

11 March 2010

Chief Executives
Directors of Finance

Local Authorities in England

Dear Colleague

CHANGES TO THE CAPITAL FINANCE SYSTEM

1. On 16 November 2009 the Department consulted you on proposals to revise: the **Capital Finance Regulations**, the **CLG Investments Guidance** and the **CLG Minimum Revenue Provision Guidance**. We are most grateful for the many comments received. This letter is to notify you of the actions we have now taken.

2. **Capital Finance Regulations** Ministers have made the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2010 [S.I. 2010/454]. An **informal commentary** is at:

<http://www.communities.gov.uk/localgovernment/localgovernmentfinance/capitalfinance/legislation/amendmentregs/>

This gives links to the online regulations and indicates the differences from the consultation draft, all of which benefit authorities and relate to the regulations on *Retirement Benefits* (regulation 3), *Capital Receipts* (regulation 4) and *Leases* (regulation 8).

3. **CLG Investments Guidance** Revised guidance on the lines of the consultation draft has been issued and is at:

<http://www.communities.gov.uk/localgovernment/localgovernmentfinance/capitalfinance/capfinquidconsultdocs/>

4. **CLG Minimum Revenue Provision Guidance** Revised guidance on the lines of the consultation draft has been issued and is at:

<http://www.communities.gov.uk/localgovernment/localgovernmentfinance/capitalfinance/capfinquidconsultdocs/>

5. Any queries should be addressed to: sarah.blackman@communities.gsi.gov.uk

Yours sincerely

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**An informal commentary
on**

**The Local Authorities
(Capital Finance and Accounting)
(England) (Amendment) Regulations 2010
[Statutory Instrument No. 2010/454]**

This is a purely informal commentary and not an authoritative interpretation of the law. Authorities are recommended to take their own legal advice on the meaning of the Regulations.

(1) INTRODUCTION

1.1. The following commentary summarises the intended effects of the new regulations. These are amendments to the **Local Authorities (Capital Finance and Accounting) (England) Regulations 2003** ("the 2003 regulations") [SI 2003/3146, as amended] made under the *Local Government Act 2003* ("the 2003 Act").

1.2 The regulations were made following consultation with local government and other interested parties. A summary of the responses is at:

<http://www.communities.gov.uk/documents/localgovernment/pdf/1482264>

1.3 Online links to the new regulations are:

HTML version - http://www.opsi.gov.uk/si/si2010/uksi_20100454_en_1

PDF version - http://www.opsi.gov.uk/si/si2010/pdf/uksi_20100454_en.pdf

1.4 The **Explanatory Memorandum** on the regulations provided to Parliament is at:

http://www.opsi.gov.uk/si/si2010/em/uksiem_20100454_en.pdf

1.5 Links to the 2003 Act, the 2003 Regulations and amendments to date are:

2003 Act http://www.opsi.gov.uk/acts/acts2003/ukpga_20030026_en_1

SI 2003/3146 <http://www.opsi.gov.uk/si/si2003/20033146.htm>

SI 2004/534 <http://www.opsi.gov.uk/si/si2004/20040534.htm>

SI 2004/3055 <http://www.opsi.gov.uk/si/si2004/20043055.htm>

SI 2006/521 <http://www.opsi.gov.uk/si/si2006/20060521.htm>

SI 2007/573 http://www.opsi.gov.uk/si/si2007/uksi_20070573_en_1

SI 2008/414 http://www.opsi.gov.uk/si/si2008/uksi_20080414_en_1

SI 2009/321 http://www.opsi.gov.uk/si/si2009/uksi_20090321_en_1

SI 2009/2272 http://www.opsi.gov.uk/si/si2009/uksi_20092272_en_1

1.6 Several of the new regulations mitigate adverse financial impacts of accounting practices, including those arising because, from 2010-11, local authorities will prepare their statements of accounts in accordance with *International Financial Reporting Standards* (IFRS) rather than UK standards. The new accounting provisions will be found in CIPFA's *Code of Practice on Local Authority Accounting in*

the United Kingdom, applying with effect from 1 April 2010. The power to modify accounting practice by regulations is in section 21(1) of the 2003 Act.

(2) COMMENCEMENT & APPLICATION

2.1 The regulations come into force for the purposes of the amendments made by Amendment Regulation 3(2) and (3) on 31 March 2010 and thus apply with effect from the financial year 2009-10. For all other purposes, the regulations come into force on 1 April. The regulations apply to local authorities in England.

(3) RETIREMENT BENEFITS [Amendment Regulation 3]

3.1 **Background** Regulations 4 and 30 in the 2003 Regulations protect authorities from what could be an unmanageable burden imposed by accounting standards in relation to long-term pension liabilities. Without this, the full value of the future liabilities would have to be charged to revenue now. Regulation 30 provides for the revenue charge for a financial year to be equal to the retirement benefits *actually* payable in that year. For the purposes of Regulation 30, Regulation 4(2) lists by name the various specific pension schemes to which this measure applies. The relevant accounting provisions will be found in CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom (Chapter 6 - Employee benefits)*.

3.2 **Problem** Some of the schemes referred to in Regulation 4(2), mainly relating to police and fire services, have recently changed their descriptions, so that they are no longer covered by the regulation.

3.3 **Effect of amendment** The amendment revokes all the specific scheme references in Regulation 4(2) and replaces them with a general form of words covering all local government pension schemes accounted for as defined benefit schemes. This overcomes the immediate problem and ensures that any future changes in the legal names of schemes will have no adverse effect. An appropriate cross-reference is included in Regulation 30.

3.4 Following consultation, the definition of benefits covered by the regulation has been widened to include also *injury awards* (particularly those given in the police and fire services) and other long-term employee benefits, which will generate similar problems from 1 April 2010.

3.5 **Timing** To offer immediate protection, these changes come into force on 31 March 2010, so as to apply with effect from the financial year 2009-10. Because of the timing of the accounting changes, for the year 2009-10 the wording needs to be slightly different from that which will apply in subsequent years; this is provided for by Amendment Regulation 3(2).

(4) USE OF CAPITAL RECEIPTS [Amendment Regulation 4]

4.1 **Background** Regulation 23 specifies the various ways in which capital receipts may be used; and 23(e) allows capital receipts from disposals of *housing* land to be used to meet the "administrative costs of or incidental to" the disposals.

4.2 Problem No such concession currently applies in the case of *non-housing* property. This discourages disposals of surplus land, because the costs (eg advertising, professional fees) must be met from revenue, not sales proceeds.

4.3 Effect of amendment Regulation 23 is extended, by the insertion of new paragraph 23(h), to allow the disposal costs of all *non-housing* sales to be met out of capital receipts. But, because overall costs are unpredictable and could be large, the Government considers that there needs to be a ceiling. So the amount of the costs of a disposal met out of a capital receipt may not exceed 4% of the receipt (this figure was increased in the light of the consultation). Regulation 23(e) will operate exactly as before (the 4% restriction is not being applied to housing disposal costs); but the word “administrative” is being removed, since this term seems superfluous.

4.4 Separately, following consultation, an additional new paragraph 23(i) is being inserted in Regulation 23 to allow “*claw-back*” payments to be paid out of capital receipts. Authorities may be required on selling property (for example, former New Town assets) to make payments to a previous owner and at present must use revenue resources for that purpose. The regulation allows such payments to be made out of the capital receipts.

(5) EXPENDITURE TO BE CAPITAL EXPENDITURE [Amendment Regulation 5]

5.1 Background Regulation 25(1)(d) provides that the acquisition of *shares* in individual companies is capital expenditure. This is meant as a disincentive to the use of this potentially speculative form of investment. But Regulation 25(3) makes exceptions to that rule, in particular, for the purchase of shares through regulated collective investment schemes - which spread and mitigate the risk.

5.2 Problem The *Local Authorities' Property Fund* (LAPF) is an unregulated collective investment scheme and operates as an open-ended unauthorised property unit trust. It was established in 1972 by local authorities themselves and is managed on their behalf to provide local government with a way of gaining diversified access to UK commercial property investment. Placing money in the fund however counts as a share purchase which, at present, does not benefit from the exemption in Regulation 25(3), and thus has the disadvantage of scoring as capital expenditure.

5.3 Effect of amendment Since the LAPF is a local government investment scheme, approved by the Treasury under the Trustee Investments Act 1961 (section 11), there seems no reason why authorities be discouraged from placing money with it, provided that they are satisfied that such a transaction is appropriate and consistent with their investment strategies. The amendment therefore inserts a new subparagraph 25(3)(d), with the effect that acquisition of shares in an investment scheme approved under the 1961 Act is not to be capital expenditure. This change does not, of course, imply any Government recommendation to use any such scheme – that is entirely a matter for local decision.

(6) BACK PAYMENT FOLLOWING UNEQUAL PAY [Amendment Regulations 6 & 10]

6.1 Background Many authorities are liable to make lump-sum back-pay awards in relation to former unequal pay arrangements. Accounting practice requires financial provision for anticipated future liabilities to be made in the financial year when the

liability is identified, rather than in the year when the actual payments fall due. It is undesirable for authorities to have to fund these often large provisions in advance of the need to make the payments. To protect authorities, Regulation 30A was inserted in the 2003 Regulations (by SI 2007/573), with the effect that authorities need not charge back pay awards until the date on which they must make the payments.

6.2 Problem Regulation 5(1) of SI 2007/573 provided that the protection conferred by regulation 30A was to expire on 1 April 2011. It was hoped that by then all these cases would have been settled. But equal pay claims are still going through the courts and the process is unlikely to be complete by the end of 2010-11.

6.3 Effect of amendment The period of operation of regulation 30A is extended for two years, until 1 April 2013. This is achieved jointly by Amendment Regulation 10, which revokes regulation 5(1) of SI 2007/573; and by Amendment Regulation 6, which inserts in Regulation 30A a new paragraph (5), specifying a revised expiry date of 1 April 2013. Also inserted in Regulation 30A is a new paragraph (6), which makes clear that where a liability is identified on or before 1 April 2013, the benefit of Regulation 30A will apply, even though the payment falls due after that date.

(7) SHORT-TERM ACCUMULATING COMPENSATED ABSENCES [Amendment Regulation 7]

7.1 Background The new IFRS accounting standards will require authorities to make a charge in each year for the value of holiday entitlements that employees have not taken up by the end of the year. The relevant accounting provisions will be found in CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom (Chapter 6 - Employee benefits)*.

7.2 Problem The amounts will be high for numerous authorities, in particular because of the nature of teachers' employment contracts. By 31 March 2010 teachers will have built up significant entitlements, which they will take in the summer of 2010, but which under the new rules must be charged in 2009-10.

7.3 Effect of amendment A new regulation (30H) is inserted to negate this impact of the transition to the new IFRS accounting basis. The new regulation provides that holiday benefits are to be charged to revenue in the financial year in which the holiday absence occurs.

7.4 In the light of responses to the consultation, it may also be helpful to clarify two points. Firstly, the regulation determines what ultimately impacts on the revenue account, but the accounting code will specify the treatment in the Income and Expenditure Account and will require compliance with IAS 19. Secondly, in the context of accounting for schools, it should be noted that the holiday pay accrual will not need to be charged against the delegated budget: what is charged against that delegated budget will be determined by the new regulation.

(8) LEASE CLASSIFICATION [Amendment Regulation 8]

8.1 Background Authorities often own and grant leases on buildings (eg shops, industrial units) from which the rents make a contribution to their revenues. Under the new accounting standards, property leases are to be accounted for as separate

leases of land and buildings. The relevant accounting provisions will be found in CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom* (Chapter 4 – Non-current assets).

8.2 Problem This accounting change may lead to *operating leases* being reclassified as *finance leases* and vice versa. In both cases, while this reclassification does not change the amount of money the authority receives under the lease, it can have an adverse impact on the authority's flexibility to apply those resources to meet expenditure.

8.3 Effect of amendment To protect authorities from unexpected revenue shortfalls, a new regulation (30I) is inserted. This provides that authorities may account for the money received under the lease in accordance with the accounting practices which applied on 31 March 2010. The draft regulation consulted on covered only reclassifications of operating leases as finance leases, but following consultation has been extended to apply in addition to reclassifications of finance leases as operating leases. Also, in the light of consultation responses, it has been reworded in recognition of the fact that some arrangements becoming operating/finance leases may not previously have been formally classified under either heading.

8.4 Timing The concession is a transitional one for existing leases, since authorities granting leases subsequently will do so in full knowledge of the new accounting standards. The regulation thus applies only to leases in existence on 31 March 2010 (this is a later date than that specified in the consultation draft).

8.5 The regulation only covers cases where authorities are *lessors*. The implications of the accounting changes where authorities are *lessees* require different treatment, which is provided in the revised ***CLG Guidance on Minimum Revenue Provision***.

(9) PROPER PRACTICES [Amendment Regulation 9]

9.1 Background Regulation 31 lists accounting codes which are "proper practices".

9.2 Problem The CIPFA code identified in Regulation 31(a) is to be renamed in 2010-11, so the reference in the regulation as currently worded will be inapplicable. The new Code will be called the ***Code of Practice on Local Authority Accounting in the United Kingdom*** (thus the change from the present name is the removal of the words "A Statement of Recommended Practice").

9.3 Effect of amendment The title of the CIPFA code is changed to the new one.

(10) REVOCATION [Amendment Regulation 10]

10.1 See paragraph 6.3 above.