

4 March 2009

Chief Executives
Directors of Finance

Local Authorities in England

Dear Colleague

CHANGES TO THE CAPITAL FINANCE SYSTEM
Accounting for possible investment losses

The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2009 [S.I. No. 321]

1. On 10 December 2008 the Department consulted you on draft amendments to the Capital Finance Regulations. We are most grateful for the comments we received. The consultation documents and a summary of the responses are at www.local.communities.gov.uk/finance/capital/index.htm

2. The regulations have now been made and will come into force on 31 March 2009. The text follows that of the consultation draft, except for minor drafting changes to improve clarity. The regulations are available online at http://www.opsi.gov.uk/si/si2009/uksi_20090321_en_1

3. The **informal commentary** attached below explains the intended effects. Broadly, **amendment regulation 3** helps local authorities with funds in banks where there is uncertainty about the recovery of the investment. It enables such authorities to postpone until 2010-11 the impact on budget calculations of the impairments required by accounting practice.

4. A minor and unrelated amendment has been added since consultation (**regulation 4**). This deals with the change of title of a guidance document for **parish councils**.

5. Any comments or queries on the regulations should be addressed to:
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Yours sincerely

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Communities and Local Government

**An informal commentary
on**

**The Local Authorities
(Capital Finance and Accounting)
(England) (Amendment) Regulations 2009
[Statutory Instrument No. 321]**

This is a purely 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.

(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 by SIs 2004/534, 2004/3055, 2006/521, 2007/573 & 2008/414], made under section 21(1) of the *Local Government Act 2003* (“the 2003 Act”).

1.2 The online link to the new regulations is

http://www.opsi.gov.uk/si/si2009/uksi_20090321_en_1

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

http://www.opsi.gov.uk/si/si2009/em/uksiem_20090321_en.pdf

1.4 Links to the other pieces of legislation mentioned above are as follows:

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

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

(2) TIMING

2.1 The regulations are in force from 31 March 2009 and thus apply with effect from the financial year 2008-09.

(3) POLICY BACKGROUND

3.1 In his Statement to the House of Commons (26 November 2008) on the provisional local government finance settlement for 2009-10, the Minister for Local Government announced that the Government would change the law to allow local authorities with funds invested in Icelandic banks to postpone the impact of the impairments required by accounting practice, from 2008-09 to 2010-11.

3.2 The need for such measures for local authorities arises from the rigorous budgetary regime which applies to them under the *Local Government Finance Act 1992* and imposes, in particular, the requirement for an annually balanced revenue budget. This means that, by contrast with other kinds of bodies, local authorities normally have no discretion to spread revenue costs from one year to another.

3.3 The desired result is now achieved by **amendment regulation 3**, which inserts a new **regulation 30G** into the 2003 Regulations. The immediate practical benefit is that authorities have been relieved of the need to make provision in their budgets for 2009-10 for any possible loss on these investments (other than the loss of interest – see paragraph 7.2 below). The accounts will continue to show the impairments in accordance with proper accounting practices, but authorities have been enabled to make offsetting credits to prevent any impact on budget calculations for 2009-10.

(4) ACCOUNTING GUIDANCE

4.1 The regulations need to be considered in the context of the comprehensive guidance recently issued by CIPFA's Local Authority Accounting Panel. **LAAP Bulletin 78** (on accounting for investment losses) and **LAAP Bulletin 79** (on the accounting implications of the amendment regulations themselves) are available at <http://www.cipfa.org.uk/pt/laap.cfm>

4.2 In view of that guidance, this commentary uses certain accounting concepts without explanation. It does however include a simple example (paragraph 9.1).

(5) APPLICATION

5.1 New **regulation 30G(9)** provides that the regulation applies to any local authority investment in a bank affected by a loss event which occurred between 1 April 2008 and 26 November 2008 (the date on which this concession was announced).

5.2 The regulation does not apply to investments on behalf of **pension funds** (or other external funds) as referred to in section 17(1)(e) of the 2003 Act.

(6) IMPAIRMENT

6.1 **Regulation 30G(1)** relates to the treatment of an impairment loss in respect of a loss event which is recognised in the authority's accounts for the financial years 2008-09 or 2009-10.

6.2 In these circumstances, the authority will have a discretion to make a credit in its accounts in the year the impairment loss is recognised for an amount up to the amount of the impairment loss **[30G(1)(a) and (b)]**.

6.3 Also, if in 2009-10 an authority has to recognise an **increase** in the value of impairment loss already recognised in 2008-09, it may make a credit of up to an equivalent amount **[30G(1)(c)]**.

6.4 The effect of these credits is for the time being to neutralise the debits for the impairment losses required by accounting practice. However, an authority taking advantage of that relief will be required to make a debit in the 2010-11 accounts equal (subject to paragraphs 6.5 and 6.6 below) to the total of all the credits made under the regulation **[30G(8)]**. Thus, the benefit conferred by the regulation is temporary – it simply postpones the effect of the impairment loss.

6.5 Authorities making a credit under the regulation in 2008-09 may, if they prefer, make all or part of the reversing debit in 2009-10. Such a debit will reduce the debit required in 2010-11 **[30G(2)]**.

6.6 A slightly different procedure applies where in 2009-10 an authority has to recognise a **decrease** in a 2008-09 impairment loss in respect of which a credit was made in 2008-09 under the regulation. Standard accounting practice provides for the amount of the decrease to be credited to the 2009-10 accounts. In such a case, **regulation 30G(3)** requires a debit in the 2009-10 accounts equal to the decrease amount (but not exceeding the 2008-09 credit amount **[30G(6)]**). That debit will reduce the eventual debit required in 2010-11 **[30G(8)]**.

(7) INTEREST

7.1 The impairment charge which is deferred by this regulation will typically include elements relating both to the principal of the investment and to interest.

7.2 However, the Government does not consider it appropriate to defer the impact of an actual loss of interest specific to the year.

7.3 Where an authority uses the regulation to offset an impairment charge and accounting practice requires a credit for interest on the investment that has not been received, then the authority will be required **[30G(4) and (5)]** to make a debit offsetting the interest credit (up to the amount of the credit made under the regulation **[30G(6)]**).

7.4 This means that authorities will not be able to use the regulation to avoid the impact of any loss of interest on the investment for the period up to 31 March 2010.

(8) CAPITALISATION DIRECTIONS

8.1 CLG will shortly be issuing its general guidance on applications for capitalisation directions for 2009-10. The Government considers that there will normally be no case for capitalisation of potential losses of investments or loss of interest in respect of those investments.

(9) ACCOUNTING TREATMENT - WORKED EXAMPLE

9.1 Fully worked examples of the accounting treatment will be found in CIPFA's bulletins (see paragraph 4.1 above). The simplified example below shows the accounting entries required in the revenue account by proper accounting practice for the impairment of a typical investment, together with (*in italics*) the entries permitted or required by the proposed regulation. An investment of £2 million is assumed.

| Year | Description | Debits £'000 | Credits £'000 |
|---------|--|---------------------|---------------------|
| 2008-09 | Authority decides, on the basis of the best available information, that an impairment of £1m should be recognised <i>Authority decides to exercise its discretion under the regulation to make an offsetting credit of the full amount</i> Authority makes credit for interest on the investment <i>Authority is required to make an offsetting debit</i> | 1,000 80 | 1,000 80 |
| 2009-10 | Authority makes credit for interest on the investment <i>Authority is required to make an offsetting debit</i> Authority decides, on the basis of new information from the administrators, that the impairment should be increased by £200,000 <i>Authority exercises its discretion to make an offsetting credit of the full amount</i> | 100 200 | 100 200 |
| 2010-11 | <i>Authority is required to make a debit equal to the net credit under the regulation in earlier years [1000 + 200 - (80 + 100)]</i> | 1,020 | |

(10) PARISH COUNCILS – PROPER PRACTICES

10.1 **Amendment regulation 4** makes an entirely unconnected minor amendment to reflect a change in the title of the document formerly known as “*Governance and Accountability in Local Councils in England and Wales: A Practitioners’ Guide 2003 Edition*”, which is referred to in regulation 31(c) of the 2003 Regulations.