EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2025

2025 No. 422

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 His Majesty.

2. Declaration

2.1 Jim McMahon MP, Minister of State at the Ministry of Housing, Communities and Local Government confirms that this Explanatory Memorandum meets the required standard.

2.2 Suzanne Clarke, Deputy Director for Local Government Finance Stewardship at the Ministry of Housing, Communities and Local Government confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Matthew Hemsley at the Ministry of Housing, Communities and Local Government email: la.financialcontrolframework@communities.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 These Regulations make amendments to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146) ("the 2003 Regulations"). These amendments extend for a further four years the provisions of regulation 30K relating to fair value gains and losses on pooled investment funds, and regulation 30M relating to the accounting of infrastructure assets. These changes will mitigate risks to local authority finances and support the timely completion of local authority audited accounts.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument is England and Wales.

4.3 The territorial application of this instrument is England.

5. Policy Context

What is being done and why?

Fair value gains and losses on pooled investment funds

5.1 In 2018, regulation 30K (S.I. 2018/1207) was introduced to allow councils to disapply part of International Financial Reporting Standard 9 (IFRS 9), which would otherwise require councils to make provision in their budgets for changes in value (gains or losses) of certain types of financial investments (pooled investment funds). This

statutory accounting override was put in place in response to local authorities concerns that this requirement would adversely affect their financial position. The original override was a temporary measure due to end 31 March 2023, to provide time for councils to prepare for full compliance with IFRS 9. It was later extended by 2 years following consultation with the sector (S.I. 2023/241). If unamended, regulation 30K would cease to have effect from 31 March 2025.

5.2 Ahead of this accounting override ending, the 2025 Local Government Finance Settlement consultation sought authorities' views on allowing the accounting override to elapse and what the financial impacts might be. Based on the evidence received, the government set out in its response that the override would not be extended for new investments, but it would consider transitional arrangements to limit the risk that losses on existing investments could negatively affect the financial resilience of some authorities. On that basis, this amendment permits the override to continue on a limited basis until 31 March 2029 for relevant investments made before 1 April 2024. Any investments in pooled funds made on or after 1 April 2024, including any investments made subsequent to these Regulations, will need to be accounted for in compliance with the IFRS 9 as adopted by *The Code of Practice on Local Authority Accounting in the United Kingdom*[1] ("the Code") from 1 April 2025 onward.

5.3 The intent is that all pooled investment funds will eventually be accounted for in compliance with the Code, but where authorities hold investments based on historic decisions there is additional time for authorities to take actions necessary to mitigate any risks to their financial positions. The 2003 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.

On accounting for infrastructure assets

5.4 These Regulations extend the time period to which regulation 30M applies but do not otherwise change regulation 30M, which was introduced in 2022 (S.I. 2022/1232) to prescribe the accounting treatment for local authority 'infrastructure assets'. These are defined in the Code 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 override was deemed necessary as issues with accounting for these assets, particularly roads, were creating otherwise unresolvable delays in the completion of local audits for many authorities.

5.5 Until 2022, the accounting treatment of infrastructure assets had 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. Consequently, there is an increased requirement for local authorities to provide auditors with evidence in respect of infrastructure assets, specifically, the value of components of an infrastructure asset when they are replaced. Due to significant historical information deficits, many authorities are unable to provide sufficient evidence of the value of replaced components. To avoid this issue exacerbating delays to audited accounts, the government put in place a statutory override to allow local authorities to apply a simplified accounting treatment without

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

the need to provide further evidence. The intent was that this would be temporary while a long-term solution was put in place.

5.6 Without further amendment, the Infrastructure Assets override would expire on 31 March 2025. In the consultation, Local audit reform: a strategy for overhauling the local audit system in England[2], the government stated its intention to extend the current override while work continues work to address issues with the audit and accounting system that have contributed to widespread delays to audited accounts. The government is committed to resolving audit issues, including a long-term solution for infrastructure assets, but were the override to elapse on 31 March 2025, this would create an additional impediment to timely, audited accounts. This Regulation extends the statutory override for a further 4 years, until 31 March 2029.

6. Legislative and Legal Context

How has the law changed?

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.

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 SI amends regulation 30K and 30M in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 Act.

Why was this approach taken to change the law?

6.5 Extending the length of the overrides, and in the case of regulation 30K, imposing a condition on an override via a negative instrument, is considered the clearest drafting approach.

7. Consultation

Summary of consultation outcome and methodology

7.1 The consultation on the provisional local government finance settlement sought views on the government's intention to allow the current statutory override, relating to the treatment of pooled investment funds under IFRS 9, to elapse from 1 April 2025. A link to the Government's response can be found here: Provisional local government finance settlement 2025 to 2026 consultation: summary of responses - GOV.UK.[3]

[2] https://www.gov.uk/government/consultations/local-audit-reform-a-strategy-for-overhauling-the-local-audit-system-in-england

[3] https://www.gov.uk/government/consultations/consultation-provisional-local-government-finance-settlement-2025-to-2026/outcome/provisional-local-government-finance-settlement-2025-to-2026-consultation-summary-of-responses#the-international-financial-reporting-standard-9

7.2 Overall, 49% of respondents either agreed with the proposal or did not have a view. In total, 137 respondents provided additional comments to this question. Of the 137 respondents who provided additional comments, the majority (114, 68%) did not agree with the government's intention to allow the override to elapse. A third of respondents (45 respondents) expressed the view that the override should be made permanent. The main arguments for retaining the override, as set out in the responses, remain substantively the same as those out forward in previous consultation on the override in 2018 at inception and in 2022 when the override was extended. The government recognises the views of the sector and that without the IFRS 9 override in place, this will mean that fair value movements of pooled investment funds will need to be reflected in budgets. However, the override has always been a time-limited measure, intended to give local authorities time to prepare for full compliance with the Code.

7.3 Reflecting on the financial position of the sector, and the responses provided, Government recognised the case for additional transitional support for historic investments, which is why the accounting override remains in place for investments made before 1 April 2024 for a further four years.

7.4 The Government consulted on the assets infrastructure override in 'Local audit reform: a strategy for overhauling the local audit system in England'.[4] The consultation ran from 18 December to 29 January 2025.

7.5 The consultation yielded 237 responses in total, of which 175 answered the question on the need to extend the infrastructure assets accounting override and 128 left additional comments. Overall, 87% (153) of respondents were in favour of extending the override beyond 31 March 2025. Over a third of respondents who made further comment were in favour of an extension until a longer-term solution could be identified. Many of these respondents highlighted the current crisis in local audit and the risk of creating additional unnecessary burden in the event of the override expiring. In its response, the government committed to extending the override.

8. Applicable Guidance

8.1 No formal guidance will be issued by the Ministry of Housing, Communities and Local Government on implementing these regulations. The CIPFA Code of Practice sets out the requirements for local authorities to fully comply with accounting practices and the 2003 Regulations sets out how local authorities will account for the relevant instruments during the specified period.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because this instrument is related to updating existing regulatory standards.

Impact on businesses, charities and voluntary bodies

9.2 There is no impact on business, charities or voluntary bodies as this legislation applies to accounting practices of local authorities.

9.3 The legislation does not impact small or micro businesses.

[4] https://www.gov.uk/government/consultations/local-audit-reform-a-strategy-for-overhauling-the-local-audit-system-in-england/local-audit-reform-a-strategy-for-overhauling-the-local-audit-system-in-england#scope-of-the-consultation

9.4 The impact on the public sector is limited. The amendments made by this statutory instrument 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 an override to normal accounting practices were not provided.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The Approach to monitoring this legislation is that MHCLG, in liaison with the local authority associations, CIPFA and private-sector advisers to local government will keep the effect of these amendments under review.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Minister of State, Jim McMahon has made the following statement regarding Human Rights:

"In my view the provisions of The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").