Response to Consultation on Mitigating the Impact of Fair Value Movements on Pooled Investment Funds on Local Authority Budget Setting

Purpose of report

For decision.

Summary

The Government is consulting on mitigations to the implementation of International Financial Reporting Standard 9 (IFRS 9) in 2018/19. This follows concerns raised across the sector that the implementation would have unintended consequences on funding available for services though cash adjustments made to revenue accounts. The Government’s proposals go some way to mitigating the possible effects in the short term, but do not go all the way to a full statutory override that had been called for. A suggested draft response from the LGA is appended for approval.

Recommendation

That the LGA’s response to the consultation on mitigating the impacts of fair value movements on pooled investment funds on local authority budget setting be approved for submission.

Action

That the approved response is submitted to the Ministry of Housing, Communities and Local Government.

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Response to Consultation on Mitigating the Impact of Fair Value Movements on Pooled Investment Funds on Local Authority Budget Setting

Background

1. IFRS 9 is an international financial reporting standard which is due to be implemented by local authorities in England from the financial year 2018/19. UK law stipulates that such reporting standards must be implemented into public service reporting. The standard includes new rules for the valuation of certain pooled investments in local authorities’ final accounts, for example a holding in a property investment fund. This will means that local authorities will have to account for any loss or gain in value of those investments in their accounts each year even if the asset is not necessarily going to be sold. At present the investments are valued each year, but the change is effectively just noted and no cash adjustment is made to the accounts until the gain or loss is actually realised.
2. The new rules will mean that local authorities will have to make an adjustment to their revenue account every year for increases or decreases in the value of certain affected investments, even where these changes are on paper only because the investment is not being sold. This may force some councils to hold additional reserves to ensure that when there is a book reduction in the value of investments there is no impact on revenue spending. If reserves are not sufficient to cover any reduction the councils could be forced to make actual spending reductions as a result of a “loss” which may never be realised. Either way, this will decrease the amount of revenue funding available to provide local services. It could also lead to some councils needing to increase council tax by more than would otherwise have been necessary, assuming they have the flexibility to do so.
3. Should the value of investments rise (as they have done recently) the council will have to take the increased value into its accounts each year even though there is no profit from the investment if it is not being sold. This could make it seem as though it has more money available than it actually does. This could lead to a notional increase in reserves even though additional money is not available to authorities. It will be difficult to explain to the public that this increase in reserves held by an authority is not real and, therefore, it would not be prudent for councils to commit this to ongoing service provision.
4. The consultation itself notes that one example of a pooled investment fund that local authorities have invested in is the CCLA Local Authorities Property Fund and that local authorities holdings in this fund are approximately £1 billion. If local authorities were forced to make reserves provision for possible losses on such a fund at a rate of say 10 per cent then that would mean immediately £100 million less available to pay for local services for this investment alone; provision for a fall in value of up to 30 per cent (the fall in many investment values in the 2008 crash and which some councils have indicated they believe would therefore be a prudent figure) would be proportionally higher. The CCLA example is just one example of the investments likely to be affected. Total English local authority investments in non money market externally managed funds are approximately £2.5 billion [[1]](#footnote-1) but it is not possible to identify what proportion of these are pooled funds and are therefore affected nor whether any money market funds or other investments (a further £10 billion) are also affected. Clearly it will be more than just the £1 billion CCLA fund.
5. As a result of the concerns outlined above, the LGA and many others in the sector including individual councils, Treasurers’ societies and the Chartered Institute of Public Finance and Accountancy (Cipfa) approached the Ministry of Housing, Communities and Local Government (MHCLG) and called for the implementation of statutory override to this aspect of IFRS 9. There is precedent for using this approach. It has been applied to accounting for pensions to avoid changes in the valuations of a pension fund assets directly affecting resources available for services.
6. In response to this call, in July the Government issued the “consultation on mitigating the impact of fair value movements on pooled investment funds on local authority budget setting”. The proposal in the consultation is for a temporary statutory override for three years and the consultation looks at some of the actions to go with this and the timetable. Separately the consultation also looks at other changes to capital finance and accounting regulations as they affect the charging of equal pay back-pay awards.
7. These changes under IFRS 9 do not impact on direct investment in property where the council owns the property itself or on most types of direct shareholdings, both of which are covered by the definition of capital expenditure.
8. The deadline for responding to the consultation is 28 September 2018.
9. The draft response is appended to this report for approval.

Main proposals in the consultation

1. The consultation says that the Government recognises that for the first time changes in the market value of investments in pooled investments will directly impact on non ring fenced revenue reserves and annual budget calculations (para 16) and that this could mean that there is less money available to fund services (para 20). Nevertheless the consultation also says that the Government fully supports the objectives of IFRS 9 and that introducing a statutory override would mean that local authorities are not subject to the same requirements as the private sector (paras 17/18).

1. The Government therefore proposes to introduce a time limited statutory override for a period of three years ending in April 2021. During the period of the override local authorities would still be required to identify and account for the changes in value as under IFRS9, but would then reverse them out of the accounts so that such changes would not impact on the balanced budget requirement or on the money available to fund services. From 2021/22 councils would have to implement IFRS 9 in full.
2. The Government argues that the period of the override will give local authorities either time to divest themselves of the affected investments or to build up revenue reserves to mitigate the impact of movements in value if they wish to continue to hold the investments.
3. Local authorities hold the investments because they give a return balanced against risk. If local authorities divest themselves of the investments then it is likely that alternative investments will either give a smaller return (affecting money available to fund services) or be at a higher level of risk, or both. If local authorities have to create new reserves that too could impact on funding available for services. Further, the period of three years to April 2021 and then the financial year 2021/22 are likely to be difficult years of financial uncertainty for local authorities with a number of changes and possible pressures already being identified. For example, 2021/22 will be the first year for revised pension contributions following the triennial valuation as at 31 March 2019, it will be shortly after the implementation of further business rates retention and the Fair Funding Review in 2020, and will be part of a new spending review cycle.
4. The suggested response, which is attached, therefore argues that a full permanent statutory override would be better for the sector, and that if the override has to be temporary, then a period of five years would be better than three.
5. The consultation also asks about whether local authorities should disclose the value of the change that has been reversed out under any statutory override. This seems to be sensible.
6. It also asks whether a similar override should be applied to changes in impairments to loans and debt. This is a different case to the value of pooled investments. The value of investments will go up as well as down, and the without a statutory override the revenue account will be having cash adjustments made for what could be temporary (paper) changes in value. The impairment of loans and debts is much more likely to be provision for a loss that actually will occur and therefore it seems reasonable that this should be met from revenue when it is identified.
7. Finally the consultation asks whether 2018/19 is still the right date for the implementation of IFRS 9 regulations. Since local authorities have been planning for this for some time, it seems sensible to implement on the planned date and this should help avoid confusion and uncertainty.

Other proposals in the consultation

1. Separately the consultation identifies that a regulation was introduced in 2011 to allow local authorities a breathing space by allowing them not to charge back-pay awards for equal pay to revenue until they actually made the payment. This regulation has been extended twice and is currently due to expire in 2018. The proposal is for this to be extended for a further two years to 2020. This will provide further optional flexibility for councils and so is welcomed.

Implications for Wales

1. The consultation covers English local authorities only. The Welsh Government is responsible for any statutory override in IFRS 9 for Welsh local authorities.

Financial Implications

1. This is part of the LGA’s core programme of work and as such has been budgeted for

Next steps

1. Draft suggested consultation response appended for approval.

1. <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/735518/Borrowing_and_Investment_Live_Table_Q1_2018-19.xlsx> [↑](#footnote-ref-1)