

EXPLANATORY MEMORANDUM & REGULATORY IMPACT ASSESSMENT FRAMEWORK

Explanatory Memorandum to - The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2008

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 so that local authorities can mitigate the revenue consequences of complying with new accounting standards. Additionally it will substitute, the regulation that requires a detailed calculation of Minimum Revenue Provision ("MRP"), being a calculation that provides an amount to be set aside each year as a provision to repay debt, with a simple requirement to calculate an amount of MRP which the local authority considers to be prudent and this is supported by statutory guidance that local authorities should have regard to in this matter.

(ii) Matters of special interest to the Subordinate Legislation Committee

None.

(iii) Legislative Background

Sections 9 and 21 of the Local Government Act 2003 (the "2003 Act") provide 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 9 and 21 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

The introduction of new accounting standards with effect from the 2007-08 financial year, would have led to significant additional revenue costs for local authorities on implementation of these standards. Changes brought in last year via the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2007 sought to mitigate the impact of these costs. Three further changes are now brought forward to achieve more consistently the objective of mitigating the impact mentioned above. One of the changes, Early Repayment of Loans, corrects a drafting error from the previous amending regulations. The other two changes, interest on Stepped Interest Rate Loans and Financial Guarantees given by local authorities to third parties, would also in particular situations lead to additional revenue costs which are mitigated by these Regulations.

The regulation that defines how MRP is calculated is amended and replaced with a requirement that enables a local authority to calculate what it feels is a prudent amount of MRP. The current MRP calculation is not sufficiently flexible to allow local authorities to consider a wider range of capital schemes. This amendment, underpinned with statutory guidance, will provide additional flexibilities.

(v) Implementation.

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

In terms of those changes relating to the mitigation of the impact of complying with accounting changes, there will be revenue consequence for the majority of local authorities in Wales.

Not introducing the regulation regarding a different approach to calculating MRP 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.

(vi) Consultation

A consultation on policy intentions, draft regulations and supporting statutory guidance was undertaken over the period 18 January 2008 to 18 February 2008. Details of the Regulatory Impact Assessment is shown below.

(vii) Regulatory Impact Assessment

a) Options

Do nothing – In respect of those regulations which address mitigating the revenue consequences of complying with the new accounting standards, this option is likely to require local authorities to find additional revenue resources to comply. This could be achieved by reducing services, seeking to raise revenue via council tax increases or perhaps increasing fees and charges for delivering services.

The status quo, regarding calculation of MRP, would deprive those authorities who wished to take up the additional flexibilities offered of innovation in terms of future capital programmes and projects. Whilst the existing method of calculating MRP is now well established, it can to an extent constrain innovation.

Implement amending regulations – This option will assist local authorities in mitigating the revenue impact of compliance and additionally give them more scope in calculating the MRP. This could

lead to benefits in terms of more effective and innovative capital programmes bring developed in the future.

b) Benefits

The benefits arising from this legislation will accrue to local authorities and indirectly Council Tax payers. Implementation should ensure most authorities will not need to find additional revenue resources to fund compliance with the above mentioned accounting standards. One reasonable estimate of the additional cost to local authorities for the Stepped Interest Rate amendment would be a one off revenue charge of £2m. The costs for not being able to bring forward the Loan and Guarantees amendments have not been calculated but could be reasonably substantial.

The changes to MRP offer additional flexibilities to local authorities. The regulation allows local authorities to decide on their own prudent assessment of how to calculate MRP. This is supported by various options contained in statutory guidance to which local authorities should have regard. The guidance provides a framework within which they can operate or even, if relevant and justifiable, some other method may be justified and a more appropriate method deployed. In the latter instance this would need to be agreed with their external auditor as being sustainable, affordable and prudent in the circumstances.

c) Costs

The proposed amendments will not result in additional costs to the Welsh Assembly Government. There are likely to be some modest resource implications associated with changes to the methodology for calculating MRP. This would likely be by way of some additional spreadsheet work by the local authority finance staff. Reference to these “costs” has been highlighted by a number of consultation responders who are generally not in favour of the change, but no specific value has been put on the input required to set up and maintain the spreadsheets. It should be noted that the responders who welcomed or supported the proposals did not comment on any perceived additional costs. It is assumed that they feel the additional administration is outweighed by the benefits likely to accrue. Officials own desk based research on the initial set up of spreadsheets indicated that the resource effort required to set up to adopt the new methodology was not substantial.

d) Competition Assessment

This is not applicable to these regulations.

e) **Consultation**

A one month consultation on the policy, Regulations and supporting guidance was undertaken 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 21/2/08. There were 16 replies received, mainly from local authorities, by the closing date. The responses fall into two main areas a) technical changes related to Loans and Guarantees and b) minor changes to the calculation of MRP.

In respect of a) universally the responses supported changes regarding Loans and Guarantees. The only substantive exception being Wales Audit Office (WAO) who thought the suggested amendment on stepped interest rate loans could apply a stricter interpretation leading to more revenue charge and less mitigation. It was accepted by WAO that they, like local authorities, are bound by regulations in force however occasionally problems can arise in interpretation of regulations and accounting standards, which is at the heart of the need for this regulation. It arises as some Local Authorities took out stepped interest rate loans, in good faith and accounted for them in a way they thought correctly reflected accounting standards. These decisions were accepted by their External Auditors at the time. It therefore would be unfair now to penalise these authorities, hence the regulations framed as they are. 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.

In respect of b) opinion was divided. Nine authorities welcomed or were supportive of the MRP changes. Some of these had minor reservations or some specific questions or one off suggestions. Of the balance of respondents (7) that were not supportive, a number had qualified views mainly around additional record keeping, timing of implementation and / or transitional arrangements. On balance the positive responses outweighed the negative and of the unsupportive responses many matters raised will be addressed by clarification within the statutory guidance and in monitoring the situation in practice and possibly revisiting the guidance during the transition period.

f) **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.

The statutory guidance for MRP provides for a transitional period during 2007-08 and 2008-09 where the existing method of calculating MRP can still be followed. Over the coming 12 month period Officials will monitor the practical implications of the introducing the new

method for calculating MRP and can make further charges if necessary to the guidance.

g) **Summary**

The 2008 amending regulations are necessary so that certain aspects of the current regulatory framework are amended in line with policy intent. The effect of compliance with the new accounting standard would have a disproportionate impact on local authorities' ability to operate effectively and likely require significant amounts of revenue resources to fund.

The change related to the calculation of MRP, being a calculation that provides an amount to be set aside each year as a provision to repay debt, should assist local authorities in setting and effectively paying for capital programmes and projects.

Summary of consultation responses

Respondent / Date rec'd	Summary of Consultation responses – changes to Local Authorities (Capital Finance and Accounting) (Wales) Regulations (Wales) 2003
Bridgend CBC – 28/1/08	Regulations broadly welcomed by the LA. One minor suggestion made to amend the MRP guidance which has been taken on board. Stepped Interest Loans – this authority reached agreement with their external auditor on Stepped Interest rate loans in 2005 (and going forward) and wanted to know if the regulation could be extended to unwind transactions from 3 years ago.
Conwy CBC – 4/2/08	Welcome the changes to mitigate the impacts on revenue account related to existing “Stepped loans” and Guarantees. Sensible approach to replacing Regulation with simpler guidance to calculate MRP – this de-mystifies the calculation. Some of the suggested options in the guidance may not suit Conwy currently.
Mid & West Wales Fire and Rescue Service – 4/02/08	Regulation changes for loans and guarantees are supported: One exception being stepped loans which the respondent felt should be delayed to allow for budget setting to take account of this proposal (To Note – this change was flagged up in Feb 2007 – not to proceed now would in fact lead to a significant hit on revenue resources for a number of authorities in this financial year). MRP Changes not supported: General <ul style="list-style-type: none"> ▪ Request extension to transitional arrangements. ▪ Additional work and administration / record keeping. ▪ Feel that linking specific assets to financing goes against good treasury management principles. Specific – FRA’s (in particular Mid Wales), unlike Unitary LA’s, have no supported borrowing paid to them as part of the RSG – Capital funding is paid as Grant. They have mainly short life assets and will need to follow Options 3 & 4 from the MRP guidance leading to higher MRP charges.
Butlers – Treasury Management Consultants – 6/02/08	Supportive of the changes suggested to in the draft regulations. <ul style="list-style-type: none"> ▪ In respect of the MRP guidance a number of suggestions were put forward to make the guidance clearer. Most have been reflected in updated guidance. ▪ Stepped Loans regulations – supportive. Wondered if they could go further and allow for some authorities who, following discussion with their auditors, charged additional revenue on stepped loans in line with a particular interpretation of the accounting requirements. See Bridgend CBC comment above.
Ceredigion CC – 4/2/08	Proposals are acceptable. Raised one exception: - requested that where capitalisation directions are given the MRP calculation be based on 20 and not 25 years. This would help when they came to request a direction for equal pay compensation payments.
Swansea City & CBC - 5/2/08	Most of the changes are supported the exception the MRP guidance. Proposals for introducing simplification and additional flexibilities to the calculation and charging of MRP are not supported at this time. In particular:- <ul style="list-style-type: none"> • Consider the existing system has worked successfully and to change it would be precipitate – not persuaded as to the

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	<p>argument to change;</p> <ul style="list-style-type: none"> • Would like more time to consider the ramifications; • Would incur additional administration burdens on staff to introduce. • The new guidance may lead to some manipulation of the methodology – in particular by allowing application of the existing method to Assembly supported capital expenditure.
CIPFA / IPF (composite response from feedback from IPF events across England / Wales)	<p>Generally positive response to the legislation for MRP calculation being replaced with statutory guidance. Concerns expressed:-</p> <ul style="list-style-type: none"> ▪ Some concerns over additional administration. ▪ Option 4 (using proper depreciation accounting) may be too complicated for many authorities leaving Options 1-3 as the more viable options. ▪ Some general comments as to improving the clarity of the guidance.
Arlingclose – Treasury Management consultants – 13/2/08	<p>Supports the proposals.</p> <p>Stepped Interest Rate Loans:-</p> <ul style="list-style-type: none"> ▪ It would be helpful if it were clear that in applying the choice to deploy this amended regulation it should be clear that this is applied consistently over the remaining life of the loan. ▪ Understands why the Assembly has proposed the change – i.e. to mitigate the impact on Council Tax for those authorise who have interpreted and been allowed to treated these loans in this way. However, questions could similar mitigating regulations be brought in similar circumstance (i.e. thin end of the wedge). <p>Welcome the introduction of the statutory MRP guidance. This will address difficulties that existed in the current formula basis for calculating MRP.</p> <p>Support the timing of introduction i.e. available from the 2007-08 financial year.</p> <p>Support the additional option of an Annuity based approach in Option 3 which will provide a clear and simple basis for charging MRP.</p>
Carmarthenshire CC – 14/2/08	<p>Welcome all of the proposals – one minor suggestion:-</p> <p>Stepped Loans – maybe a little unfair on any LA that has followed the perceived correct approach and is not subject to additional revenue charges to comply with the new SORP requirements. Suggestion that a backdate change to allow any affected LA's to benefit.</p>
North Wales Police – 14/2/08	<p>Support the principles of the guidance – would like a delay of 12 months to consider the implications.</p> <p>NW Police have been following Option 3 for short life assets anyway for a number of years.</p> <p>Raised additional question about defining asset lives (which are required to undertake the calculation). Wondered if the using Option 4 would depreciation polices need to be aligned?</p>
Wales Audit Office – 15/2/08	<p>WAO consider the MRP guidance as written is contradictory in respect of defining how to calculate a Prudent amount of MRP. They acknowledge in their response some helpful comments from CIPFA for adjusting the wording in the guidance which</p>

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	<p>would address the issue they have raised. Additionally, there are a number of other helpful suggestions made to clarify the content of the guidance.</p> <p>The amendment regulation on Stepped Interest rate loans is not supported. It is acknowledged that some authorities, due to ambiguity in the SORP prior to 2007-08, have these loans and would impact significantly their revenue accounts if this regulation does not come in. WAO suggest that the regulation could be changed to simply allow authorities impacted not to charge a higher rate of interest going back to the start of the loan but suggest that they should move to the more correct way of accounting, involving some revenue consequences, going forward.</p>
Wrexham CBC – 18/2/08	<p>Welcome the additional flexibility for MRP.</p> <p>Particularly support the additional option of calculating MRP on an annuity basis.</p> <p>A couple of suggested amendments to the wording of the guidance also made, most have been accommodated.</p>
RCT – 18/2/08	<p>Support loans and guarantees changes to regulations. Requested that for guarantees that it would be helpful if the effective date could be changed from 21 January 2008 to 31 March 2008.</p> <p>A number of specific comments on introduction of MRP guidance:-</p> <ul style="list-style-type: none"> ▪ Timing – would prefer a longer period to consider the implications. ▪ Transitional arrangements will not apply to MRP calculation in 2009-10. Due to the setting of forward capital programmes it is suggested that may impact decisions made in 2007-08 i.e. impact the rolling medium term capital programme. ▪ Additional administrative burden. ▪ Request for more clarity on a number of points in the guidance. ▪ Question as to the linking of financing to specific assets – does this go against best practise?
Flintshire County Council – 18/2/08	<p>Proposals for loans; stepped interest rate loans and guarantees are essential in mitigating the impact of FRS26 and are fully welcomed.</p> <p>MRP calculations:-</p> <ul style="list-style-type: none"> ▪ A welcomed benefit will be the clarity provided for future capital financing requirements. ▪ Would like the guidance extend to Housing MRP. ▪ Cautious welcome to option 3: helpful for assets up to 50 years asset life – but with MRP reduced for assets with a life over 50 years – would this be prudent/ <p>Annuity method – may be helpful for certain leased assets.</p>
Cardiff City & Council – 18/02/08	<p>No comments received on the loans and guarantees.</p> <p>Welcome the introduction of guidance for MRP – but suggest further flexibility, including simply allowing the Chief Finance Officer deciding on the level of MRP based on that officer's judgement.</p> <p>A number of detailed points as to the guidance and procedure itself:-</p>

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	<ul style="list-style-type: none"> ▪ Timing: would like the transitional guidance to be applicable for calculating MRP in 2009-10. ▪ Suggest that the guidance on linking financing to particular asset types may go against the CIPFA prudential code. ▪ Additional record keeping and administration may result from the introduction of the guidance. ▪ Existing system is a concept familiar to practitioners. This calculates the “minimum” amount of MRP that has to be charged to revenue (4% on Ono-housing assets) – Cardiff in fact usually charges up to 5% each year. ▪ Wondered if the guidance could be expanded to pick up on Housing Assets. ▪ Request more guidance on using the “Annuity Method” of calculating MRP under option 3.
Gwynedd CC – 18/2/08	<p>Support Swansea’s view – accept changes in respect of loans and guarantees.</p> <p>MRP calculation:-</p> <ul style="list-style-type: none"> ▪ Is there a need for change – what is the problem? ▪ Additional bureaucracy would be created. ▪ Need more time to assess the practical consequences of introduction.
Closing Date 18/2/08	Additional comments received after the closing date for consultation responses.
Monmouth CC – 21/2/08	<p>MRP – Support the underlying proposals – they could allow some capital schemes to go-ahead which may not otherwise due to prohibitively high MRP calculated under existing regulations. Some concerns:-</p> <ul style="list-style-type: none"> ▪ Additional record keeping may be an administrative burden. ▪ Questions whether some authorities may manipulate the guidelines to minimise, possibly imprudently, the amount of MRP charged. This particularly it is suggested could take place if implementation was delayed. ▪ Timescales – suggests that transitional protection could be allowed to extend further to allow the impact of implementation to be assessed further. ▪ Some suggestions made to allow further flexibility within the guidelines. <p>Support other amendments in the regulations regarding loans and guarantees. One comment on the date for implementation of transitional protect regarding Stepped Loans. Suggested that the implementation date should be moved from 21/1/08 (date flagged up formally) to 31/3/08.</p>
South Wales Fire and Rescue Authority– 21/02/08	<p>Comments on MRP changes only.</p> <ul style="list-style-type: none"> ▪ As Fire and Rescue Authorities have no “Supported Borrowing” provide from the Assembly as part of the settlement, they will not be able to use Options 1 or 2. This could lead to higher amounts of MRP being charged. This appears unfair in relation to Unitary authorities who do get “Supported Borrowing” and can use Option 1 and 2 to calculate MRP on this. ▪ Changes to the method for calculating MRP will add an additional complexity to the process and hinder understanding

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	<p>for members and officials.</p> <ul style="list-style-type: none"> ▪ The guideline goes against current practise that does not match borrowing to specific assets. ▪ Timescales – as the guidelines apply from 2007-08 they will have resource implications for the authority. <p>Suggest that Options 1 and 2 also be made available to FRA's</p>
Powys cc - 21/2/08	<p>Generally supportive - Appreciates the opportunity to defer MRP until assets are operational - may be a factor in determining the short-term affordability of schemes which have long term benefits.</p> <p>Some concerns as follows:-</p> <ul style="list-style-type: none"> • Allocating specific assets to particular borrowing goes against best practise. • Additional work in keeping spreadsheets – whilst this may be relatively straightforward initially, this may become gradually more complex as each year passes.