

Explanatory Memorandum to The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2022

This Explanatory Memorandum has been prepared by the Covid Recovery and Local Government Group and is laid before Senedd Cymru in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

Minister's Declaration

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2022.

Rebecca Evans MS
MINISTER FOR FINANCE AND LOCAL GOVERNMENT

30 November 2022

PART 1

1. Description

- 1.1 These regulations amend the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (“the 2003 Regulations”) so as to enable local authorities to continue to use a longstanding accounting practice (the historic method) in relation to the treatment of local authorities’ infrastructure assets. The regulations have the effect of allowing local authorities to elect to treat a component of an infrastructure asset which they own as having a value of nil when it is replaced. Local authorities are not required to use this accounting treatment. This accounting treatment can be applied for the preparation of all statements of accounts from 1 April 2021 up to and including the financial year ending 31 March 2025.

2. Matters of special interest to the Legislation, Justice and Constitution Committee

- 2.1 In accordance with section 11A(4) of the Statutory Instruments Act 1946, the Llywydd has been informed that the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2022 will come into force less than 21 days after the instrument has been laid.
- 2.2 This is a technical amendment to enable local authorities in Wales to continue current operational practice. Adhering to the 21 day period would mean that local authority accounts could not be approved until the Statutory Instrument came into effect. This would increase the uncertainty for local authorities and delay the provision of accounts information for scrutiny by elected members and by members of the public. Local authorities are currently facing significant budget pressures and some very difficult decisions over services. They will receive their draft settlement on the 14 December 2022 and will need to focus all available officer and council time on budget and service planning. If further delayed the accounts approval process for financial year 2021-22 would take up officer and council time at a critical point. A delay also has a knock-on impact on Audit Wales’s timetables, with work being delayed until January/ February 2023 impacting on capacity in Audit Wales to complete all the community council audits and the start of the 2022-23 local authority audits.
- 2.3 There is an element of retrospectivity to the regulations in that they will apply to accounts for financial year 2021-22. Local authority accounts for financial year 2021-22 have not yet been audited, as such the regulations will only apply to accounts where an audit has not been completed.

3. Legislative background

- 3.1 Section 21(1), when read with section 24, of the Local Government Act 2003 (“the 2003 Act”) provides that the Welsh Ministers may make provision about the accounting practices to be followed by local authorities. Section 123 (1) and (2) of the 2003 Act enables the Welsh Ministers to make different provision for different cases and for different descriptions of local authorities. Section 21(2) provides that ‘proper practices’ includes both accounting practices prescribed in legislation, and those contained in codes of practice specified by the Welsh Ministers in legislation.
- 3.2 Regulation 25(1)(a) of the 2003 Regulations specifies that the accounting practices contained in the “Code of Practice on Local Authority Accounting in the United Kingdom” (“the Code”), are to be regarded as proper practices. The code is issued by the Chartered Institute of Public Finance and Accountancy (“CIPFA”), who may amend and reissue the code from time to time.
- 3.3 Section 21(3) of the 2003 Act provides that where there is a conflict between accounting practices required to be followed by legislation, and accounting practices contained in codes of practice, the legislative provisions are to be regarded as the proper practices.
- 3.4 These regulations are subject to the negative resolution procedure by virtue of section 123(6) of the 2003 Act, read with paragraph 34 of Schedule 11 of the Government of Wales Act 2006.

4. Purpose and intended effect of the legislation

- 4.1 These regulations insert a new regulation 24L into the 2003 Regulations. New regulation 24L makes provision about the accounting treatment that applies to local authority infrastructure assets. Infrastructure assets are a class of asset held by local authorities to provide infrastructure for the delivery of public services. The Code defines infrastructure assets as “inalienable assets, expenditure on which is only recoverable by continued use of the asset created, that is there is no prospect of sale or alternative use. Examples include highways, structural maintenance of highways, footpaths, bridges, permanent ways, coastal defences, water supply and drainage systems”.
- 4.2 These regulations provide that where a local authority replaces a component of an infrastructure asset that it owns, it must either determine that the replaced component has a value of nil and therefore that there is no requirement to remove any amount from its balance sheet in respect of the disposal of that component, or it must account for

the asset in line with the accounting practice in the Code. Where an authority determines a value of nil, the regulations require the authority to disclose this in its statement of accounts. These regulations apply to local authority statements of accounts prepared in accordance with regulation 8 of the Accounts and Audit (Wales) Regulations 2014 for the year beginning 1 April 2021 up to and including statements of accounts produced for the financial year ending 31 March 2025. As this provision will be contained in legislation, it will take precedence over any conflicting accounting practice contained in a code of practice or other document identified by the Welsh Ministers.

- 4.3 Until 2022, the accounting treatment of infrastructure assets has not generally been an issue. There has, however, been increased scrutiny of the audits of local authority accounts in recent years, particularly on the accounting for property, plant and equipment. As a consequence, there is an increased requirement for local authorities to provide auditors with evidence in respect of infrastructure assets, specifically in terms of how the replacement of a component of an infrastructure asset is accounted for. In accordance with proper practices, when a component of an infrastructure asset is replaced, an amount representing the remaining value of the replaced component should be removed (derecognised) from the balance sheet. This may be nil if there is no residual value.
- 4.4 The issue is that, due to significant historical information deficits, many authorities are unable to provide sufficient evidence of the value of replaced components of infrastructure assets when they are derecognised. This is particularly the case in relation to roads. Some of these issues date back to 1994, when these assets were first brought onto local government balance sheets. Furthermore, the reporting requirements have not been consistent over time: it is only since 2010/11 that the Code has required all replacement costs to be capitalised and replaced components to be derecognised.
- 4.5 This issue has contributed to delays in the completion of 2021-22 local authority audits as both local authorities and auditors have sought a resolution. Without resolution, there is a significant risk that many local authority financial statements could be subject to qualified audit opinions in this area, whereby the auditor is unable to give an opinion that the accounts are not misstated. It is anticipated that this may also lead to delays to future audits.
- 4.6 The issue is not deemed to impact the interpretation of the accounts but a qualification could be detrimental to a local authorities reputations. Widespread qualifications could undermine the value of local authority accounts as part of the financial accountability and transparency of local authority services and expenditure. A qualification on this minor technical matter for all/ the majority of local authorities runs the risk of reducing the gravity of future qualifications and undermining the audit framework.

4.7 In response, CIPFA attempted to implement changes to the Code to provide a temporary dispensation on the reporting requirements for infrastructure assets. Despite every effort being made to find a solution through the Code, a solution has not been found that satisfies all stakeholders. To avoid the widespread qualification of local authority accounts for these financial years, Welsh Ministers are putting in place a statutory override to allow local authorities to treat the value of any replaced component of infrastructure assets as nil, without the need to provide further evidence that this is the case. This instrument also provides that historic infrastructure asset balances will not require further adjustment. This is in keeping with historic practices, where authorities derecognise infrastructure components at nil on the basis that an authority would not replace an asset unless it was at the end of its useful life. However, for reasons set out, without the statutory accounting provision there are likely to be a significant number of qualified accounts and further delays to audit completion.

4.8 The Welsh Government recognises that a long-term solution is needed that addresses the underlying issues. This is, however, a complex issue that will take both time and resources to fully address. Therefore, the override is provided on a temporary basis as an isolated measure to mitigate the risks of widespread accounts qualifications and delays to audit completion.

5. Consultation

5.1 CIPFA issued its urgent consultation on temporary changes to the code to resolve infrastructure assets reporting issues on 12 May 2022, [Urgent Infrastructure Assets Task and Finish Group | CIPFA](#) which closed on 14 June 2022; the timescale reflected the urgency of the matter. The consultation tested proposed accounting solutions to address the issues raised by auditors with respect to the derecognition of infrastructure assets. In total, 83 stakeholders responded. CIPFA's update on the response notes that while there was support for a solution, there were varying views on how the Code changes should be implemented. Based on the consultation response, CIPFA developed a temporary solution with two substantive elements: the first related to the disclosure of certain balances relating to infrastructure assets, and the second involved enabling authorities to derecognise replaced components of infrastructure assets at nil value. Stakeholders have agreed for the first element to be implemented through the Code, but not the second element, which is being addressed through the regulations.

5.2 Given the technical nature of these changes no public consultation has been undertaken by Welsh Government. However the Welsh Government has consulted with local authority treasurers, Welsh Local Government

Association, CIPFA and Audit Wales to draw on their specialist expertise in drafting the technical amendments and to ensure that the instrument meets its intended purposes. Those that the Welsh Government has spoken to have been supportive of both the principle and form of the accounting treatment set out in this instrument.

6. Regulatory Impact Assessment (RIA)

- 6.1 As this instrument makes a technical amendment to the proper practices for local authority accounting for a time limited period only, which maintains the historical treatment of infrastructure assets, and the amendments do not alter the impact to the readers of the accounts in any significant way an RIA is not required.
- 6.2 Due to the technical nature and limited impact of the regulations no IIA has been produced as there will be no impacts for any of the assessment areas.