserves. It was agreed that until the deficits are closed, measures should be taken to ensure the deficits could be held separately.

7.2 To provide a statutory basis for the separation of the deficits from the general fund, the School and Early Years Finance (England) Regulations 2020 ("the 2020 Regulations") established a ring-fence by specifying that a local authority must either deduct the deficit from its school budget, or carry forward the deficit to future

[1] References to a 'revenue account' has the same meaning as given in Local Government Act 2003, Section 22.
[2] Schools budget has the meaning given to it in Section 45(A)(2) of the School Standards and Framework Act 1998.
[3] The dedicated schools grant (DSG) is payable to local authorities under section 14 of the Education Act 2002. The grant is paid in support of the local authority's schools budget. It is the main source of income for the schools budget.
[4]The requirement for a local authorities to establish a general fund is set out in the Local Government Finance Act 1988, Part VI, Section 91.

financial years rather than fund it from other sources. Further, the regulations specify that a local authority is only able to fund a deficit from a previous financial year from other sources if the Secretary of State has given authorisation to disregard the requirements in the regulations. The effect is to clearly separate the deficits from the general fund.

7.3 However, notwithstanding these changes, during the audits of the 2019-20 local authority accounts, auditors raised concerns that there was still uncertainty as to whether proper accounting practices permitted this separation. Government engaged with auditors, the sector and CIPFA to establish the issue and what further steps were required. As a result of these discussions, the Government decided that accounting practices that provided for the separation of the deficits from the general fund would provide a solution to the outstanding concerns raised by councils and auditors.

7.4 This instrument sets out the proper accounting practice such that where a local authority has a schools budget deficit from prior accounting periods, or where a deficit arises in a reporting period covered by this regulation, the deficit must not be a charge to a revenue account and must be recorded in an account dedicated to recording the deficit. This has the effect of separating any such deficit from a local authority's general fund. It aligns local government accounting practices with the ring-fencing of deficits by the 2020 Regulations, and reduces the risk that deficits create pressures to the general fund in the short-term.

7.5 The accounting treatment introduced by this regulation does not provide a permanent solution to the issue posed by the deficits. The issue can only be fully resolved by closing the deficits as planned. Therefore, the accounting treatment introduced by this regulation is limited to the financial reporting periods 2020/21, 2021/22 and 2022/23 to provide time for Government and local authorities to implement the plans to reduce the deficits.

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 plans to consolidate the 2003 Regulations.

10. Consultation outcome

10.1 We have sought the views on these technical amendments from sector stakeholders including local authorities, auditors of local authority statutory accounts, the National Audit Office and CIPFA, to understand the basis of the issue and the necessity for Government to respond. We have also drawn on their specialist expertise throughout the process of drafting these technical changes, to ensure that the instrument meets the intended purpose. All those we have spoken to have been supportive of the changes set out in this instrument. We have not consulted generally on these changes as they represent technical amendments.

10.2 In autumn 2019, the Department for Education also ran a consultation[5] to clarify the specific grant[6] and ring-fenced status of the DSG. The purpose was to clarify that any deficit that a local authority may have on its DSG account (the schools budget) is expected to be carried forward to the next year's schools budget and is not required, or permitted without the Secretary of State's authorisation, to be covered by the authority's general reserves. There were 152 responses to the consultation, with the majority of respondents in agreement with the clarification*:* 84 per cent of responding local authorities (91 authorities responded) agreed with changes that mandate local authorities to carry forward any DSG overspend to the schools budget in future years unless they have Secretary of State's permission to apply the general fund to deficits. This instrument aligns accounting practices with the changes to the grant status.

11. Guidance

11.1 There are no current plans for MHCLG 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 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 Matt Hemsley at the Ministry of Housing, Communities and Local Government Telephone: 0303 444 0472 or email: matthew.hemsley@communities.gov.uk can be contacted with any queries regarding the instrument.

15.2 Stuart Hoggan, Deputy Director for Local Government Finance, at the Ministry of Housing, Communities and Local Government can confirm that this Explanatory Memorandum meets the required standard.

15.3 Luke Hall MP, Minister of State for Regional Growth and Local Government, at the Ministry of Housing, Communities and Local Government can confirm that this Explanatory Memorandum meets the required standard.

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[5] Department for Education, *Clarifying the Specific Grant and Ring-fenced Status of the Dedicated Schools Grant (DSG)*, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/861859/Clarifying_status_of_DSG_consultation_response.pdf

[6] 'Specific grant' has the meaning given to it in Section 1(4) of The School and Early Years Finance (England) Regulations 2020,