

CONSULTATION ON THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (WALES) REGULATIONS 2004

Introduction

1. Part 1 of the Local Government Act 2003 contains the primary legislation which enables the Welsh Assembly Government to introduce a new capital finance system (the 'prudential system) for local authorities in Wales. Part 1 of the Act was commenced by the Local Government Act 2003 (Commencement)(Wales) Order 2003 (SI No. 3034 (W.282)) for financial years from 1 April 2004.
2. The National Assembly for Wales approved the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (SI No. 3239 (W.319) on 9 December 2003 and the majority of these regulations come into force on 1 April 2004. However, regulation 2 which contains the requirement for local authorities to use the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities came into force on 31 December 2003 to reflect the fact that local authorities will be making decisions in respect of these limits in the run up to the new financial year.
3. When the Welsh Assembly Government consulted upon these regulations it stated that it would hold a further consultation in respect of the treatment of local authority investments in the new system including consultation as to whether any further regulations would be required to be made.
4. Since the consultation period last September and October discussion has been ongoing with the Welsh Local Government Association (WLGA) and local authorities through the Capital Finance System Task and Finish Group as to the way forward for investments in the new system. The Welsh Assembly Government is currently consulting on these arrangements and one of the proposals is to continue the treatment of share and loan capital as capital expenditure in the new system on the basis that this type of investment is unlikely to meet the criteria discussed in the consultation paper in respect of investments made for treasury management purposes. Investments made of this kind are more likely to be for 'service' purposes related to local authorities powers in respect of social, economic and environmental well-being and it would therefore seem reasonable that authorities should be accountable for these decisions through the capital finance system.
5. In addition to this proposed regulation a number of issues were raised by responses to the consultation on the 2003 regulations in Wales which were worthy of further consideration. However, these either represented new policy or it was simply not possible to include the proposal in the 2003 Regulations in time for regulation 2 to be made and come into force by 31 December 2003.
6. This paper therefore seeks views on the proposed treatment of loan and share capital and the further regulations outlined below.

7. The Welsh Assembly Government welcomes responses on these proposals and will be pleased to receive responses no later than close of business on 9 February 2004. We apologise for the shorter than usual consultation period but unfortunately this will be the maximum possible if the regulations are to come into force on 1 April 2004. Responses should be sent to:

LGF 3

Local Government Finance Division

Welsh Assembly Government

Cathays Park

Cardiff

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Or email LGF3L@wales.gsi.gov.uk

8. If you have any queries on this paper or would like to discuss any of the matters raised please contact Lisa James or Sarah Stacey on 029 20826953 or email the LGF mailbox as above.

9. Respondents should note that the National Assembly for Wales intends to publish the responses to this document. Normally, the name and address (or part of the address) of its author are published along with the response, as this gives credibility to the consultation exercise. If you do not wish to be identified as the author of your response, please state this expressly in writing to us.

Local Authority Investments

10. The Welsh Assembly Government proposes that the purchase of share and loan capital should be treated as capital expenditure in the prudential system. This reflects the probability that these investments are made not for treasury management purposes but to meet the 'service' objectives of local authorities.

11. This could be achieved by designating the acquisition of share or loan capital in any body corporate as capital expenditure by regulation. This replicates the situation under the Local Government and Housing Act 1989 regime.

12. Other investments would not count as capital expenditure and would not need to be charged to revenue or capital. However, if any investment ever appeared to be at risk of loss normal accounting practice would as now require the authority to make a revenue provision of an appropriate amount.

13. To achieve this a regulation could be made to require that the ‘the acquisition of share or loan capital in any body corporate’ is defined and treated as capital expenditure by local authorities. This regulation would also apply to community councils and charter trustees required to prepare their financial statements on the basis of compliance with the Chartered Institute of Public Finance and Accountancy’s (CIPFA’s) Code of Practice on Local Authority Accounting in the United Kingdom, A Statement of Recommended Practice (the SORP).

Variation on Credit Arrangements

14. To avoid any confusion in respect of the transitional treatment of credit arrangements in the new system the Welsh Assembly Government proposes to make a regulation which will clarify the treatment of a credit arrangement which exists on transition later being varied. If the variation requires a fixed asset to be recognised on the local authority’s balance sheet then the credit arrangement becomes a qualifying one. This results in;

a) a requirement for the authority to show the fixed asset on the balance sheet in accordance with proper practice and

b) that from the time of the variation the qualifying credit arrangement should be taken account of in respect of the authority’s affordable borrowing limit.

Other Issues in respect of Credit Arrangements

15. The Welsh Assembly Government has made transitional savings and provisions in respect of the treatment of credit arrangements which are in existence immediately prior to implementation of the new capital finance system on 1 April 2004. These are contained in the commencement order for the Local Government Act 2003 (The Local Government Act 2003 (Commencement Order) (Wales) Order 2003 No. 3034 (W.282)) and the relevant sections are replicated in Annex A.

16. When and if existing credit arrangements are varied their treatment will then be determined by the new regulation proposed above (see paragraph 14) and/or the provisions in the commencement order. However, as this is a complex and technical area of the current system, the Welsh Assembly Government would like to ask the question as to whether interested parties feel there is a need for any further transitional savings and provisions in respect of existing credit arrangements and their treatment in the new system and if so what should they be?

Loans by Community Councils and their repayment

17. The Welsh Assembly Government proposes to make regulations to clarify that the making of loans by community councils and charter trustees and their repayment do not constitute capital expenditure nor capital receipts if the loan has been made to a third party for capital expenditure.

Treatment of Leases where the Authority is leasing an asset to a third party

18. The Welsh Assembly Government proposes that the situation where an authority leases assets to a third party in the new capital finance system could benefit from clarification by regulation. A regulation is therefore proposed which would clarify that where an authority is leasing an asset to a third party, whether by finance lease or by operating lease, the amounts received by the authority as part of the arrangement would not be treated as a capital receipt if proper practice requires that they should be credited to a revenue account.

19. It is suggested that this regulation also applies to community councils and charter trustees as above in paragraph 13.

Capital Receipts and the payment of premia

20. Local authorities are reminded that the Local Authority SORP provides proper practice for the accounting treatment of premia and discounts payable and receivable on the early settlement or repurchase of borrowing.

21. However, the Welsh Assembly Government now seeks views as to whether a regulation should provide for the payment of premia in respect of early settlement or repurchase from capital receipts. This would not be a requirement but an additional flexibility.

22. This could be achieved by making a regulation to allow capital receipts to be used 'to pay a premium charged in relation to any amount borrowed'. Authorities are reminded that this regulation would mean that HRA capital receipts could only be applied to pay HRA premia and non-HRA capital receipts to repay non-HRA premia. In reality this would mean that if an authority chose to repay premia from capital receipts it would need to arrive at a suitable HRA/non-HRA split. It is suggested that this regulation should also apply to community councils and charter trustees as per paragraph 13.

Repayment of grant given to the authority for capital purposes

23. The Welsh Assembly Government proposes to make a regulation which would make the repayment of a grant or other financial assistance given to a local authority for the purposes of capital expenditure, capital expenditure itself. This replicates the 1989 Act system and allows authorities additional flexibility to make these repayments out of capital or revenue resources.

24. This would be achieved by making a regulation to make 'the repayment of any grant or other financial assistance given to the local authority for the purposes of expenditure which is capital expenditure' capital expenditure itself.

Capital Expenditure on Assets not owned by the Authority

25. The Welsh Assembly Government proposes making a regulation which makes it clear that an authority may undertake capital expenditure on land or buildings which it does not own. This would be achieved by making a regulation such as ‘expenditure incurred on works to any land or building in which the local authority does not have an interest, which would be capital expenditure if the local authority had an interest in that land or building’.

Minor Wording Changes

26. The Welsh Assembly Government suggests that the words ‘as amended from time to time’ should be inserted in respect of all of the codes of practice referred to in Regulation 25. This will ensure there is no confusion that proper practice is constituted by the current version of these codes not the version of the code in print when the regulations were made.

Supplementary Credit Approvals issued under Regulation 136 of the Local Authorities (Capital Finance) Regulations 1997

27. These supplementary credit approvals can be amortised over a maximum period of seven years. The Welsh Assembly Government suggests that a regulation should be made which allows this amortisation to continue after commencement of the new system as an amount in addition to the Minimum Revenue Provision required to be charged by the 2003 Regulations.

Community Councils

28. Certain Sections of Part 1 of the Local Government Act 2003 include community councils and charter trustees in the definition of a local authority. These are set out in Section 19 as follows:

‘Application to parish and community councils

(1) In sections 2(3) and (4) (borrowing must be in sterling unless the consent of the Treasury is received), 6 (protection of lenders), 9 to 13 (capital receipts, non-money receipts, use of capital receipts, power to invest, security for money borrowed), 15 (Guidance), 16 (capital expenditure), 17(1)(a), (b) and (d) to (f) and (2) (external funds) and 18 (local authority companies) references to a local authority include a parish council, a community council and charter trustees.

(2) Schedule 1 (which makes provision about capital finance in relation to parish and community councils and charter trustees) has effect.

(3) The appropriate person may by regulations-

(a) apply any of the other provisions of this Chapter to parish or community councils or charter

trustees, or parish or community councils or charter trustees of any description, with or without modifications, and

(b) make any corresponding disapplication of any of the provisions of Schedule 1.’

29. This has implications for those community councils which are required to prepare their financial statements on the basis of proper accounting practice as per the Accounts and Audit Regulations 1996 as many of the regulations made under these sections serve to ‘overwrite’ proper accounting practice. Therefore in order to clarify the application of the 2003 Regulations to community councils and charter trustees the Welsh Assembly Government suggests the following:

30. In respect of the 2003 Capital Finance and Accounting Regulations the following regulations (made under the above sections) should apply to community councils and charter trustees:

1- Name commencement, application and interpretation

6(1) and (2)- Repayment of loan etc to a local authority (but note discussion above in respect of loans)

9(1)- Capital receipts less than £10,000 and 9(3) the aggregate of a capital receipt less than £10,000.

18 (1) and 18(2)(a) and (b) i.e. that capital receipts may only be used to meet capital expenditure and to repay the principal of any amount borrowed.

20- Items to be capital expenditure (see discussion in respect of loans above)

31. Community councils and charter trustees are not liable to charge a minimum revenue provision (MRP) to their revenue account. Their obligations to charge the revenue account for the repayment of borrowing is governed by paragraph 3 of schedule 1 to the Act. However, it is suggested that a regulation be made which allows community councils to finance capital expenditure from revenue in the year it is incurred from 1 April 2004 if it so determines.

32. Regulation 25 of the 2003 Regulations sets out the codes of practice which make up proper practice for section 23 authorities of the 2003 Act. The Welsh Assembly Government could specify proper practice for community councils in a similar way. However, in light of the ongoing consultation on the role and future arrangements of community councils in Wales and developments in respect of an all Wales representative body it is suggested that consultation should take place on this matter in the new financial year.

Local Government Finance Division

Welsh Assembly Government

Extract from The Local Government Act 2003 (Commencement Order) (Wales) Order 2003 No. 3034 (W.282)

Capital Finance - Part 1 of the Act

3. - (1) Any credit arrangement -

(a) within the meaning of section 48 of the **Local Government** and Housing Act 1989 (credit arrangements);

(b) in existence immediately before 1st April 2004; and

(c) which, if it had been entered into on 1st April 2004, would be a credit arrangement within the meaning of section 7 of the Act ("credit arrangements"),

shall be treated as if it were a credit arrangement for the purposes of Chapter 1 of Part 1 of the Act (capital finance etc.).