

## **EXPLANATORY MEMORANDUM**

### **Explanatory Memorandum to - The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2009**

This Explanatory Memorandum has been prepared by Social Justice and Local Government Department and is laid before the National Assembly for Wales in accordance with Standing Order 24.1.

#### **i. Description**

This Statutory Instrument amends existing Regulations, (the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (“the 2003 Regulations”)), so that local authorities can mitigate the financial impact of accounting for possible investment losses. These amending Regulations are designed to help local authorities with funds in banks where there is uncertainty about the recovery of the invested sums. The Regulations will enable authorities to postpone the impact on budget calculations of the impairments required by accounting practice from the financial year 2008-09 to 2010-11. Regulation 2 inserts new regulation 24G into the 2003 Regulations. Regulation 24G makes provision to alter the ordinary accounting treatment of certain financial losses suffered by local authorities by allowing an affected local authority to record an offsetting credit in its accounts of up to the value of the loss. The effect of this is that whilst the authority’s accounts continue to fully show the loss that has been incurred, the effects of the loss on the authority’s budget calculations are mitigated. This is a temporary arrangement: the offsetting credit must be fully reversed in the financial year beginning on 1 April 2010 if it has not already been reversed by then.

#### **ii. Matters of special interest to the Subordinate Legislation Committee**

None.

#### **iii. Legislative Background**

Section 21 of the Local Government Act 2003 (the “2003 Act”) provides the Secretary of State with powers to make regulations on the matters contained within this Explanatory Memorandum and section 24 of the 2003 Act provides that the powers contained in section are now exercisable as regards Wales by the Welsh Ministers. These Regulations are made using the negative resolution procedure.

#### **iv. Purpose and intended effect of the legislation**

In October 2008, a number of local authorities had investments in various Icelandic banks with a range of payment due dates. In the week beginning 6 October 2008, a number of Icelandic banks went into administration. This provided objective evidence that an impairment event had occurred and where information is available to allow the authority to assess the impairment, even where this information is imperfect, the authority would be required to make an

assessment of the impairment, and recognise this in the Income and Expenditure Account in 2008-09. Funding the impairment of an investment would also have other consequential impacts and Authorities would have to take all such factors into account in setting their 2009-10 budget.

The new regulation 24G will mean that authorities can postpone the effect of the impairment loss and will not need to make provision in their budgets for 2009-10 for any possible loss on these investments. The accounts will continue to show the impairments in accordance with proper accounting practices, but authorities will be permitted to make offsetting credits to prevent any impact on budget calculations for 2009-10.

The new regulation will apply to any local authority investment in a bank affected by a loss event which occurred between 1 April 2008 and 27 November 2008 (the date on which this concession was announced).

#### v. **Implementation.**

There are no specific legal ramifications if this legislation is not made.

Not introducing the regulation regarding the treatment of an impairment loss would mean the additional flexibilities offered would be lost. Similar regulations are being brought in on the same timescales in England. If the regulations are not made Welsh local authorities would be disadvantaged in comparison to counterparts in England.

A regulatory impact assessment has not been produced for this instrument as no impact on business, charities or the voluntary sector is foreseen.

#### vi. **Consultation**

A consultation on policy intentions and draft Regulations was undertaken over the period 27 January 2009 to 17 February 2009 with a wide range of appropriate stakeholders. The shortened period for consultation was discussed with and supported as suitable by the WLGA.

The consultation ended on 17/2/09. There were 11 replies received mainly from local authorities, by the closing date.

The 11 responses include 5 local authorities with investments in Icelandic banks and directly affected by these regulations. Two of these authorities fully supported and welcomed the mitigation measures with the remaining 3 authorities ideally requesting further support to protect both the principal *and interest* from the requirement to take account of impairment losses in 2008-09 and 2009-10. Of the remaining replies overall the responses were supportive of the proposed Regulations. Of particular note is the Wales Audit Office who

had some reservations but as the Regulations are for a limited period felt comfortable to “raise no fundamental objections”.

Some minor reservations were made in regards to accounting practice or again suggesting widening the scope of the regulation to encompass mitigation for both principal and interest losses. It is not considered appropriate to defer the impact of any deemed loss of interest, and some reassurance can be taken from the fact that similar regulations will come into force in England and on the same basis as in Wales.

#### **vii. Post implementation review**

The current regulatory framework has been in place since April 2004. Since that time the effectiveness of the system in place has been kept under regular review by Assembly Officials and in regular formal and informal situations with interested stakeholders’ examples being local authorities, WLGA and Wales Audit Office.

#### **viii. Summary**

The 2009 amending regulations are necessary so that certain aspects of the current regulatory framework are amended in line with policy intent. They deal with the treatment of any “impairment loss” in respect of these investments which should, as required by accounting practice, be recognised in the local authority’s accounts for the financial years 2008-09 and/or 2009-10.

This will enable local authorities to defer budget decisions regarding the accounting treatment of the consequences of the investments in Icelandic banks, until a point when any impairment in the value can be determined with greater certainty.

<b>RESPONDENT DATE REC'D</b>	<b>SUMMARY OF COMMENTS</b>
Bridgend CBC – 16/02/09	Agree with the new regulation that affected authorities will not need to make provision in their budgets for 2009-10 for investment losses, but will need to take account of the impact of any loss of interest on the investment
Torfaen CBC – 16/02/09	There should be a requirement to protect both principal and interest from impairment, to provide consistency of treatment and avoid unsubstantiated costs affecting the budget preparation for 2009-10.
Wales Audit Office – 14/02/09	While we do have some reservations, in view of the fact that the amendments only apply to events which occurred between April and November 2008 and the period of relief is limited, we do not have a fundamental objection to the proposed amendments.
Neath Port Talbot CBC– 17/02/09	<p><u>Long Term Solution</u> – we consider it absolutely necessary that the requirement to reverse entries by 2010-11 should be replaced by the ability to spread any such losses over a longer period subject to the discretion of the authority after taking into account medium and long term plans. Renew calls on the Government to compensate Authorities for any such losses</p> <p><u>Interest</u> – question why the regulations specifically exclude the ability to impair and if necessary defer the impact of any loss of interest.</p> <p><u>HRA</u> – we believe it totally appropriate that the HRA should properly bear its share of losses and would request the regulations be amended to enable this to happen as all HRA balances are clearly part of the total external investment of the authority.</p> <p><u>Commercial sensitivity</u> – the regulations and accounting code of practice should not require note disclosures which might indicate an expectation of loss as this could prejudice ongoing negotiations with administrators and third parties.</p> <p>Additional comments were raised concerning the guidance provided in CIPFA LAAP bulletin 79.</p>

<p>Caerphilly CBC – 03/02/09</p>	<p>Supportive of the proposed regulation. In particular welcome the fact that it enables decisions to be deferred regarding the accounting treatment of the consequences of the Icelandic bank situation, until a point when any impairment in the value of the investments can be more determined with greater certainty.</p>
<p>South Wales Police - 16/02/09</p>	<p>Until the receivers/ administrators give a view there will be no certainty about amounts of principal returned or amounts of interest – either interest up to the date of failure, or up to the maturity date of the investment. Clearly encouraging the Assembly to provide guidance which protects all interest expected by the investment deed, would be the most equitable way forward – avoiding unnecessary budgetary impact until some clarity emerges from the administrators. We would recommend this.</p> <p>We recognise that interest lost on assets frozen beyond their maturity date is unlikely to be covered by the administrators, and should therefore be taken into account.</p>
<p>CIPFA – 16/02/09</p>	<p>Overall CIPFA supports the proposed changes to mitigate the financial impact of possible investment losses as a pragmatic approach to what is still an uncertain outcome for a number of authorities.</p> <p>Specific comments made regarding the cut off date in Wales of 27 November 2008, the date on which the concession was announced and the decision being made on the 2 December 2008. In England the announcement and cut off date is 26 November. You may want to consider whether it is appropriate or necessary to amend either the regulation or the justification to deal with the inconsistency.</p>
<p>Flintshire CC– 16/02/09</p>	<p>The mitigation measures are welcomed pending resolution of the Icelandic banks investment issue.</p> <p>Questioned whether there is a need for an authority to disclose anything other than a contingent liability in the statutory accounts. Additional comments made regarding the complexity of required accounting in LAAP Bulletins 78 and 79</p> <p>Additional issues raised regarding</p> <ul style="list-style-type: none"> <li>• the effect on Whole of Government Account figures</li> <li>• whether the Assembly is aware that recovery of lost interest is unlikely</li> <li>• further guidance regarding the interest rate calculation option for HRA charging purposes</li> </ul>

<p>Rhondda Cynon Taff CBC – 12/02/09</p>	<p>The absence of any protection for loss of interest does not appear to be a consistent treatment of the claim which local authorities have logged with administrators wherein both principal and interest are included. Whilst not a material issue for this council we would have anticipated a protection/ deferral of the impact of interest losses.</p> <p>Request clarity for the issue and timing of potential capitalisation directions.</p> <p>Questioned whether regulation (distinct from capitalisation) is an option to allow for the effects of the losses to be written to the revenue account over a 25 year (or other appropriate) period.</p>
<p>Wrexham CBC – 17/02/09</p>	<p>Welcome and support the aim of the changes to mitigate the financial impact on local authorities accounting for possible investment losses. However wish to see proposed mitigation extended to apply to all investments made up to 27 November 2008.</p> <p>Support an extension of the period of mitigation to a maximum of 10 years to allow Local Authorities greater flexibility in managing the impact of these impairments</p>
<p>Richard Dunlop Butlers – 16/02/09</p>	<p>We believe there is a strong argument for producing regulations which eliminate the whole of the impairment required by accounting practice and allowing local authorities to make prudent provision for the expected loss. We would urge Ministers to revisit the draft regulations and</p> <ul style="list-style-type: none"> <li>• protect both principal and interest from impairment</li> <li>• provide consistency of treatment</li> <li>• avoid unsubstantiated costs, arising from accounting adjustments, affecting the budget preparation for 2009-10.</li> <li>• Clarify if, under any circumstances, funds invested on behalf of pension funds could be included.</li> </ul>