Future of the IFRS 9 statutory override: mitigating the impact of fair value movements of pooled investment funds. LGA response

September 2022

About the Local Government Association

1. The Local Government Association (LGA) is the national voice of local government. We are a politically led, cross party membership organisation, representing councils from England and Wales.

2. Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.

3. This response has been cleared by the LGA's Resources Board.

General points

4. We support making the IFRS 9 statutory override permanent or, as a minimum, extending for another five years. The IFRS 9 statutory override was introduced in 2018 following concerns raised by the sector that without it councils would be subject to unnecessary financial volatility that would have unwanted impacts. In January 2018 the then Chair of the LGA's Resources Board wrote to then Local Government Minister calling for an override; the call was backed across the sector, including by CIPFA and by Treasurers' Societies. The Government then undertook a formal consultation on proposals to introduce the override. In our response to that consultation in 2018, we argued for the override to be introduced and made permanent. In response a five-year override was introduced from the 2017/18 financial year; this expires at the end of the current financial year.
5. We believe that the Government was right to introduce an override in 2018. Recent evidence from a survey by Room 151 magazine of 77 local authorities showed that over the last three balance sheet dates the majority of those surveyed held investments that were affected by the override and all that did experienced a change in value that would have impacted in the revenue account if the override was not in place. About a third of them experienced such volatility that the value of their investments went up and down significantly at the different balance sheet dates in that short period. Having the override in place meant that these councils did not have to make unnecessary cuts in service in response to these differences in valuations.
6. Having the override in place does not mean that local authorities do not have to monitor or measure changes in value at balance sheet date, just that such changes, particularly temporary changes, do not affect the revenue account directly in the short term.

Individual questions

Local Government Association

Submission

18 Smith Square London SW1P 3HZ
020 7664 3000 info@local.gov.uk **www.local.gov.uk**
Local Government Association company number 11177145
Improvement and Development Agency for Local Government company number 03675577

Question 1. In your view, what should the future of the IFRS 9 override be post March 2023 [elapse/extend/make permanent]? Please set out your rationale.?

7. In our view as a minimum the statutory override should be extended, and preferably it should be made permanent. The investments affected by the override (pooled funds) are long-term investments and if the override is not in place, holders of such investments will have to make revenue adjustments for what are paper changes in value at balance sheet dates. The balance sheet is a snapshot at a single date; the paper valuations could be different a few days before and few days after or before the balance sheet date.
8. The point that a change in value actually has a real impact is the point at which any real gain or loss is realised. Having to make real revenue provisions for temporary paper losses or take real revenue cash for temporary paper gains, measured at a single date each year, creates unnecessary real revenue risks that could have a significant negative impact on a local authority's ability to provide local services.

Question 2: Please describe any financial consequences for your authority if the statutory override is allowed to elapse from 31 March 2023?

9. This is a question for individual local authorities to answer.

Question 3: What are the advantages and disadvantages of investing in pooled investment funds for your LA?

10. This question is aimed at individual local authorities. However, comments made by councils are that local authorities hold the investments because they give a return balanced against risk.

Question 4: How would removing the statutory override change your current approach to investing in pooled investment funds?

11. This question is aimed at individual local authorities. However, we have heard comments from local authorities that removing the statutory override would make it less likely that they will invest in pooled funds. 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.
12. Another option would be for local authorities to continue to hold pooled investments, but to hold additional cash reserves to enable the smoothing of the impact of volatility between year-end valuations. This could mean that the level of local authority reserves would rise, tying up further funds and that local authorities would come under pressure to spend them whenever investment values rise.

Question 5. Assuming the statutory override elapses March 2023, what impact might this change have on your audit process?

13. This is a question for individual local authorities and local auditors to answer. Even with the override in place, the paper changes in values at balance sheet

days are still recorded in the accounts (with changes then being reversed out). The current position therefore should be that the figures are already subject to audit scrutiny; however, it is possible that the real impact on revenue funding will mean the valuations could be subject to additional audit work, putting further pressure on local audit, which is already in crisis.

Question 6. (a) Assuming that the statutory override is continued beyond March 2023, do think it should be time-limited or permanent? Please set out your rationale.

Question 6. (b) If you think it should be time-limited, what do you consider the appropriate length of time it should be extended?

14. As outlined above, our view is that as a minimum the statutory override should be extended, and preferably it should be made permanent. In our opinion, the argument in favour of having an override is one that is not affected by time factors. So long as local authorities hold pooled funds as long-term investments then the argument remains that it would be a bad risk for temporary paper changes in value for these investments to impact on revenue resources.
15. In these circumstances, a permanent override is more efficient than an extension as an extension means that there must to be a further detailed review and public consultation at the end of the extension period, which may be unnecessary and will merely confirm a further extension of the override. Implementing a permanent extension would not, however, prevent the Government from reviewing the override at a further date if something happened to make that necessary.

Question 7. (a) If applicable, has your authority taken steps to reduce its exposure to the risks associated with pooled investment funds ahead of the statutory override potentially ending 31 March 2023? Please provide details.

Question 7. (b) If your authority has not taken steps to reduce its exposure to risks from pooled investment funds, please set out the rationale for this?

16. This is a question for individual local authorities to answer.

Question 8. Do you agree that by not recognising the fair value movement of pooled investment funds this reduces effective risk management and potentially creates future risks? Please provide details

17. We do not agree with this. The effect of the override is that fair value movement of pooled investment funds as at balance sheet date is reversed out of the final accounts so that it does not impact on revenue resources. The figure is still recorded. Further, the valuation at balance sheet date is only a snapshot of the value at a specific date (31 March). Proper management of investments requires much more frequent monitoring of fair value of investments than a year end figure at a single date. Risk management based on the recording a single paper figure each year will be entirely inadequate.

Question 9. What is the fair value of your authorities pooled investment fund investments as at 31 March 2022?

18. This is a question for individual local authorities to answer.

Question 10. Please set out the value of the gains/losses from your authorities investments in pooled investment funds for 2019/20, 2020/21, 2021/22 recognised under proper practices. Please give both absolute value and as percentage movement for each year.

19. This is a question for individual councils to answer, we assume “proper practices” means “fair value” in this context.

Question 11. What is the balance on the unusable reserve as created by the statutory override as at March 2022?

20. This is a question for individual councils to answer.

Contact:
Bevis Ingram
Senior Adviser Finance
Phone: 079 2070 2354
Email: bevis.ingram@local.gov.uk