

A commentary on the  
**Local Authorities  
(Capital Finance and Accounting)  
(England) (Amendment) Regulations 2008**  
[S.I. 2008/414]

*This is an informal commentary and not an authoritative interpretation of the law. If you need legal advice about the meaning of the Regulations, we suggest that you consult your own lawyers.*

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## **(1) INTRODUCTION**

1.1. The **Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008** [SI 2008/414] (“the 2008 Regulations”) have been made and laid before Parliament to come into force on **31 March 2008**. They are available at

[http://www.opsi.gov.uk/si/si2008/uksi\\_20080414\\_en\\_1](http://www.opsi.gov.uk/si/si2008/uksi_20080414_en_1)

1.2 The regulations amend the **Local Authorities (Capital Finance and Accounting) (England) Regulations 2003** (“the 2003 Regulations”) [SI 2003/3146, as already amended by SIs 2004/534, 2004/3055, 2006/521 and 2007/573], made under the **Local Government Act 2003** (“the 2003 Act”).

1.3 The consultation document on the 2008 Regulations of 8 November 2007 is at

<http://www.local.communities.gov.uk/finance/capital/amdregletcon.pdf>

and the comments received and the Department’s responses are at

<http://www.local.communities.gov.uk/finance/capital/amdressum2.pdf>

1.4 The **guidance on Minimum Revenue Provision**, on which we also consulted, comes into operation when the existing MRP regulations are revoked by the 2008 Regulations on 31 March 2008 and thus applies with effect from the 2007-08 financial year. The text and a commentary are at

<http://www.local.communities.gov.uk/finance/capital/statguidmrp.pdf>

1.5 Links to the other legislation mentioned in paragraph 1.2 above are

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/si2007/20070573.htm>

2003 Act <http://www.opsi.gov.uk/acts/acts2003/20030026.htm>

## **(2) TIMING**

2.1 The 2008 Regulations come into force on 31 March 2008 and thus apply with effect from the financial year 2007-08, except for regulation 3, which applies from 1 April 2008.

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## **(3) BOND REDEMPTIONS**

### **[Amendment regulation 3]**

3.1 Authorities have wide freedom to invest surplus funds. But the 2003 Regulations steer them away from more speculative options. This disincentive is achieved by regulation 25(1)(d) which defines the acquisition of both “share capital” and “loan capital” in companies as capital expenditure (subject to the exceptions specified in regulation 25(3)).

3.2 The amendment regulation relates to corporate bonds, the main form of “loan capital”. Where the acquisition of such a bond will have scored as capital expenditure, it follows automatically that its subsequent sale on the open market will generate a capital receipt.

3.3 However, the previous wording of the 2003 Regulations left it unclear how to treat the proceeds which arise when a bond which has reached maturity is redeemed by the company that issued it (rather than being disposed of in the market). The policy intention is that these sums should also be capital receipts and the amendment regulation inserts a new regulation 7A to ensure that such an effect is achieved. The wording has been revised in the light of the consultation exercise to clarify that it applies only where the purchase of the bond in question would have counted as capital expenditure.

3.4 This change applies from **1 April 2008**.

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## **(4) REVENUE PROVISION**

### **Calculation of minimum revenue provision**

#### **[Amendment regulation 4(1)]**

4.1 This regulation amends regulation 28 of the 2003 regulations, replacing the detailed formulae for calculating Minimum Revenue Provision (MRP) with a duty to make an amount of MRP which the authority considers “prudent”. This is linked to the introduction of statutory guidance on MRP, which is being issued in parallel and contains recommendations on determining a prudent amount of MRP. The new arrangements are set out in more detail in the MRP guidance and the informal commentary on it which are available online at:

<http://www.local.communities.gov.uk/finance/capital/statguidmrp.pdf>

4.2 One element of the guidance is the recommendation that an annual statement on MRP is to be put to the full council. This is underpinned by changes to the *Local Authorities (Functions and Responsibilities) (England) Regulations 2000* [SI 2000/2853]. More details are in the MRP guidance.

### **Past errors in minimum revenue provision [Amendment regulation 4(2)]**

4.3 This regulation, which replaces regulation 29 in the 2003 Regulations, is intended to deal with what has become known informally as the “Adjustment A” problem.

4.4 When introducing the Prudential system in 2004, the Government revised the MRP regime but built a safeguard into regulation 28(1) to ensure that the transition did not lead to any artificial increase in MRP liability. This was based on calculating an amount known as “Adjustment A”.

4.5 The calculation of “Adjustment A” however also led to auditors checking on the correctness of the MRP made in earlier years under the former capital finance system. In some cases, auditors concluded that their authorities had made significantly less MRP than was required and asked the authorities to rectify the past deficits by making extra revenue provision now.

4.6 The amendment regulation is designed to assist such authorities and works in two ways. First, where the provision has not yet been made, the regulation will require the incorrect calculations made in the past to be treated as correct, so that no provision is now needed [new regulation 29(1)(a)]. (Authorities will also retain their existing discretion to make additional voluntary revenue provision.)

4.7 Alternatively, where authorities have already made the revenue provision requested by auditors, the regulation will enable them to treat their revenue balances as increased by the same amount (thus neutralising the provision) [new regulation 29(1)(b)]. Since the consultation exercise, the regulation has been revised to clarify the timing of this option and now specifies that the revenue credit must be recorded in a financial year beginning before 1 April 2010.

4.8 Authorities benefiting under new regulation 29(1) are required to include a note to that effect in their statement of accounts. There were requests in the consultation exercise for clarification about the timing of this procedure. The regulation has accordingly been revised to say that authorities treating earlier calculations as correct under new regulation 29(1)(a) should include a note to that effect in their statement of accounts for a financial year ending no later than 31 March 2010 [see new regulation 29(2)]. Authorities recording a credit in a revenue account under new regulation 29(1)(b) are to include the note in the statement of accounts for the year in which the credit is recorded [new regulation 29(3)].

4.9 The regulation comes into force on **31 March 2008** and thus applies with effect from the present financial year, 2007-08.

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## **(5) EARLY REPAYMENT OF LOANS**

### **[Amendment regulation 5]**

5.1 Major revisions to CIPFA's Code of Practice on Local Authority Accounting have introduced new accounting standards on financial instruments. However, they have potentially adverse effects on the revenue resources of some authorities.

5.2 Amendments brought into force in April 2007 by SI 2007/573 began to tackle this problem by modifying the effects of the new accounting procedures on the amounts which actually have to be charged to a revenue account. They included new regulations to modify the accounting treatment of **premiums** and **discounts** arising when loans are repaid early. The background is in the CLG commentary at:

<http://www.local.odpm.gov.uk/finance/capital/letter07-03-07.pdf>

5.3 However, regulation 30C, which deals with premiums and discounts arising after 31 March 2007, contained some minor drafting errors which the new amendment puts right. The changes are as follows:

**Regulation 30C(1)(b)(i).** The wording is brought in line with 30B(1)(b)(i), to deal with cases where the authority is *treated* as having paid a premium (but has not in fact paid over any cash).

**Regulation 30C(1)(b)(ii).** The wording is brought in line with 30B(1)(b)(ii), to deal with cases where the authority is *treated* as having received a discount (but has not in fact received any cash).

**Regulation 30C(6)** A definition of "replacement loan" is inserted in exactly the same terms as that in regulation 30B(8).

5.4 These corrections come into force on **31 March 2008** and so apply with effect from the current financial year 2007-08.

5.5 In the consultation exercise, there were some queries about the accounting implications of the recent change by the Public Works Loan Board (PWLB) in its arrangements for early loan repayments. The Department has been advised by CIPFA that a proposed clarification of the relevant International Accounting Standards Board standard should ensure that there are no adverse revenue effects for authorities. CIPFA will publish a bulletin to confirm the position once the clarification has been finalised. The bulletin will be available on the CIPFA web-site at <http://www.cipfa.org.uk>

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## **(6) LOANS AND GUARANTEES**

### **[Amendment regulation 6]**

6.1 The revisions to CIPFA's Code of Practice on Local Authority Accounting on financial instruments have effects in two further areas, which the 2008 Regulations address.

### **Interest on stepped interest rate loans taken out by local authorities**

6.2 The first is a private-sector financing option used by numerous authorities. *Stepped Interest Rate Loans* are loans taken out by authorities from financial institutions. Their special feature is that the rate of interest is very low for an initial period (usually of several years) and then increases in one or more steps.

6.3 Where authorities are already party to such agreements and have up until now been charging only the actual low interest amount to revenue, the new accounting requirements require additional amounts to be charged now, resulting in a substantial revenue charge in 2007-08.

6.4 The amendment regulation inserts a new regulation 30E into the 2003 Regulations to protect authorities from the retrospective impact. It ensures that the charge to the revenue account in 2007-08 and subsequent years need not be based on the new accounting standard (though authorities may opt to follow the new accounting treatment if they prefer). Instead, the revenue charge may be equal to the amount of interest actually payable on the loan in the year.

6.5 Some authorities may have already made a higher provision than the interest they actually had to pay in a particular year. New regulation 30E does not require them to make any further provision in respect of that year.

6.6 New regulation 30E will not modify the accounting requirements in respect of such loan agreements entered into after the date on which the consultation letter was issued (8 November 2007 – see paragraph 1.3 above). If authorities wish to enter into new Stepped Interest Rate Loans after date, they will need to be ready to follow the revised accounting procedures without modification.

6.7 The regulation comes into force on **31 March 2008** and so applies to the financial year 2007-08.

### **Financial guarantees given by local authorities**

6.8 The second type of transaction addressed by the 2008 Regulations is the financial guarantee which authorities sometimes give on behalf of local organisations whose activities they wish to support. For example, an authority may guarantee to repay the lender to such a body in the event of the latter

defaulting on a loan it has taken out. The authority will only have to make a payment in the event of actual default, but accounting rules may require it to make a charge to a revenue account before that point is reached, when there is a significant risk of the guarantee being called. Under the new accounting rules, a charge representing the fair value of the guarantee will be required from the outset, and a retrospective adjustment may be required in 2007-08 in relation to existing guarantees.

6.9 The new regulation 30F will provide that, in respect of existing guarantees, any charge to a revenue account may be determined in accordance with proper practices applicable during the financial year 2006-07, rather than the new accounting rules.

6.10 Again, the regulation will not modify the accounting requirements in respect of guarantees entered into after the date on which the consultation letter was issued (8 November 2007).

6.11 The regulation comes into force on **31 March 2008** and so applies to the financial year 2007-08.

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