

## **REGULATORY APPRAISAL**

### **LOCAL GOVERNMENT, WALES**

#### **THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (WALES) (AMENDMENT) REGULATIONS 2006**

##### **Background**

1. The Local Government Act 2003 (“the 2003 Act”), together with Regulations made under it, gave effect to major changes to Local Authorities capital finance and accounting and those changes became operative for financial years commencing 1 April 2004. The relevant sections are contained in Part 1 of the Act. They replaced the previous capital finance regime under Part IV of the Local Government and Housing Act 1989 (LGHA 1989).
2. This major policy change was initially consulted upon by the Welsh Assembly Government in ‘Simplifying the System’ (September 2000) on the basis that the then system in operation blurred accountability, limited local financial freedom and had become an obstacle to securing effective capital investment. Following this, further consultation resulted in the publication, in 2002, of ‘Freedom and Responsibility in Local Government’, which sets out the Welsh Assembly Government policies for local government in Wales and its vision for the future of local government. The clear intention was expressed then to introduce primary legislation to give effect to a new system of local authority capital finance. This system has come to be known as the ‘Prudential Regime’.
3. The ‘Prudential Regime’ must be looked at in terms of each of its component parts:
  - the legislative framework as set out in the 2003 Act;
  - the supporting secondary legislation which ‘fleshes out’ the broad intentions laid out in the primary legislation;
  - the Chartered Institute of Public Finance and Accountancy (CIPFA) ‘Prudential Code for Capital Finance in Local Authorities’;
  - other professional codes of practice and statements such as those on treasury management, reserves and balances and the role of the finance director in local authorities;
  - the ‘balanced budget requirement’;
  - asset management plans;
  - medium and longer-term financial strategies based on the most effective management of revenue and capital resources; and

- the form of Assembly financial support to local authorities for capital investment.
4. It must be recognised that no single component will achieve all of the objectives of the Prudential Regime, but taken as a whole, the system should be capable of achieving the objectives.
  5. Therefore, the intention is that the primary legislation should set the broad framework of the system, supported by secondary legislation, with the detail of the system being contained in professional codes of practice compliance with which would form part of the audit process within local authorities.
  6. Amongst other items, the primary legislation therefore includes the following sections, each of which contain Regulation making powers for the Assembly:

#### Part 1- Local Government Act 2003

- Section 3 – Duty to determine affordable borrowing limit
  - Section 9 - "Capital Receipt"
  - Section 10 - Non-monetary receipts
  - Section 11 - Use of capital receipts
  - Section 16 - "Capital expenditure"
7. To support the primary legislation and operationalise the prudential borrowing system in Wales, two items of secondary legislation have so far been issued:
    - The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, SI No. 3239 (W.319) ("the main Regulations"); and
    - The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2004, SI No. 1010 (W.107), which amended the main Regulations.
  8. The rationale behind the making of the main Regulations was to support the introduction of the Prudential Regime in 2004-05 and ensure that the main Parts of the Act were supported by the necessary detailed legislative framework for its operation. Amongst other items, the main Regulations provide for the detailed legislative position in respect of the following:

- Specification that certain amounts should be regarded as capital receipts (section 9 of the 2003 Act)
- A requirement for cash pooling of the housing capital receipts in respect of Housing Revenue Account (HRA) debt free authorities (section 11 of the 2003 Act)
- A requirement that capital receipts generated from the sale of Housing Revenue Account assets are retained to either repay HRA debt or purchase further HRA assets (section 11 of the 2003 Act)

### **Purpose and Intended effect of the measure**

9. Following further review of the existing position, and in the light of various amendments made to the equivalent regulations applying in England, it is now opportune to consider further possible amendments to the current legislative framework in Wales. Such amendments could cover the following:
  10. To assist Authorities and other relevant organisations in the implementation of its provisions, it is considered that Regulation 10(9) of the main regulations should be the subject of re-numbering and re-lettering of its existing sub-paragraphs. This does not entail any policy change.
    - In the case of any future Large Scale Voluntary Transfer (LSVT) of Local Authority housing stock to a Registered Social Landlord (RSL), a levy could become payable to the Assembly. It is proposed that any such levy be classified as capital expenditure, thus enabling it to be paid out of the associated capital receipt that the Authority would receive from the RSL. (Provision to be made under section 16 of the 2003 Act)
    - Under the main Regulations, the opening Council Fund Capital Financing Requirement (CFR) for any year could be affected if the opening Housing CFR for that year were to become a negative figure. (The CFR is broadly a measure of indebtedness, and is used for the calculation of annual repayment amounts to be charged to revenue accounts). It was not intended that a negative Housing CFR should affect the Council Fund CFR. Accordingly, it is considered that the existing basis for calculating the opening Council Fund CFR needs a minor amendment. (Provision to be made under section 3 of the 2003 Act)
    - The main Regulations provide that, for any LSVT of 500 or more LA dwellings to an RSL, any capital receipt received by the LA shall be exempt from any pooling requirements for such receipts. It is now considered that this exemption should be extended to also include any small scale voluntary transfers to RSLs. (Provision to be made under section 9 of the 2003 Act)

- The main Regulations provide that the trigger point, at which an Authority becomes liable to make pooling contributions to the Assembly from certain Housing capital receipts that they receive, is when their Housing CFR becomes nil, or negative. It is considered that this point should be amended to that when either Housing CFR or the Authority's Housing *Subsidy* Capital Financing Requirement becomes nil, or negative. (Provision to be made under section 11 of the 2003 Act)
11. It should be noted, however, that by reinvesting Housing Right to Buy capital receipts in their social housing, Authorities can significantly reduce any pooling liability in respect of those receipts.

### **Risk Assessment**

12. It is not considered that any of the proposed amendments will pose any additional risks to the limited ones identified when the initial main Regulations were made in 2003. As previously identified, there remains a risk that, within the prudential system, Local Authorities will attempt to set themselves limits which are not affordable. However, there are several controls within the system to prevent this scenario. Firstly, there are duties placed on the professional chief finance officer to ensure that Authorities undertake all of the appropriate deliberations as set out in the prudential code and that corporate governance requirements therein are given due process. The local authorities' external auditor then audits compliance with the code.
13. In extremis, the Assembly has reserve powers to set affordable limits for an authority but it is not envisaged at this time that these reserve powers will need to be exercised.
14. If these Regulations were not brought into effect there is a risk that a local authority could avoid pooling arrangements because the pooling arrangements have not been defined as closely as these new Regulations intend.

### **Options**

#### Option 1: Do Nothing

15. The re-numbering has been proposed to address possible confusion caused by the current paragraph numbers. The Welsh Assembly Government could also miss the opportunity to obtain receipts for re-distribution if local authorities get into the position of being HRA debt free if these Regulations were not made.

#### Option 2: Make the Legislation

16. The development of the prudential system has taken place over a period of time since 2000. The guiding principles have been the general aim for a simplified local authority capital finance system. The issues now under consideration affect existing Regulations. As such they can only be amended by further Regulations. These Regulations would result in

reducing the risk of confusion due to the numbering of paragraphs and more importantly ensure more effective delivery of pooling arrangements if an authority becomes HRA debt free in the next financial year.

### **Benefits**

17. The main benefit to local authorities of the introduction of the Prudential Regime is that overall there is a reduction in complexity in both the statutory system and the supporting accounting requirements, which should reduce the burden of regulation on local authorities. The proposed amendments make minor changes to the existing regulatory framework.

### **Costs**

18. There are no costs for the Assembly as a result of these Amendment Regulations.

19. As with the main Regulations for the introduction of the prudential system, these amendments should not result in additional costs to Local Government. The amount of funding, which the Assembly provides to Local Authorities for capital investment is a separate issue to any amendment now proposed. Some of the amendments will impact on the timing and amount of future possible pooling contributions to the Assembly.

20. There are no financial implications for the wider business sector as a result of the proposed 2006 Regulations. Authorities will continue to be free to determine the most appropriate financing package for particular projects and their capital programmes as a whole.

21. The proposed 2006 Regulations have no implications for the voluntary sector.

### **Competition Assessment**

22. This is not applicable to these Regulations. Local authorities will continue to be free to determine the most appropriate ways for the delivery of their capital programmes, and for the financing of that programme.

### **Consultation**

#### With Stakeholders

23. The policies contained in the proposed 2006 Regulations were the subject of consultation from 8 December 2005 to 23 January 2006, to ensure that all stakeholders, including County and County Borough Councils, the Welsh Local Government Association (WLGA), Fire and Police Authorities, the Wales Audit Office (WAO) and professional bodies could comment. The reduced consultation period was agreed with the WLGA.

24. A total of ten Local Authorities, and a Fire Authority, together with the Wales Audit Office, The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Welsh Treasurers (SWT) responded to the consultation. Of these, five Local Authorities, the Fire

Authority and CIPFA either did not object to the amendments, or accepted them without comment. One comment was received in respect of the amendment for the calculation of the CFRs, and hence Council Fund MRP. This matter had already been identified during the consultation period, and the Regulations have been revised accordingly.

25. The remaining responses, from five Local Authorities, SWT and the WAO, were received in connection with the pooling of RTB receipts, and the change to the point at which pooling commences. One Authority and the SWT questioned whether there should be pooling, given Authorities possible use of such receipts for future investment in the housing stock. However, this was not consulted on, as the existing main Regulations already set out the framework under which pooling will take place.
26. Varying concerns were expressed by four Local Authorities in respect of the impact of changing the pooling point, to when either CFR became nil, or negative. However, the WAO took the view that in certain circumstances it should only be when the Housing Subsidy CFR became nil, or negative.
27. In view of the differing responses, and that twelve Local authorities did not respond at all, the proposed 2006 Regulations have been framed to reflect the policy changes that were consulted on.

#### With Subject Committee

28. These Regulations were notified to the Local Government and Public Services Committee via the list of forthcoming legislation on 21 September 2005 (LGPS 08-05(p.7), Item No: CFA01), and will remain on the list until they come into force. The item was not identified for detailed scrutiny.

#### **Review**

29. The prudential system has now been in operation since April 2004. Since then the efficacy of the existing Regulatory framework and supporting mechanisms has been kept under review by Assembly officials, and whenever appropriate discussed and considered further with WLGA and/or Local Authorities in relevant joint working groups. It will to be kept under review in the future.

#### **Summary**

30. In summary, these proposed Regulations are necessary so that certain aspects of the prudential regime in Wales, as set out in the main Regulations, can be amended to reflect the Assembly's policy intentions.
31. The intention of the Prudential Regime is that this will provide Local Authorities with the freedom to make responsible decisions about all of the resources and assets at their disposal. The Prudential system also represents a significant simplification on the previous complex system of local authority capital finance. If these Regulations were made, the main Regulations would subsequently be amended. Those amendments would give implementation to the Assembly's policy intention. The broad

principles behind the Prudential Regime, as outlined above, would not be affected by any such amendments.