

## **EXPLANATORY MEMORANDUM**

### **Explanatory Memorandum to the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018**

This Explanatory Memorandum has been prepared by Local Government Finance Policy Division in the Local Government and Communities Department and is laid before the National Assembly for Wales in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

#### **Cabinet Secretary'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 2018.

**Alun Davies**

**Cabinet Secretary for Local Government and Public Services**

9 March 2018

## **i. Description**

This Statutory Instrument amends existing Regulations, the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (“the 2003 Regulations”).

The 2003 Regulations provide the regulatory regime for accounting practices to be followed by a local authority in Wales. They contain detailed provisions for the capital finance and accounting controls, including the rules on the use of capital receipts and what is to be treated as capital expenditure. They also modify accounting practice in various ways to prevent adverse impacts on authorities’ revenue resources.

The Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 (“the Regulations”) make provision in connection with the local government capital finance and accounting regime in Wales. Specifically the 2018 Regulations will relax the current constraints around loan capital transactions, specific share capital transactions and bonds placing local authorities in Wales on an equivalent footing to counterparts in England.

## **ii. Matters of special interest to the Constitutional and Legislative Affairs Committee**

None.

## **iii. Legislative Background**

Under Part 1 of the Local Government Act 2003 (“the 2003 Act”), the Welsh Ministers have power to make provisions in regulations regarding certain aspects of capital finance and accounting rules and practices. The powers are expressed as being those of the Secretary of State, however, section 24 of the 2003 Act provides that in its application to Wales, Part 1 has effect as if for any reference to the Secretary of State there were substituted a reference to the Welsh Ministers.

In particular, the Regulations are made by the Welsh Ministers in exercise of the powers conferred by section 7(2)(b), 8(3), 9(3), 11, 16(2), 21(1) and (2), 24 and 123(1) and (2) of the 2003 Act.

The Regulations are subject to the negative resolution procedure.

## **iv. Purpose and intended effect of the legislation**

The 2003 Regulations contain detailed provisions for the capital finance and accounting controls applicable to local government bodies in Wales, including the rules on the use of capital receipts and what is to be treated as capital expenditure. They also modify accounting practice in various ways to prevent adverse impacts on authorities’ revenue resources.

The Regulations make some important changes:-

### Securitisation Transactions

“Securitisation” as used in this context means the disposal of an interest in an entitlement to future revenues. For example, a landlord receiving rents from properties might transfer the entitlement to that income to a bank for (e.g.) 20 years, in exchange for an immediate lump-sum payment. From a technical accounting viewpoint, securitisation appears to be the sale of an asset (the future revenue stream) and the lump-sum received is the sale proceeds, not borrowed money. But the strategy achieves the same result as borrowing and might be seen as an alternative to it.

Whether any such securitisation transaction would be lawful is a matter for individual authorities to consider, taking account of the precise nature of the contract and of their statutory powers.

The Regulations amend the 2003 Regulations to ensure that, if it is used lawfully by local authorities in Wales, securitisation will be on an equal footing with borrowing and other forms of credit.

In particular, the Regulations inserts a new regulation 2A into the 2003 Regulations. Regulation 2A provides that a securitisation transaction must be treated as a credit arrangement for the purposes of the 2003 Act. Regulation 5 of the 2003 Regulations is also amended to provide that entry into a credit arrangement, in the case of a securitisation transaction, must be treated as the borrowing of an amount equal to the value of the consideration received by the authority as a result of that securitisation transaction.

The Regulations also insert a new regulation 8A into the 2003 Regulations to ensure that the value of any consideration received as a result of a securitisation transaction by a local authority must be treated as a capital receipt.

### Expenditure to be capital expenditure

The Regulations amend the 2003 Regulations to relax the constraint in relation to all loan capital transactions which means that authorities will not incur capital expenditure if they lend to individual companies by means of corporate bonds (or any other similar instrument or arrangement). The relaxation is, of course, not meant as a Welsh Government recommendation on investment practice. Investment decisions remain entirely matters for individual authorities, which need to have regard, both to the Welsh Government investments guidance and to CIPFA’s Treasury Management Code.

Since bond acquisitions will no longer be capital expenditure, the Regulations amend regulation 6 of the 2003 Regulations to ensure that the disposal of or redemption of a bond on maturity will not generate capital receipts. However this will not apply to sums received by a local authority in respect of the redemption on maturity or disposal if the bond was acquired before 1 April 2018 and the expenditure on acquisition was treated as capital expenditure.

The purchase of share capital will continue to be capital expenditure but the Regulations amend regulation 20 of the 2003 Regulations to provide exemptions for shares in collective investment schemes. This will limit the risks associated with investments of share capital by being spread across a number of organisations. This will ensure local authorities in Wales are placed on an equal footing with their English counterparts and have clarity that they are permitted to invest in money market funds, Real Estate Investment Trusts and local authority investment schemes approved by treasury without incurring capital expenditure.

The 2003 Regulations permits a local authority to incur expenditure on works to any land or building, which they do not have an interest in, to be capital expenditure. The changing landscape of local government reform and increased scope for sub-regional working through city deals has highlighted the potential need for this to be extended to include assets other than land and buildings. The draft Regulations insert a new regulation 20(1) (h) into the 2003 Regulations to provide that expenditure incurred on the acquisition, production or construction of assets for use by, or disposal to, a person other the local authority, must be treated as capital expenditure, if it would have been capital expenditure had the assets been acquired, produced or constructed for use by the local authority.

#### Use of capital receipts

The Regulations amend regulation 18 of the 2003 Regulations to remove the requirement that only capital receipts received in respect of a disposal of an interest in non-housing land may be used to meet the costs of its disposal, provided that such costs do not exceed 4% of the capital receipt arising from the disposal. The amendment will avoid any potential practical implications should the disposal costs and capital receipts not occur in the same financial year.

#### Back pay following unequal pay

Regulation 10 extends until 1 April 2020 the ability of local authorities to defer charging liabilities for back pay due to equal pay claims to revenue account until the date on which the local authority must pay that back-payment. This provides that all payments will be paid before 1 April 2020.

#### Proper practices

Regulation 11 removes the reference to one of the documents identified as constituting proper practices for the purposes of section 21 of the Local Government Act 2003.

### **v. Implementation.**

The amendments to the regulations will come into force on 31 March 2018. There are no specific legal ramifications if this legislation is not made.

### **vi. Consultation**

A consultation on the proposed amendments to the 2003 Regulations was undertaken over the period 20 October 2017 to 12 January 2018 with a wide range

of appropriate stakeholders. This included amongst others, all local government bodies in Wales, Wales Audit Office, Welsh Local Government Association, One Voice Wales and the Chartered Institute of Public Finance and Accountancy.

Stakeholders were invited to comment on the proposed 2018 Regulations. In total, 14 responses were received. Responses were received from the following categories of organisations and individuals.

Local Authorities – 6

Community and Town Councils – 4

Others – 4 (including the Auditor General for Wales and the Chartered Institute of Public Finance and Accounting)

A summary of responses can be found at

<https://beta.gov.wales/proposed-amendments-local-authorities-capital-finance-and-accounting-wales-regulations-2003>

As a result of responses, the Welsh Government have revised the draft regulations to extend the definition of money market fund to refer more broadly to collective investment schemes authorised or recognised under Part XVII of the Financial Services and Markets Act 2000.

#### **vii. Regulatory Impact Assessment (RIA)**

A regulatory impact assessment has not been produced for this instrument as the amendments to the Regulations do not create an additional regulatory burden. No impact on business, charities or the voluntary sector is foreseen.

#### **viii. Post implementation review**

The current regulatory framework has been in place since December 2003. Since that time the effectiveness of the system in place has been kept under regular review by the Welsh Government and in regular formal and informal situations with interested stakeholders, examples being Local Authorities, Welsh Local Government Association and Wales Audit Office.

#### **ix. Summary**

The 2018 Regulations will relax the current constraints around loan capital transactions, specific share capital transactions and bonds placing local authorities in Wales on an equivalent footing to counterparts in England.