EXPLANATORY MEMORANDUM

Explanatory Memorandum to - The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2010

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”).

These amending Regulations cover a number of areas. They are of particular importance to larger local government bodies (county and county borough councils, fire and rescue, police and National Park authorities) as they mitigate the revenue impact of introducing a new accounting regime – International Financial Reporting Standards (IFRS).

Other significant areas include extending existing regulations that support temporary mitigation related to impairments of investment at risk in Icelandic banks and the treatment of back pay following payment of unequal pay compensation.

Further regulations deal with a change to the way capital receipts can be used as well as tidying up existing regulations. Amending references are made to proper (‘accounting’) practices and redefining reference to retirement benefits. The latter will put beyond doubt the correct accounting treatment of defined benefit pension schemes.

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 Welsh Ministers with powers to make regulations on the matters contained within this Explanatory Memorandum. These Regulations are made using the negative resolution procedure.

iv. Purpose and intended effect of the legislation

The 2003 regulations set out operational detail for capital finance and accounting controls applicable to local government bodies in Wales. The amending regulations also make alterations in the designation by the Assembly Government of what are called "proper practices". These proper (accounting) practices describe how accounting standards are to be applied in a local government setting. These amending regulations refine or amend a number of existing areas already provided for and introduce three new aspects not previously covered.

For larger public sector bodies the formal basis for accounting is changing. A new accounting regime - IFRS - will impact these bodies from 2010-11. An unintended revenue consequence of this change may fall to certain of these local authorities hence the need for mitigating regulations. Two particular issues covering IFRS mitigation are included in the amending regulations. These are:

- Accruing for holiday pay owed at the year-end: the value of unused annual leave at year end will need to be credit to accounts. These charges, if not mitigated, will result in authorities needing to finance this cost from Council Tax. Due to the uneven way leave accrues from one year to the next, the largest impact would arise due the way teachers pay is calculated.
- Reclassification of leases: under IFRS all or part of a lease may need to be classified differently to the current arrangements. This will apply to existing and new leases. One consequence of this is that part or all of the rental income may then need to be classified as a capital rather than revenue receipt. Capital receipts cannot be used for revenue purposes and as a result this change will lead some local government bodies having to raise additional revenue to make good the revenue shortfall. For leases in place before 1 April 2010 it is intended to preserve the accounting practices related to these leases so that the planned use of the income can remain unaltered. New leases taken out after 1 April will be treated in accordance with the relevant accounting standards.

Two changes to existing regulations will extend mitigations already in existence:-

- A change brought in last year via the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2009 meant that authorities with investments at risk in Icelandic banks could temporarily defer setting aside an estimated impairment loss. This temporary mitigation allowed a breathing space until it became clearer what the actual loss, if any, would be. The mitigation was envisaged to end on 31 March 2011. As the situation has not yet been fully clarified, the intention of this regulation is to allow for an extension to the original date until 31 March 2012 when the position is likely to have been resolved across the board. This amending regulation will come into effect on 31 March 2010.

- 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 current financial year, rather than in the year when the actual payments fall due. It is detrimental for authorities to have to fund these often large provisions in advance of the need to make the payments. To protect authorities against this a regulation was brought forward in 2007 which meant that authorities need not charge back pay awards until the date on which they must make the payments. It is estimated that it may take a further two years for this issue to reach a conclusion. Therefore the existing mitigating regulation has been extended to 31 March 2013.

Other changes:-

Current regulations allow a local authority to defray the cost of disposal of a Housing Revenue Account (HRA) asset by using part of the capital receipt from the sale of the asset. This permission is being extended to non-housing revenue account assets with the proviso that the costs involved do not exceed 4% of the capital receipt arising on disposal.

Tidying up existing regulations - amending regulations will change existing references in legislation to specific retirement benefit schemes and replace them with general references so that any future name changes would not have adverse consequences in relation to accounting for long-term pension liabilities. The name of the designated proper practices applicable to larger local government bodies is changing. As a result, similar to the amendment above regarding Retirement benefit schemes, a change to references to proper ('accounting') practices is required. The regulation redefining references to Retirement benefit comes into effect from 31 March 2010.

v. **Implementation**.

These amending regulations, aside from where specifically mentioned above, came into effect from 1 April 2010.

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

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**

Informal contact with a range of stakeholders took place during 2009 when the potential impacts of moving to an IFRS based accounting regime were explored. A consultation followed over the period 17 December 2009 to 28 January 2010 when proposed policy and draft Regulations were put to a wide range of appropriate stakeholders. This included, amongst others, all local government bodies in Wales, Wales Audit Office (WAO), Welsh Local Government Association (WLGA), One Voice Wales and the Chartered Institute of Public Finance and Accountancy (CIPFA). The shortened period for consultation was discussed with and supported as suitable by the WLGA.

The consultation ended on 28/01/10. There were 27 replies received from local authorities and other interested parties, by the closing date.

There was substantial support for changes to mitigate the effect of moving to an IFRS based accounting regime. Sixteen respondents supported mitigation linked to holiday accruals, none were against the proposal. On changes linked to reclassification of all or part of an operating lease to a finance lease, 5 respondents requested that the effective date of the mitigation be extended from the propose date (17 December – date consultation document issued) until the 31st March 2010 to allow for leases in current negotiation to be completed. The consultation also highlighted the possibility that a similar situation may exist in the reverse situation described above i.e. where a finance lease is reclassified as an operating lease. As a result the Regulation will be extended to cater for both finance and operating leases and the effective date for mitigation will be moved to 31 March 2010.

There was strong support for regulations extending existing regulations related to potential impairment charges related to investments at risk in Icelandic banks. Similarly good support was given for extending mitigation related to provisions related to the possible treatment of equal pay compensation.

The proposal to allow costs of administration of or incidental to an asset disposal of non-HRA assets to be met from capital resources was generally welcomed. WAO confirm that this aspect will bring LA accounting broadly into line with proper accounting practice. Thirteen respondents commented on the proposal and a number asked why it was necessary to apply a 2% cap and could the figure be increased. A few also asked whether a cap was really necessary at all. In discussions with HMT and Communities and Local Government it was agreed that an open ended arrangement would not be appropriate but an increase in the cap could be considered. Both Wales and England have moved the cap from 2% – 4% of the capital receipt which seemed to a reasonable compromise.

There was broad support from 11 respondents relating to accurate and future proofed definition in legislation of retirements benefit schemes. Similarly as regards the description of the CIPFA accounting document, defined as proper practices, for those authorities that required to follow it.

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 2010 amending regulations are necessary so that certain aspects of the current regulatory framework are amended in line with policy intent. They deal with technical mitigations related to the possible revenue consequences of complying with the introduction of International Financial Reporting Standards (IFRS).

Other significant areas include extending existing regulations related to potential impairments investments at risk in Icelandic Banks by deferring the impairment charge for a further year to provide additional breathing space for authorities. Similarly existing regulations that allow local authorities with possible equal pay compensation liabilities to defer ring fencing resources in a special reserve until such a time as the compensation is actually paid. This has been extended a further year to the end of the financial year 2012-13 in recognition of the difficulties faced by local authorities completing this exercise.

Further amending regulations deal with the costs associated with the disposal non-HRA assets. This will extend some of the flexibility currently given to HRA assets. Additionally a tidy up of existing regulations to amend references related retirement benefits schemes and references to proper accounting practices completes the scope of the regulations.