The Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024

Business and Regulatory Impact Assessment

Scottish Government
Riaghaltas na h-Alba
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Title of Proposal

The Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024

Purpose and intended effect

Background

The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 (the 2016 Regulations) require a local authority to make an annual charge against the revenue of the authority to meet the costs of borrowing, known as 'the statutory repayment of debt' or 'loan fund repayment'. This replaces the requirement of accounting standards for an annual charge for depreciation to be made against revenue, to reflect the declining value of an asset as it is used and to allocate in the annual accounts the original cost of the asset to periods in which the asset is used. (References in this document to "accounting standards" are to International Financial Reporting Standards).

The statutory arrangements are intended to ensure that a local authority sets aside sufficient revenue, in the form of 'loans fund repayments' (the 'statutory repayment of debt'), to meet the costs of capital investment. However, these arrangements have been superseded by advances in accounting standards which have introduced greater rigour to the recognition of such costs. Despite this, the statutory arrangements, which permit far greater flexibility for calculating the charge against revenue than would be permitted by accounting standards, have continued.

The Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024 will amend the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 to address the following financial risks:

Current statutory arrangements allow a local authority to make capital investments that would not be affordable applying accounting standards. The statutory arrangements allow a local authority to defer a substantial proportion of the costs of borrowing to later years, creating a future affordability risk.

There is evidence that the statutory arrangements are being widely interpreted by local authorities as permitting the retrospective restatement of borrowing costs, which was not the intention of the statutory arrangements.

'Retrospective restatement' refers to the practice of reassessing previous borrowing costs charged against revenue in prior years' annual accounts and subsequently reprofiling the repayments to produce a lower cost profile to-date. This allows a local authority to defer a large proportion of the borrowing costs to later years, in order to generate a one-off surplus to reserves and an immediate budget saving for the authority.

The deferred costs (which have previously been charged to tax payers) will result at an increased cost to future Council Tax payers which may not align with the benefits to the community of the capital investment.

Accounting standards do not permit the retrospective restatement of accounting estimates, such as depreciation, already charged in prior years' accounts. Given that loans fund repayments are akin to depreciation and replace depreciation as the charge against revenue in the annual accounts of a local authority it is inconsistent to permit the retrospective restatement of loans fund repayments.

The deferral of borrowing costs to future years creates a significant financial sustainability risk for the local authority as the deferred costs still have to be met in future but has wider implications for the Scottish budget and the future of public services.

There is also evidence that local authorities are retrospectively reprofiling or restating historic borrowing costs as an affordability measure in place of sustainable long term financial plans.

A local authority is required to assess the affordability of borrowing at the time of the capital investment, in accordance with the Prudential Code for Capital Finance in Local Authorities. A variation to the pattern of charges for borrowing should only be undertaken to better align the repayment period with the period and pattern of benefits to the community, not as an affordability measure.

Objectives

There is evidence that Local authorities in Scotland are interpreting the flexibility of the statutory framework as permitting the reversal of borrowing costs which have already been incurred (and passed on to council tax payers) and that, under international accounting standards, would be required to be recognised in the current financial year. Local authorities are also using the flexibility of the statutory framework to then defer the reversed costs to future financial years in order to make further borrowing appear more affordable and to generate one-off reserves for use towards budget pressures, in place of sustainable, long-term financial strategies. This approach introduces serious affordability risks in the medium to longer term.

Rationale for Government Intervention

Disproportionate borrowing and failure to make adequate provision from revenue to meet the costs of borrowing have been a significant cause of financial failure in England. The Department for Levelling Up, Housing and Communities has made significant improvements to the equivalent statutory arrangements in England and Wales to address the financial sustainability risks of these practices and to specifically prohibit the accounting practices which continue to be adopted in Scotland. The amendments to the 2016 Regulations will bring alignment with the measures introduced for England and Wales.

The statutory framework must ensure a transparent and prudent approach to financing capital investment, ensure an equitable charge to Council Tax payers for that investment and incorporate the right balance of flexibility and financial controls to support local authorities to be financially sustainable whilst requiring fiscal prudence in order to protect public services and the Scottish budget from undue risk.

The 2016 Regulations will be amended to incorporate the following provisions:

New Regulation 14(4)(c) and (d)

A variation to a loans fund repayment must only be calculated on the balance of the loans fund advance as it applies on the first day of the financial year in which the variation is made and must never give rise to a nil or negative repayment.
This amendment will prevent a local authority from reprofiling historic borrowing costs in order to produce a negative charge as a means to increase reserves.

This amendment will prevent a local authority from reprofiling historic borrowing costs in order to produce a negative charge as a means to increase reserves.

New Regulations 14(4)(a) and (b)

A variation must not result in the repayment period exceeding the useful life of the asset, as determined in accordance with proper accounting practice, in relation to which the loans fund advance was made and may not result in the repayment period exceeding 50 years if the loans fund advance does not relate to an asset for which a useful asset life can reasonably be determined.

This amendment will prevent a local authority from assigning a loans fund repayment term that does not align either/both to the life of the asset for which the capital expenditure was incurred and/or the period over which benefit will be provided to the community of the capital expenditure. It will also prevent such an approach from being used as a means to reprofile historic loans fund repayments in order to generate an ‘overpayment’ to increase reserves, by the reversal of borrowing costs charged in prior years’ annual accounts. This will also bring the 2016 Regulations into alignment with the equivalent statutory requirements for local authorities in England and Wales.

New Regulation 14(5)

A variation may result in a repayment period exceeding the useful life of an asset, or in the repayment period exceeding 50 years, with the consent of the Scottish Ministers.

This will allow the Scottish Ministers to vary the standard requirements where there is a compelling reason to do so.

New Regulation 14(6)

The useful life of an asset is to be determined in accordance with proper accounting practices.

This will ensure that the loans fund repayment term aligns to the useful life of an asset, as determined applying accounting standards, for which the capital expenditure was incurred and will therefore align the loans fund repayment term to the period over which the benefit of the capital expenditure is provided to the community.

Amendment to Existing Regulation 14(3)(b)

A loans fund repayment may not be varied where the borrowing was with the consent of the Scottish Ministers.

This amendment will prevent the variation of loans fund advances where Scottish Ministers have consented to that borrowing, regardless of whether the Scottish Ministers have determined the amount and period of repayment. Ministerial consent will usually be required for borrowing where an exception to defined proper accounting practice is required, for example to permit a local authority to borrow to incur expenditure which is not capital in nature and therefore requires an exception to current rules. In such cases, the Ministerial consent will specify a reasonable repayment period for the expenditure to be treated as capital. As the repayments will not align to a specific asset, there is no basis to permit a future variation.

These amendments will apply to variations of repayment of loans fund advances where the loans fund advance was made on or before 31 March 2023 but the variation takes place on or after 1 April 2024.

Consultation

Within Government

Throughout policy development of the regulations, the Local Government Finance team have worked closely with the Scottish Government Legal Directorate.

Consultation with Local Government

A consultation document setting out both the reasons for the improvements and the detail of those improvements was sent to COSLA, Audit Scotland, CIPFA (Chartered Institute of Public Finance and Accountancy), LASAAC (Local Authority Scotland Accounts Advisory Committee) and all local authorities along with the draft statutory instrument and draft accompanying statutory guidance. In line with the standard consultation arrangements, all stakeholders were invited to comment and were given 4 weeks in which to do so.

Consultation responses were carefully considered and significant concessions have been made to the original proposed amendments to regulations to address the concerns raised by Local Government.

Business

No businesses are impacted by the amendment regulations.

Options

Option 1: Do Nothing

Benefits

The only benefit of this option would be the simplicity of maintaining existing statutory arrangements indefinitely. However, significant weaknesses have been identified within current statutory arrangements that represent a financial risk and therefore must be addressed.

Costs

There are no direct costs although if a local authority undertakes borrowing that it is subsequently unable to afford this may have a detrimental impact on public services.

Option 2: Implement Amendment Regulations

Benefits

This option retains the substance of existing statutory arrangements and therefore will have minimal impact on local authority financial management and administration whilst addressing financial risks.

Costs

There are no direct costs although a local authority will be required to take a more prudent approach to borrowing and to financing borrowing commitments over a period that aligns with the benefits provided to the community of the capital investment.

Sectors and Groups Affected

The amendment regulations only affect local authorities.

Intra-UK Trade

Is this measure likely to impact on intra-UK trade? No.

International Trade

Is this measure likely to impact on international trade and investment? No.

EU Alignment

Is this measure likely to impact on the Scottish government's policy to maintain alignment with the EU? No

Scottish Firms Impact Test

It is not considered that the proposal will have any impact on Scottish business as the required amendments relate solely to accounting practices within local authorities.

Competition Assessment

It is not considered that the proposal will have any impact on competition.

Consumer Assessment

It is not considered that the proposal will have any impact on consumers.

Test run of business forms

No new forms will be introduced.

Digital Impact Test

N/A

Legal Aid Impact Test

It is not considered that the proposal will have any impact on the Scottish Legal Aid Fund.

Enforcement, sanctions and monitoring

The proposal does not create any new enforcement mechanisms.

How will the proposal be implemented and in what timescale?

The proposals will be implemented by the regulations. These will be laid on 26 January 2024 and are The Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024

The following improvements would be delivered through amendments to legislation:

- Regulations will be amended to prevent a local authority from reprofiling historic borrowing costs in order to produce a negative charge as a means to increase reserves.
- Regulations will be amended to prohibit the retrospective restatement of historic borrowing costs and the deferral of previously incurred costs to future years.
- Regulations will be amended to prevent the artificial extension of the asset life as a means to extend the loans fund repayment period and thereby defer loans fund repayments.
- Regulations will be updated to limit the flexibility that can be applied in calculating the charge to revenue and will set a maximum period of 50 years

to ensure an equitable charge to Council Tax payers, unless the Scottish Ministers consent to a longer period, on the basis that there is a compelling reason for that longer period.

Post-implementation review

Compliance with the changes to accounting practices will be monitored through data collected within the annual Local Financial Returns.

The effectiveness of the improvements will be monitored in consultation with Audit Scotland, LASAAC and CIPFA.

Summary and recommendation

Option 2: Implement Amendment Regulations

Benefits

This option retains the substance of existing statutory arrangements and therefore will have minimal impact on local authority financial management and administration whilst addressing financial risks.

Costs

There are no direct costs although a local authority will be required to take a more prudent approach to borrowing and to financing borrowing commitments over a maximum term of 50 years.

Declaration and publication

Signed:

Date:

Minister for Public Finance and Community Wealth

Scottish Government contact point:

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