# EXPLANATORY MEMORANDUM TO

# THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2023

## 2023 No. 241

## 1. Introduction

1.1 This explanatory memorandum has been prepared by the Department of Levelling Up, Housing and Communities and is laid before Parliament by Command of His 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 amendment extends a temporary suspension of one aspect of normal accountancy practices that apply to all local authorities. Introducing these changes will ensure that local authority 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.

## 4. Extent and Territorial Application

4.1 The 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 that 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 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.

6.3 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]

6.4 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.

## 7. Policy background

***What is being done and why?***

7.1 From April 2018, authorities were required to implement International Financial Reporting Standard 9 ("IFRS 9"), one of a set of accounting standards that form the basis of the accounting practices used by central and local government. The Code, which sets the practices for local authorities, requires IFRS 9 to be applied in full. One change introduced by IFRS 9 is that local authorities are required to recognise the movement in value for certain types of financial assets in their revenue accounts in the year that they occur, even if the assets have not been sold. Such movements are referred to as 'unrealised gains or losses'.

7.2 Prior to implementation of IFRS 9, authorities raised concerns that recognising such gains and losses could potentially affect service delivery by creating a loss that would need to be managed, or a gain that gives a false inflation of resources. In particular, many authorities had investments in 'pooled investment funds' a type of collective investment that would be affected by the changes introduced by IFRS. In response, the government introduced a statutory override allowing authorities to keep unrealised gains and losses separate from their budgets. This was a temporary measure, due to end 31 March 2023, reflecting that it was not considered appropriate to put in place a permanent departure from accounting standards, while allowing local authorities time to make any changes necessary to address any risks that applying IFRS 9 might bring. Such changes might include reducing holdings in pooled investment funds, restricting taking on new investments or setting aside funds in reserves to help manage annual volatility. At the time, the government said that it would keep use of the override under review but made no further commitments.

7.3 Ahead of the statutory override ending 31 March 2023, the government has consulted on the future of the override and carefully considered the options to allow the override to elapse, extend it by a fixed period, or make it permanent. Pooled investment funds are still commonly used by the sector, and so the risks and concerns raised in 2018 remain extant. The government remains of the view that it is not appropriate to implement a permanent deviation from accounting practices set out in the Code and used by other public bodies. However, the government also recognises that recent economic instability and other external factors have placed greater pressure on local government, and allowing the override to elapse at March 2023 could have adverse consequences. Therefore, the government will put in place a two-year extension of the existing override until March 2025.

7.4 The override will continue to operate as it has done since April 2018. That is, under the Regulation, gains and losses resulting from unrealised fair value movements relating to pooled investment funds, that otherwise must be recognised in profit or loss under IFRS 9, are not charges to the revenue account, and must be taken into a

[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.

separate reserve account. The Regulations continue to 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. Therefore, aside from the period to which the Regulation applies, no other changes are introduced by this instrument.

## 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 A public consultation was run from 11 August to 7 October 2022. The consultation asked 13 questions designed to collect the local government sector's views on the override. It asked questions to understand the risks and benefits of the following options: allowing the override to elapse from March 2023; extend it; or making it permanent. The consultation was also used to collect financial data on the value of the investments held by the respondents, and the changes in market value over the past three financial years. There were 104 respondents, including: 96 local authorities, the regulatory bodies of CIPFA and the Institute of Chartered Accountants for England and Wales, and treasury advisors.

10.2 The majority of responses from local authorities indicated their preference for the override to made permanent, citing the same concerns that were raised in the original consultation from 2018. The main arguments were recognising changes in value of pooled investment assets would either result in an annual loss to be managed or an apparent gain when they had not yet received any cash. Authorities are of the view this would adversely affect their ability to manage their annual budgets and was unnecessary as the investments are low risk and can be held long-term. Further, that if the override were to end, this would discourage their investment leading to loss of dividend income and capital gain. A counter view was presented by the regulatory bodies that IFRS 9 was introduced to tackle a deficiency in financial reporting that meant investment risks were not fully reported, and that removing the override should make local authorities more aware of risks in how they approach investing in these funds; the response did acknowledge, however, that this was a particularly challenging time to be introducing changes that affect local authority finances and therefore supported a short extension of 2 years.

10.3 The consultation also collected information on the potential financial implications. Of the 96 local authorities that responded, 85 provided data on the position of their investments as at 31 March 2022. According to the data provided, 64 authorities were holding an overall surplus (a positive position) on their investments, while 16 were holding a deficit.

## 11. Guidance

11.1 No formal guidance will be issued by DLUHC on implementing these Regulations. The Code sets out the requirements for local authorities to fully comply with IFRS 9 and the 2003 Regulations set out how local authorities will account for the relevant instruments during the specified period. Further, no new requirements or conditions

are introduced by this instrument, it extends a measure that authorities will already be familiar with.

## 12. Impact

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

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 were 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. The two-year extension to March 2025 is a continuation of that due to recent economic instability and other external factors.

12.3 A formal Regulatory 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 impacts these Regulations have throughout the periods within which they will have effect.

## 15. Contact

15.1 Matthew Hemsley, at the Department of Levelling Up, Housing and Communities Telephone: 03034 440472 or email: Matthew.Hemsley@levellingup.gov.uk can be contacted with any queries regarding the instrument.

15.2 Suzanne Clarke, Deputy Director for Local Government Finance Stewardship, at the Department of Levelling Up, Housing and Communities can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lee Rowley at the Department of Levelling Up, Housing and Communities can confirm that this Explanatory Memorandum meets the required standard.