



Ministry of Housing,
Communities &
Local Government

Local authority budget setting: mitigating the impact of fair value movements on pooled investment funds

Summary of consultation responses and Government response



© Crown copyright, 2018

Copyright in the typographical arrangement rests with the Crown.

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/version/3/>

This document/publication is also available on our website at www.gov.uk/mhclg

If you have any enquiries regarding this document/publication, complete the form at <http://forms.communities.gov.uk/> or write to us at:

Ministry of Housing, Communities and Local Government
Fry Building
2 Marsham Street
London
SW1P 4DF
Telephone: 030 3444 0000

For all our latest news and updates follow us on Twitter: <https://twitter.com/mhclg>

November 2018

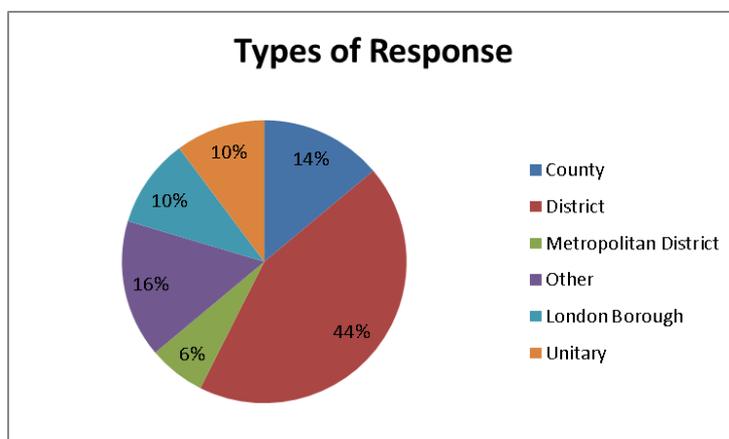
ISBN: 978-1-4098-5358-9

Contents

Introduction	4
Summary of Responses	6
Draft Regulations	10

Introduction

1. The Ministry of Housing, Communities and Local Government has policy responsibility for local authority accounting. In practice, under Regulation 31(a) of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* the Chartered Institute for Public Finance and Accountancy (CIPFA) has responsibility for setting 'proper practices' for local authority accounting.
2. Under the Regulations, local authorities must follow CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom, as amended or reissued, as a code of practice containing proper accounting practices. This Statutory Code is reissued in every financial year. The code applies only to principal authorities.
3. The Government can modify local authorities' duties to follow the proper practices as set out in the Code on Local Authority Accounting, by including specific provisions in the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003*.
4. The Government regularly reviews all new accounting standards and how these have been introduced into proper practices, to see if any new statutory overrides are necessary. However, statutory overrides are only normally introduced by the Government in strictly limited circumstances where they are absolutely necessary. The Government is conscious that each new statutory override introduced means that local authority accounts will differ from accounts prepared by other entities reducing their transparency and comparability.
5. Local authorities previously made representations to Government, raising concerns that some of the provisions in IFRS 9 *Financial Instruments* will have negative impacts. We therefore consulted on potential mitigations to those provisions.
6. The consultation lasted from 25th July to 28th September 2018, and we received a total of 107 responses. In addition we also received the outcome of the consultation that formed part of an annual survey run by the website www.room151.co.uk. The Government has noted the views expressed in response to this survey but it does not directly form part of the summary of responses below.



7. All responses have been taken into consideration when deciding what action should be taken regarding this topic. As this document is a summary of responses it does not attempt to capture all views that were shared as part of the consultation.
8. Having considered the consultation responses the Government intends to:
 - Require local authorities to account for fair value movements in financial instruments in accordance with proper practices as set out in the Code on Local Authority Accounting published by CIPFA.
 - Introduce a mandatory statutory override requiring local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from financial year commencing 1 April 2018
 - Extend the proposed period for which the statutory override applies to five years. The Government will keep use of the override under review.
 - Require Local Authorities to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override
 - Introduce a 2 year extension of the unequal pay regulation.
9. There will be no override for the expected loss model or for the extra disclosures that the new standard requires.
10. These changes are reflected in the draft Regulations, attached to the end of this document.
11. Below is a summary analysis of the responses received in response to the consultation.

Summary of Responses

Q1. Do you agree that local authorities should be allowed to reverse out the impact of fair value movements on pooled investment funds to unusable reserves? If not, why not and what alternative approach would you propose?

12. All 107 respondents to the consultation gave an answer to question one. Overwhelmingly 99% of respondents gave the opinion that local authorities should be able to reverse out the fair value movements relating to pooled investment funds.
13. Respondents had consideration for the value of ensuring that local authority accounts are prepared in accordance with IFRS 9 to meet the IASB's objectives of improving financial reporting.
14. A large number of responses mentioned that if the statutory override was not implemented there would be increased volatility from valuations which would have an impact on local authorities when the balanced budget requirement is considered. This could therefore result in potential burdens on the council tax payer or it could have impacts on service provision or on usable reserve levels year on year as a result of the increased volatility experienced by the fair value movements of the pooled investment funds.
15. Responses also stated that if a statutory override was not implemented this would lead to local authorities divesting from their pooled investments and investing more in direct property purchases where fair value movements will still be reversed out. The Government acknowledges this point but also sees a clear difference between the two types of investment, one being a financial asset and the other being a tangible asset. Often, but not always there is a distinction in their function. Pooled investments are widely held for treasury management purposes with direct property purchases being held solely to earn rental income or for capital appreciation or both.
16. The Public Accounts Committee recommendation has also been considered in conjunction with the consultation. In the report that was published on July 4th 2018 there was a specific recommendation that the Government should produce a statutory override to ensure that IFRS 9 did not have 'any distorting effect on local government financial management'¹.
17. Considering all of this the Government has decided to introduce a statutory override. Local authorities will be required to account for financial instruments in accordance with proper practices. To mitigate the impact of fair value movements on the balanced budget requirement they will be required to reverse out the unrealised fair value movements of pooled investment funds from profit/loss to an unusable reserve. This statutory override will be mandatory and

¹ Public Accounts Committee - Financial Sustainability of Local Authorities

will apply to both the losses and the gains that would otherwise impact on the revenue account under the new financial standard.

Q2. Do you agree that the statutory override should be time limited? If not, why not? If it is time limited, is a three year period appropriate?

18. This question was answered by all respondents to the consultation, often with views that were expressed in conjunction with question 1. Around 90% of respondents answered that the proposed override should not be time limited. The majority of responses stated that the reasons for introducing the override would still be relevant at the end of the 3 year period. This included the volatility of general fund balances still having an impact on the budget setting process, on service provision and reserve levels when the time limited override ends.
19. Other responses indicated that if there was to be a time limit on the override it should be for a period longer than 3 years because a 3 year period would coincide with funding arrangement changes for local government. As well as this respondents commented that pooled investments are often medium term investments and therefore a statutory override that mirrors that time period would be more suitable.
20. Having considered the responses received the Government has decided to extend the period of the statutory override to 5 years instead of the 3 years which was initially proposed in the consultation. This will give local authorities the assurance that is needed in their medium term financial planning whilst also allowing time to consider investment strategies.
21. The Government does not see the case for issuing an initial statutory override that has no time limit. This is because it would result in a permanent deviation from normal accounting practices which would add another level of complexity to local government accounts. However, the Government also recognises the vast majority of respondents had concerns over the possibility of any time limit being imposed at all. Therefore, the Government will keep use of the override and the impact of allowing it to lapse on balanced budget calculations under review.

Q3. If you agree that local authorities should be allowed to reverse out the impact of fair value movements on pooled investment funds should this be limited to pooled property funds or apply to all pooled investment funds, and why?

22. Around 90% of responses to the consultation answered that the reversal of fair value movements should apply to all pooled investment funds as opposed to just pooled property funds. A need for consistent treatment of different types of pooled investments was often mentioned as a key reason in this answer.
23. Some respondents acknowledged that the statutory override would be most applicable to pooled property funds which, by their nature, experience more short term volatility in valuation than other short dated pooled investments such as money market funds.

24. The Government does not wish to directly influence investment decisions and recognises comments which stated that if the override was to apply to only pooled property investments it could have an unintentional impact of incentivising this type of pooled investment over others.
25. Considering this the Government has decided to implement the statutory override to all pooled investments that local authorities hold. This is consistent with the view that the Government does not wish, through a statutory override, to influence investment decisions that are made at a local level.

Q4. Do you agree that local authorities should be required to disclose the net profit/loss reversed out of the general fund to mitigate the impact of the introduction of IFRS 9, as a separate line in the Unusable Reserves note? If not, please explain why not and detail the alternative approach you would prefer.

26. Just under 60% of respondents agreed that there should be a separate line introduced in unusable reserves to disclose the net profit/loss. The majority of the responses that disagreed suggested that the Financial Instruments Adjustment Account would be an appropriate reserve for this disclosure.
27. Having considered this, the Government will require local authorities to disclose the fair value movements as a separate line item in reserves. The Government believes that this will enhance transparency. It will also make it easier for the Government to keep use of the override under review without requesting additional information from local authorities.

Q5. Do you agree that the Government should not create a statutory override to protect local authorities from the impact of the move to an expected loss model to calculate impairments on loans and debt? If you disagree please explain why with case study examples if relevant.

28. Around 90% of responses agreed that the Government should not introduce a statutory override in relation to the expected loss model on loan and debt impairment. Responses recognised that it is prudent to make provision for expected loss and is something that would already be covered with a bad debt provision. In other cases respondents noted that some loans would be classed as capital expenditure and would therefore not impact on the revenue budget setting process.
29. In light of these responses the Government will not be creating a statutory override for this element of the new IFRS 9 standard. This reaffirms the position that was previously set out in the consultation that local authorities who will be required to recognise substantial impairments will have taken deliberate decisions to take on a more risky loan book and it is right that they recognise the potential costs of that strategy.

Q6. Do you agree that the Government should not create a statutory override for any of the disclosure requirements introduced by the new standard?

30. The majority of consultation responses agreed that it would not be necessary to introduce a statutory override for the disclosure requirements that are to be introduced by the new standard. Responses commented that enhanced transparency was important to the accounts produced by local authorities.

31. The Government agrees that no statutory override is necessary.

Q7. Do you agree with the proposal to extend the Regulation allowing local authorities not to charge back-pay awards for equal pay claims for a further two years to 2020? If not, please explain why not.

32. Of those who answered this question responses were split. Where respondents disagreed with the question reasons were mostly that it should be made permanent as opposed to another time limited extension. Therefore, there is wide support for the statutory override to be implemented but the differences resulted over views in how long it should last.

33. The Government will extend the statutory override for another period of 2 years.

Question 8: Do you agree that the updated Regulations should take effect for the 2018-19 financial year and what would be the implications of not doing so?

34. There was a strong consensus in responses that the updated regulations should take effect from the 2018/19 financial year. It is noted that if the regulations were not updated for this financial year there would be a gap in which local authorities would have to comply with the accounting standard when they had not budgeted to do so at the start of the financial year.

35. The Government is aware that a lot of local authorities set their budgets before this financial year without planning for the impacts that IFRS 9 has to the accounting of pooled investments and consequently the general fund.

36. Considering this the Government is making the necessary arrangements to ensure that the updated regulations take effect within the 2018/19 financial year which will mean that, at least for the period of the statutory override, there will not be an impact on the revenue account. This will also mean that the fair value movements relating to pooled investment funds will not have to be factored into the 2019/20 budget setting process which the Government is aware will already be underway for many local authorities. Therefore, hopefully this response will give local authorities the appropriate clarity needed in their medium term financial planning.

2018 No. [DRAFT OF 7 NOVEMBER 2018]

LOCAL GOVERNMENT, ENGLAND

**The Local Authorities (Capital Finance and Accounting) (England)
(Amendment) Regulations 2018**

<i>Made</i>	- - - -	***
<i>Laid before Parliament</i>		***
<i>Coming into force</i>	- -	***

The Secretary of State, in exercise of the powers conferred by sections 21(1) and 123(1) of the Local Government Act 2003(2), makes the following Regulations:

Citation and commencement

—a) These Regulations may be cited as the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2018.

These Regulations come into force on [date] [month] 201•.

Amendment of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003(3) are amended as specified in regulations 3 and 4.

Back payments following unequal pay: further temporary accounting treatment

After regulation 30A insert—

“Back payments following unequal pay – further temporary accounting treatment

30AA.—(1) For the purposes of this regulation—

- (a) a reference to an employee of a local authority (“E”) includes a reference to a former employee, an officer or a former officer of that authority;
- (b) a reference to the contract under which E was or is employed includes a reference to the terms of appointment under which an officer held or holds office; and
- (c) E received unequal pay when the amount of pay E received from the authority for work done by E during a particular period is less than the appropriate amount of pay for that work done during that period.

(2) In this regulation—

(2) 2003 c. 26.

(3) S.I. 2003/3146. Relevant amending instruments are S.I. 2007/573, S.I. 2010/454, and S.I. 2013/476. There are other amending instruments but none is relevant.

“appropriate amount of pay”, in relation to E, means the amount of pay to which E is entitled in accordance with any sex equality clause deemed to be included, by virtue of section 66(1) of the Equality Act 2010⁽⁴⁾, in the contract under which E was or is employed;

“back payment” means a payment of arrears of remuneration made by a local authority, for work—

- (a) done by E;
- (b) in respect of which E received unequal pay; and
- (c) done before E first receives any increase in pay as a result of receiving that unequal pay,

which is paid to E, or part of which is paid to E (“the net payment”) and part of which is paid to another person on behalf of E (“relevant deductions”), because E received unequal pay for that work; and

“social security costs” means any contributions by a local authority to any state social security or pension scheme, fund or arrangement.

(3) Where a local authority—

- (a) is required by an employment tribunal or a court to make a back payment;
- (b) (i) considers that it is probable that an employment tribunal or a court will require it to make a back payment; and
(ii) is able to make a reasonable estimate of the amount of such back payment;
- (c) has reached an agreement or otherwise determined to make a back payment; or
- (d) (i) considers that it is probable that it will reach an agreement or otherwise determine to make a back payment; and
(ii) is able to make a reasonable estimate of the amount of such back payment,

paragraph (4) applies.

(4) Where this paragraph applies, the authority need not charge to a revenue account an amount in respect of—

- (a) the back payment; or
- (b) social security costs or other costs incurred by the authority in relation to that back payment,

until the date on which the authority must pay that back payment, or the net payment, to the employee (as required by the tribunal or court or in accordance with the agreement or determination, as the case may be).

(5) Subject to paragraph (6), this regulation ceases to have effect on 1st April 2020.

(6) Where paragraph (4) applies to an amount, it continues to apply until the date on which the payment is actually made, whether or not the date is on or after 1st April 2020.”.

Fair value gains and losses of pooled investment funds

After regulation 30J insert—

“Fair value gains and losses of pooled investment funds

30K.—(1) In this regulation—

“fair value” means the fair value of an investment as determined in accordance with proper practices;

“fair value gain or loss” means a change in the fair value of an investment;

“pooled investment fund” means—

- (a) a money market fund;

⁽⁴⁾ 2010 c.15.

- (b) a collective investment scheme as defined in section 235(1) of the Financial Services and Markets Act 2000⁽⁵⁾; or
- (c) an investment scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961 (local authority investment schemes)⁽⁶⁾.

(2) Where a local authority—

- (a) invests in a pooled investment fund; and
- (b) a fair value gain or loss experienced on the authority’s investment in that pooled investment fund would otherwise be charged to a revenue account by that local authority in accordance with proper practices,

paragraph (3) applies.

(3) Where this paragraph applies, the authority—

- (a) must not charge to a revenue account an amount in respect of that fair value gain or loss; and
- (b) must charge that amount to an account established, charged and used solely for the purpose of recognising fair value gains and losses in accordance with this regulation.

(4) Paragraph (3) does not apply in respect of—

- (a) an impairment loss in relation to the authority’s investment in a pooled investment fund as recognised in a revenue account of the authority in accordance with proper practices; or
- (b) a sale or other disposal of the whole or any part of the authority’s investment in a pooled investment fund.

(5) This regulation applies in relation to each of the financial years beginning on 1st April 2018, 1st April 2019, 1st April 2020, 1st April 2021 and 1st April 2022.”.

Signed by authority of the Secretary of State for Housing, Communities and Local Government

	<i>Name</i>
	Parliamentary Under Secretary of State
Date	Ministry of Housing, Communities and Local Government

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (the “2003 Regulations”).

Regulation 3 inserts a new regulation 30AA into the 2003 Regulations. New regulation 30AA provides that a local authority need not charge to a revenue account an amount in respect of a payment to be made to an officer or employee (“E”) for work done for which E received unequal pay (where men and women were paid different amounts for similar work despite being entitled to the same amounts by virtue of section 66 of the Equality Act 2010), until the authority pays that amount to E.

Regulation 4 inserts a new regulation 30K into the 2003 Regulations. New regulation 30K provides that a local authority must not charge an amount to its revenue account to reflect any fluctuation in the fair value of a local authority’s investment in a pooled investment fund. Instead, such amounts must be recorded in a separate account established and usable solely for that purpose. The fair value of a local authority investment in a pooled investment fund is determined in accordance with the proper accounting practices which local authorities must follow by virtue of regulation 31 of the 2003 Regulations. This accounting treatment is not to apply to the recognition of an impairment loss to such an investment as recognised

⁽⁵⁾ 2000 c.8.
⁽⁶⁾ 1961 c. 62.

under those proper accounting practices, or to any disposal of such an investment, including a sale. Regulation 30K will apply for the financial years up to and including the financial year beginning on 1st April 2022.

A full regulatory impact assessment has not been produced for this instrument as no impact on the private or voluntary sectors is foreseen.