Local Government, Housing and Planning Committee

8th Meeting, 2024 (Session 6), Tuesday 5 March 2024

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

Introduction

1. The purpose of this paper is to provide information to help inform the Committee's consideration of the following affirmative instrument—

> The Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024 (legislation.gov.uk)

2. The Minister for Community Wealth and Public Finance and Scottish Government officials will provide evidence to the Committee on the draft regulations at this meeting.

3. The Minister will then move the following motion:

> **S6M-12003:** That the Local Government, Housing and Planning Committee recommends that the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024 [draft] be approved.

4. The draft regulations were laid on 26 January and have a reporting deadline of 14 March.

The Instrument

5. The Policy Note explains that—

> "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."

6. The Policy Note further states that "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."

7. The purpose of the instrument, therefore, is to amend the 2016 Regulations to address a number of "financial risks".

8. A SPICe briefing providing further information on the draft regulations is attached at Annexe A.

Consultation

9. The Policy Memorandum confirms that—

> "The Scottish Government issued a consultation paper to COSLA, CIPFA, LASAAC (Local Authority Scotland Accounts Advisory Committee), and all local authorities, setting out the intended improvements to the statutory accounting framework and the reasons for those improvements and allowed a 4-week period for consultees to respond."

10. The Annexe to the Policy Memorandum includes a short summary of the original and revised amendments to regulations which were modified following consultation in order "to strike a balance between the requirement to better constrain financial risk whilst addressing the concerns expressed by Local Government within the consultation responses received."

11. Scottish Government officials have confirmed that this was not a public consultation, as is the norm for statutory reforms that only affect local government, so the responses have not been published. However, the responses have been provided to the clerks and are available to be shared with members on request.

12. COSLA officials have confirmed that they had responded to the consultation. Further correspondence from COSLA which comments on the changes that have taken place following Scottish Government consideration of consultation responses, is attached at Annexe B.

13. The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) (an independent committee that develops and promotes proper accounting practice for local government in Scotland) also responded to the initial consultation and has also provided a further submission which is attached at Annexe C.

14. CIPFA Directors of Finance Section has also shared its original consultation response with the Committee along with a cover email confirming its current position. Both documents are attached at Annexe D.

Delegated Powers and Law Reform Committee Consideration

15. The Delegated Powers and Law Reform Committee considered the draft regulations on 6 February and confirmed that it had no points to raise.

Conclusion

16. The Committee is invited to consider the above information in its consideration of the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024 [draft].

Clerks to the Committee
February 2024

SPICe The Information Centre
An t-Ionad Fiosrachaidh

Local Authority (Capital Finance and Accounting) (Scotland) 2024 – Draft SSI

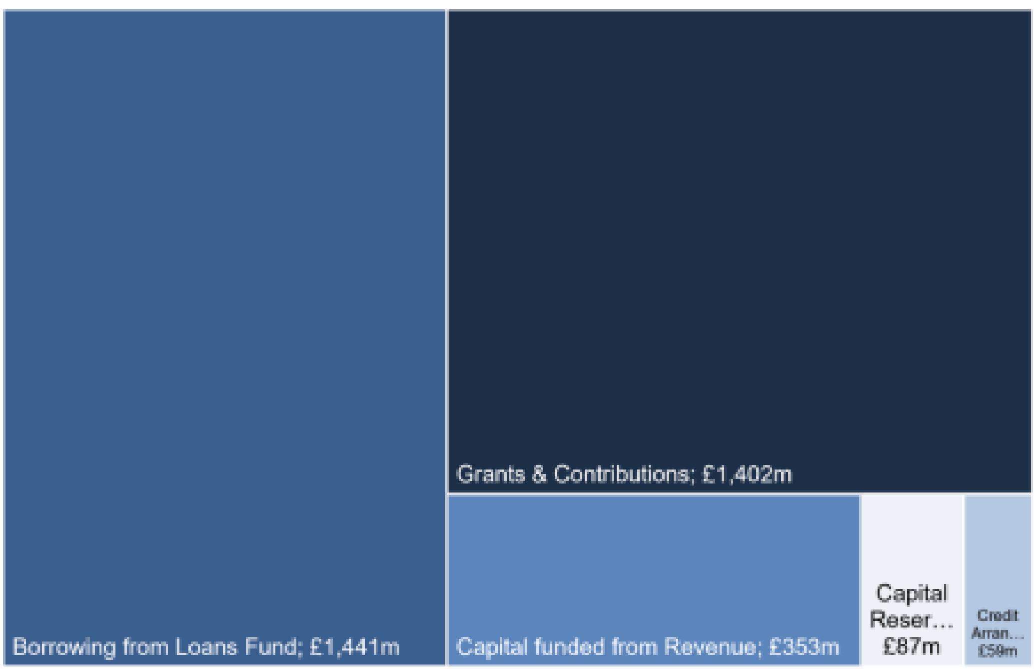
1. The Scottish Government issued a consultation paper late last year to COSLA, CIPFA, LASAAC (Local Authority Scotland Accounts Advisory Committee), and all local authorities, setting out proposed changes to the statutory accounting framework and allowed a 4-week period for consultees to respond. Responses were considered by the Government and changes were made to the original proposed amendments. The Draft SSI under consideration is the result of this consultation process.

Background information - funding for local authority capital expenditure

2. As we see in the annual budget process, the Scottish Government and other bodies provide local authorities with capital grants. However, any additional capital investment must be financed through borrowing, with the cost of borrowing being charged to revenue budgets. Councils generally only borrow for capital purposes.

3. The following chart shows how local authorities financed capital expenditure in 2021-22 (the most recent figures available):

Financing of Capital Expenditure in 2021-22 by source, £ millions



4. During 2021-22, local authorities borrowed £1.4 billion to help fund capital investment. The following table shows that this contributed to a total of £16.9 billion of loans advances being outstanding as of 31 March 2022:

Movement	General Fund	HRA	Total
Loans Fund Advances outstanding at 1 April	11,799	4,173	15,972
Add: New advances from the Loans Fund	954	487	1,441
Less: Repayments made in year	329	143	473
Less: Transfer in (+) or out (-) of assets	-	-	-
Loans Fund Advances outstanding at 31 March	**12,424**	**4,517**	**16,941**

Source: Scottish Local Government Finance Statistics 2021-22

5. This does not include PPP type arrangements, which are an entirely different matter from the SSI being considered. These sorts of credit arrangements would add another £3.6 billion to the total debt figure.

A council's loans fund

6. Loans funds were created by the Local Government (Scotland) Act 1975. This was to ensure local authorities set aside sufficient revenue, in the form of 'loans fund repayments', to meet the costs of borrowing.

7. Every Scottish local authority has a loans fund (LF). These work like internal banks in the sense that the LF borrows externally (e.g. from the Public Works Loans Board) to bring in additional money for capital projects.

8. Money is then "lent" to borrowing departments and the repayment of this borrowing (principal, interest, and expenses) is a direct cost to the council's General Fund. Internal lending from the loans fund is called a "loans fund advance".

9. Regulations introduced in 2016 gave local authorities more flexibility in how they account for loans fund advances. These regulations enabled local authorities to determine for themselves how much to charge against revenue for both the loans fund repayment term and the amount of repayment each financial year, providing they considered these to be "prudent".

10. Neither the legislation nor accompanying guidance defined what is "prudent".

11. Annual charges for loans fund advances replaced the requirement for an annual depreciation charge against revenue. Simply put, depreciation is the value of an asset that the borrowing has financed, divided by the number of years it's used for.

Problems with the 2016 regulations

12. The Scottish Government believes that the increased flexibility arising from the 2016 regulations may have led to some financial sustainability risks which the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024 aim to address.

13. Firstly, the 2016 regulations enabled local authorities to “reprofile” the repayment amounts of existing loans. Councils could then identify past “overpayments” and make retrospective adjustments to their accounts to address these. There is evidence that local authorities have applied this ‘overpayment’ method as a way of increasing their General Fund reserves with a one-off boost and thus help ease budgetary pressures.

14. In its Policy Note, the Scottish Government states:

> “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.”

15. The Accounts Commission’s recent Local Government Overview 2023 highlighted the various ways local authorities are attempting to bridge their budget gaps (between anticipated expenditure and revenue):

> “…about four per cent of the gap [across the whole country] was expected to be met by councils reprofiling their loans funds repayments by extending the repayment period. This generates one-off savings and is not sustainable in the long term”

16. In the Policy Note of the draft SSI being considered, the Scottish Government states that:

> “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.”

17. The following provides an example of how a local authority’s General Fund reserves could be boosted by the retrospective reprofiling of LP repayments:

Imaginary example of the retrospective reprofiling of Loans Fund Repayments

Loans Fund Advance 1 April 1990

Loans fund advance: £40 million
Original repayment term: 40 years
Annual repayment: £1 million
Cumulative repayments to 31 March 2023 (33 years): £33 million

Reprofiling of repayments 31 March 2023

Revised repayment term: 60 years
Annual repayment: £0.67 million
Cumulative repayments to 31 March 2023 (33 years): £22 million
Increase in General Fund reserves (£33 million *minus* £22 million): £11 million.

The reprofiled £11 million is then deferred to future years, increasing the future annual charge to taxpayers (as the £11 million will now be added to future repayments), and extending the term of the loans fund repayments.

18. Secondly, councils can extend repayment periods way into the future, beyond the actual life of an asset. This could result in a situation whereby charges against future taxpayers' revenue budgets are made for assets that no longer exist. The Scottish Government deems this unfair and contrary to international accounting standards.

19. The period over which loans fund advances are repaid can have a significant short term impact.

20. This real-life example produced by Edinburgh City Council illustrates how reprofiling may benefit councils over the short-term, whilst increasing payment amounts in later years:

Repayment profile for loans fund advances to the General Fund

	Original Repayment £m	Revised Repayment £m	Difference £m
2020/21	49.203	37.203	-12.000
2021/22	50.371	38.371	-12.000
2022/23	51.450	39.450	-12.000
2023/24	51.401	39.401	-12.000
2024/25	51.939	39.939	-12.000
2025/26	52.519	40.519	-12.000
2026/27	47.693	38.693	-9.000
2027/28	45.961	37.961	-8.000
2028/29	43.881	37.881	-6.000
2029/30	39.951	37.951	-2.000
2030/31	33.022	36.022	3.000
2031/32	31.758	34.758	3.000
2032/33	29.672	32.672	3.000
2033/34	29.061	32.061	3.000
2034/35	27.633	30.633	3.000
2035/36	28.133	30.133	2.000
2036/37	29.341	30.341	1.000
2037/38	20.859	29.891	9.032
2038/39	19.306	29.306	10.000
2039/40	17.180	26.180	9.000
2040/41	17.907	25.907	8.000
2041/42	18.386	24.386	6.000
2042/43	12.205	19.205	7.000
2043/44	3.867	10.867	7.000
2044/45	0.880	7.348	6.468
2045/46	0.597	6.097	5.500
2046/47	0.582	6.582	6.000
2047/48	0.592	3.592	3.000
2048/49	0.515	2.655	2.140
2049/20	0.140	0	-0.140
	806.005	806.005	0.000

What the new regulations aim to achieve?

21. The Scottish Government has ultimate responsibility for the capital financing system in Scotland and should ensure that there are sufficient controls within the system to mitigate financial risk and ensure fairness for taxpayers.

22. According to the Scottish Government, local authorities are interpreting the flexibility of the 2016 regulations as permitting the reversal of borrowing costs which have already been incurred (and passed on to council tax payers). Local authorities are also using new flexibilities to 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".

23. There has been heightened awareness of capital finance risks due to the situations facing a number of English local authorities (such as Thurrock and Croydon councils). The Scottish Government's Policy Note states:

> "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."

24. The Scottish Government believes that the new regulations will bring local authority capital accounting into line with international accounting standards. The UK Government has also introduced new regulations over the past year, and the draft regulations under consideration will bring Scotland in line with England and Wales.

25. As such, the draft regulations aim to:

    - Prevent local authorities from reprofiling historic borrowing costs from now on.
    - Prevent local authorities from assigning a loans fund repayment term that does not align with the useful life of the asset (with a limit of 50 years).
    - Ensure that the useful life of an asset is determined in accordance with proper accounting practices.
    - Ensure that loans fund repayments where the borrowing terms were with the consent of the Scottish Ministers may not be varied.

COSLA and CIPFA response to these changes

26. COSLA believes there is no need for a review of capital accounting. As such, the proposed changes in the consultation and the draft SSI are not supported by COSLA nor are they viewed as necessary. Both CIPFA and COSLA believe there is no clear rationale set out in last year's consultation for any review of capital accounting regulations.

27. The CIPFA Directors of Finance (DoFs) are unhappy with the limited amount of time (4 weeks) they had to consider the original proposals. They had sought an extension, especially as the consultation was taking place during a time when DoFs are busy with budget considerations.

28. As noted above, the Scottish Government has an issue with local authorities reprofiling historic borrowing costs "in order to produce a negative charge as a means to increase reserves". The new amendments prevent councils from doing this because "accounting standards do not permit the retrospective adjustment or reversal of expenditure reported in the annual accounts of an entity in prior financial years".

29. Moreover, the Scottish Government states that the draft regulations will only apply to new loans fund advances and there will be no financial consequences for local authorities for existing loans fund advances. The draft

regulations do not require local authorities to undo the retrospective reprofiling they have already carried out.

Greig Liddell, SPICe Research
20 February 2024

Ariane Burgess, MSP
Convener
Local Government, Housing and Planning Committee
The Scottish Parliament
Edinburgh
EH99 1SP

28 February 2024

Dear Ms Burgess,

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

I am writing to the Committee to highlight the COSLA position relating to the amendments to regulations. COSLA has consistently held the position that there is no requirement for a review of capital accounting. As such, the proposed changes which were consulted on by Scottish Government from 28 November to 22 December 2023 were not supported by COSLA nor are they viewed as necessary. The full response from COSLA to the consultation is attached for reference.

In light of the consultation responses received, COSLA understands that Scottish Government are not taking forward all the proposals at present, though they have indicated the intention to do further work with Local Government on the 5 outstanding proposals. Given the Deputy First Minister stated in December that there is not a requirement for a Capital Accounting Review it is not clear why any of the proposals are being implemented or further developed.

Of the three proposals that Scottish Government are seeking to implement from 1 April 2024, COSLA continue to have concerns about the risk of unintended consequences which there has been no opportunity to identify given the extremely short consultation period, limited access to the responses and analysis and decision to implement. In particular, while initial views of a small group of Directors of Finance are that these changes are unlikely to introduce additional direct costs for councils, there are concerns around the impact this will have on audit and the capacity to implement the changes. Implementation from 1 April 2025 would be preferred to ensure that this is not the case.

Local Government is fully committed to ensuring sound stewardship of public funds including prudent financial management and investment decisions, which remain in full compliance with Accounting Standards and Codes of Audit Practice and are subject to Annual Audit. Directors of Finance, as statutory officers are required to prepare detailed strategies, including Capital and Treasury Management, and our capital investment plans are underpinned by requirements to ensure that they remain affordable, prudent and sustainable in the medium / longer term.

There is no clear rationale provided to support the proposed changes and though the covering email to the consultation references concerns due to recent events in England, how these equate to the situation of Scottish local authorities nor how the proposed changes would mitigate against the perceived problems within the existing framework are not set out. This remains particularly concerning given the very significant issues around funding and future financial sustainability of Scottish local authorities, and the potential additional risks that this change to regulations may result in.

At a time when the significance and concurrent range of financial risks are growing, our collective focus should remain on exploring joint solutions to support on-going financial sustainability, and not simply adding unnecessarily to the wider risks.

Yours sincerely,

Mirren Kelly
Chief Officer – Local Government Finance Team
COSLA

COSLA

COSLA Response - Scottish Government Consultation: Amendment to the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 – November 2023

COSLA Leaders have consistently held the position that there is no requirement for a review of capital accounting. As such, the proposed changes in this consultation are not supported by COSLA nor are they viewed as necessary.

COSLA supports the response submitted by the CIPFA Directors of Finance Section and would request the following points are taken into consideration. This COSLA response must be considered alongside the previous responses to the wider Capital Accounting Review.

Given the very limited time to discuss these matters in full, we have focused on key overarching issues, but would strongly recommend that the Scottish Government pauses any further consideration on these regulations at this time, and engage in a meaningful discussion with the COSLA and Directors of Finance section on any specific areas of concerns:

- The Depute First Minister (DFM) has stated in her Budget announcement that the wider Capital Accounting Review (CAR), has again been paused. COSLA remains significantly concerned that many of the changes proposed in this consultation are aligned to the Capital Accounting Review and commencing with this consultation remains completely at odds with the wider direction particularly with no apparent immediate pressing requirement to resolve. Given the position of the DFM on the requirement for a further CAR, COSLA is of the view that none of the changes proposed in the consultation should be taken forward.

- We would wish to reiterate strong concerns around both the timing and manner in which the consultation has been undertaken:
    - Despite requests to meaningfully extend the consultation and undertake meaningful and appropriate engagement, this consultation is not only rushed, with limited time for consideration and substance but has been issued at a time when COSLA and Local Authority Directors of Finance primary focus is on undertaking budget discussions to ensure on-going financial stability. This, as you will appreciate, remains the critical priority given the severity of the current financial challenges being faced across the local government sector, further exacerbated by the draft revenue and capital settlements for Local Government.
    - The manner and timing of undertaking a consultation in this way not only creates significant additional financial risk and may impact on the on-going financial stability of local authorities, it also does not allow appropriate time for engagement and meaningful discussion with key stakeholders and undermines the spirit of openness, early engagement, and partnership working set out within the Verity House Agreement.

- Overall, COSLA supports the DOF Section position and remains opposed to the need and requirement to make any changes to the current Regulations. There is no clear rationale provided to support the proposed changes and though the covering email references concerns due to recent events in England, how these equate to the situation of Scottish local authorities nor how the proposed changes would mitigate against the perceived problems within the existing framework are not set out. This remains particularly concerning given the very significant issues around funding and future financial sustainability of Scottish Local Authorities, and the potential additional risks that this change to regulations may result in. At a time when the significance and concurrent range of financial risks are growing, our collective focus should remain on exploring joint solutions to support on-going financial sustainability, and not simply adding unnecessarily to the wider risks.

- Local Government is fully committed to ensuring sound stewardship of public funds including prudent financial management and investment decisions, which remain in full compliance with Accounting Standards and Codes of Audit Practice and are subject to Annual Audit. Directors of Finance, as statutory officers are required to prepare detailed strategies, including Capital and Treasury Management, and our capital investment plans are underpinned by requirements to ensure that they remain affordable, prudent and sustainable in the medium / longer term. These plans are subject to full Council consideration, and alongside this an independent assessment of a Council's Financial Sustainability is provided as part of the Annual Audit Report. Prudent and sustainable Treasury decisions remain at the forefront of requirements for all Section 95 officers.

- The proposals in the consultation apply to new loans fund advances for new capital investment projects not approved by Council before 1 April 2023. Introducing a retrospective adjustment will require Council to re-assess the affordability and impact on the Revenue budget of capital investment decisions in current and future years and will significantly undermine medium term financial strategies.

- The use of annuity method in loans fund advances, has been used for many years and is the basis on which current Financial Strategies, Treasury Management Strategies and Capital and Revenue budgets have been prepared and align financial plans and affordability of these strategies in the medium term. The proposed change to a straight-line depreciation method, will give rise to increased charges to current taxpayers and will reduce the affordability of current capital investment plans, and will inevitably lead to local authorities requiring to re-assess their capital investment plans. This will mean in practice:
    - An increased charge to the current Council Tax Payers and Housing Rent Payers through the appropriate revenue account. It is difficult to quantify the scale of this additional charge but it will be significant at a time when both Revenue and Capital budgets are under extreme pressure.
    - This will require all authorities to review the affordability of capital investment decisions (both across General Services and Housing) and may result in a significant reduction to capital infrastructure investment plans, the delivery of shared priorities such as Learning Estate Investment Programme (LEIP) and may reduce the capital investment available to be invested in affordable housing, of particular note given the significant reduction in capital allocation for this programme in the draft Budget, all of which remain inconsistent with shared aspirations.
    - In addition, the changes being outlined will require the financial models for LEIP funded projects to be reviewed which would have been modelled based on an annuity assumption. The revenue funding for LEIP, as you know, will not be received until certain baseline outcomes such as energy efficiency are

delivered. This may take several years, during which time the Council will be required to repay the debt used to fund the building. The ‘straight-line’ depreciation of a school will be far in excess of the repayment of debt, on an annuity basis, with the Council exposed to these higher charges and without funding in place. This places this, and likely other projects, at significant risk.
    - This also fails to take into consideration time value of money, which alongside affordability remains an important consideration to both current and future taxpayers. The current system including the ability to use annuity-based calculations has been in place for a considerable time, and in considering prudence and affordability of capital investment plans this also includes the profile of historic and future borrowing as part of that determination. The consultation proposed is likely to mean current taxpayers will be charged significantly more at the expense of future taxpayers which is neither fair nor appropriate.

- These impacts are particularly concerning given the current economic circumstance and significant concerns around on-going financial sustainability of local authorities. Investment in capital infrastructure remains critical to stimulate economic growth and create jobs and investment and Local Authorities continue to play a vital role in this area. This remains particularly important given the current economic stagnation within the national economy. Any potential change to what we can support will have significant long-term detriment on the economic viability, national tax take aligned to jobs, funding available to support vital public services, contribution to net zero and in essence a continued decline in public assets.

- The consultation is proposing introducing a maximum period of 50 years which is not helpful and again may undermine current capital investment plans. Many authorities currently apply a longer period and this should remain an appropriate consideration. Applying a maximum period does not take account that benefits can often be expected to exceed beyond 50 years which should remain an important consideration for ensuring capital investment projects are also sustainable for the future. It should also be noted borrowing decisions and asset lives are two separate considerations.

- The consultation is suggesting additional significant administration in preparing and administering the Loans Fund. The Loans Fund remains a hugely complicated area which remains subject to significant external audit scrutiny on an annual basis. Creating additional administrative burdens on local authorities and their auditors is an unnecessary risk and an unnecessary additional burden.

- The consultation proposes that where an asset is ‘derecognised’ then any outstanding loans fund advances from 1 April 2023 should be charged to the Revenue budget in full. The impact of this could give rise to significant additional and immediate charges to the Revenue budget and may be completely unaffordable and unfair to current taxpayers (both Council Tax and Rent). Furthermore this will potentially impact the ability of Councils to do Community Asset Transfers where assets are transferred to community organisations for a nominal sum and where there are remaining loans fund advances still to be repaid.

22 December 2023

Dear Local Government, Housing and Planning Committee,

The CIPFA Directors of Finance Section continue to be concerned not just at these specific regulations but at the desire by Scottish Government to force through change when no other parties, with extensive knowledge and experience, feel these are necessary.

Local Authorities are not Private Sector Organisations which is why we have statutory mitigations to our accounts. Loans Fund Accounting allows us to manage our borrowing efficiently and ensure that we minimise costs while ensuring that costs are fairly attributed to Council Tax Payers over time. The proposals in total will severally limit our ability to manage our finances and will have a significant impact on our Capital Budgets.

We are concerned that this is being rushed through during a very busy period and that despite the DFM stating that there would be no Capital Accounting Review, this is still being progressed. We are also concerned that there has been no publication of the responses to the consultation.

We are, as always happy to engage over this but are strongly opposed to any of this being rushed through for 2024.

Below is the text of an email sent on 9th February outlining our concerns and I also attach our response to the original consultation.

Dear

We were disappointed that no one was available for the Directors of Finance Section meeting on 2nd February where it would have been beneficial to hear from a wider group of Finance Directors. We all continue to be concerned at the unnecessary haste with which this is being pursued. We acknowledge that you have moved considerably on some of your proposals but remain concerned that there will be unintended consequences of introducing any changes from April 2024.

As has previously been highlighted this entire process has taken place over an extremely busy period for Finance Departments with extensive workloads around budget preparation at a time when we are also preparing final outturn reports and many of us are still finalising accounts. The workload from Auditors is definitely increasing and we are concerned that some of the unintended consequences may be that this will lead to even more work for Auditors.

Given the statements from the DFM that there would be no Capital Accounting Review and also that her concern was surrounding the lending behaviours from English Authorities (which do not happen in Scotland) we do not believe that there is a strong case to progress with any of these changes at the current time and would again request a delay to the implementation of any of these proposals for at least a further 12 months to ensure time to fully consider any consequences of these changes.

We will commit to prioritising discussion with you on these issues in the early part of 24/25 and to work with you to provide a better knowledge base of the issues from both sides of this discussion.

Kind Regards

Martin

Martin Booth B.A, M.B.A, F.C.P.F.A.
Chair CIPFA Directors of Finance Section
Past Chair CIPFA Scottish Branch

OFFICIAL

CIPFA Directors of Finance

21 December 2023

Dear Elanor,

Scottish Government Consultation: Amendment to the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 – November 2023

I write with reference to the consultation on the above which was issued on 28 November 2023. As statutory officers who have responsibility for ensuring prudent financial management, stewardship of public funds, and financial management of the statutory Loans Fund, the CIPFA Directors of Finance section would wish for the following points to be taken into consideration in response to the consultation. This response must be considered alongside previous responses set out by the Directors of Finance section to the wider Capital Accounting Review, which continue to remain appropriate and relevant.

Given the very limited time to discuss these matters in full, we have focused on key overarching issues, but would strongly recommend that the Scottish Government pause any further consideration on these regulations at this time, and engage in a meaningful discussion with the Directors of Finance section on any specific areas of concerns:

- We would wish to reiterate strong concerns around both the timing and manner in which the consultation has been undertaken:
    - As you are aware notification was only provided to me as the Chair of the Section alongside COSLA late on Monday 27 November, and issued first thing on Tuesday 28 November 2023.
    - Despite requests to extend the consultation and undertake meaningful and appropriate engagement, this consultation is not only rushed with limited time for consideration and substance but has been issued at a time when Local Authority Directors of Finance primary focus is on undertaking budget discussions to ensure on-going financial stability. This as you will appreciate remains the critical priority given the severity

of the current financial challenges being faced across the local government sector.

- o We are also aware that LASAAC has not been approached for views or comments, which is disappointing and surprising given its role, and is certainly not good practice in terms of full consultation and engagement on such an important issue.

- o Furthermore the Depute First Minister has imitated in her Budget announcement that the wider Capital Accounting Review (CAR), has again been paused. We remain significantly concerned that much of these changes proposed in this consultation are aligned to the Capital Accounting Review and commencing with this consultation remains completely at odds with the wider direction particularly with no apparent immediate pressing requirement to resolve.

- o The manner and timing of undertaking a consultation in this way not only creates significant additional financial risk and may impact on the on-going financial stability of local authorities, it also does not allow appropriate time for engagement and meaningful discussion with key stakeholders and completely undermines the spirit of openness and partnership working set out within the Verity House agreement.

- Overall, the Section remains strongly opposed to the need and requirement to make any changes to the current Regulations. Whilst we remain committed to ensure that we continue to operate in line with proper accounting practice and prudent financial management principles, no clear rationale for this review has been provided to support the proposed changes. This remains particularly concerning given the very significant issues around funding and future financial sustainability of Scottish Local Authorities, and the potential additional risks that this change to regulations may result in. At a time when the significance and concurrent range of financial risks are growing, surely, our collective focus should remain on exploring joint solutions to support on-going financial sustainability, and not simply adding unnecessarily to the wider risks.

- We remain fully committed to ensuring sound stewardship of public funds including prudent financial management and investment decisions, which remain in full compliance with Accounting Standards and Codes of Audit Practice and are subject to Annual Audit. As statutory officers we are required to prepare detailed strategies, including Capital and Treasury Management, and our capital investment plans are underpinned by requirements to ensure that they remain affordable, prudent and sustainable in the medium / longer term. These plans are subject to full Council consideration, and alongside this an independent assessment of a Council's Financial Sustainability is provided as part of the Annual Audit Report. Prudent and sustainable Treasury decisions remain at the forefront of requirements for all Section 95 officers.

- Recent permissible fiscal flexibilities granted through discussions with Scottish Government including consideration of Loans Fund repayment holidays and treatment of capital grant to fund the recent pay deals have all been taken with the responsibility given to Statutory Section 95 officers to determine the prudence, affordability and sustainability of these decisions. It seems ironic now that the consultation being drafted seems to put in question the decisions taken by statutory officers by imposing criteria and restrictions around their ability to take prudent investment decisions.

- The proposals in the consultation apply to new loans fund advances for new capital investment projects not approved by Council before 1 April 2023. Introducing a retrospective adjustment will require Council to re-assess the affordability and impact on the Revenue budget of capital investment decisions in current and future years and will significantly undermine medium term financial strategies.

- The use of annuity method in loans fund advances, has been used for many years and is the basis on which current Financial Strategies, Treasury Management Strategies and Capital and Revenue budgets have been prepared and align financial plans and affordability of these strategies in the medium term. The proposed change to a straight-line depreciation method, will give rise to increased charges to current taxpayers and will reduce the affordability of current capital investment plans, and will inevitably lead to local authorities requiring to re-assess their capital investment plans. This will mean in practice:

    - An increased charge to the current Council Tax Payers and Housing Rent Payers through the appropriate revenue account. It is difficult to quantify the scale of this additional charge but it will be significant at a time when both Revenue and Capital budgets are under extreme pressure.
    - This will require all authorities to review the affordability of capital investment decisions (both across General Services and Housing) and may result in a significant reduction to capital infrastructure investment plans, the delivery of shared priorities such as Learning Estate Investment Plans and may reduce the capital investment available to be invested in affordable housing all of which remain inconsistent with shared aspirations.
    - In addition, the changes being outlined will require the financial models for LEIP funded projects to be reviewed which would have been modelled based on an annuity assumption. The revenue funding for LEIP as you know will not be received until certain baseline aspects such as energy efficiency are delivered. This may take several years, during which time the Council will be required to repay the debt used to fund the building. The straight-line depreciation of a school will be far in

excess of the repayment of debt, on an annuity basis, with the Council exposed to these higher charges and without funding in place. This places this, and likely other projects, at significant risk.

- This also fails to take into consideration time value for money, which alongside affordability remains an important consideration to both current and future taxpayers. The current system including the ability to use annuity based calculations has been in place for a considerable time, and in considering prudence and affordability of capital investment plans this also includes the profile of historic and future borrowing as part of that determination. The consultation proposed is likely to mean current taxpayers will be charged significantly more at the expense of future taxpayers which is neither fair nor appropriate.

- These impacts are particularly concerning given the current economic circumstance and significant concerns around on-going financial sustainability of local authorities. Investment in capital infrastructure remains critical to stimulate economic growth and create jobs and investment and Local Authorities continue to play a vital role in this area. This remains particularly important given the current economic stagnation within the national economy. Any potential change to what we can support will have significant long-term detriment on the economic viability, national tax take aligned to jobs, funding available to support vital public services, contribution to net zero and in essence a continued decline in public assets.

- The consultation is proposing introducing a maximum period of 50 years is not helpful and again may undermine current capital investment plans. Many authorities currently apply a longer period, and this should remain an appropriate consideration. Applying a maximum period does not take account that benefits can often be expected to exceed beyond 50 years which should remain an important consideration for ensuring capital investment projects are also sustainable for the future. It should also be noted borrowing decisions and asset lives are two separate considerations.

- The consultation is suggesting additional significant administration in preparing and administering the loans fund. The Loans Fund remains a hugely complicated area which remains subject to significant external audit scrutiny on an annual basis. Creating additional administrative burdens on local authorities and their auditors is an unnecessary risk and we need to think very carefully about creating any unnecessary additional burden.

- The consultation proposes that where an asset is derecognised then any outstanding loans fund advances from 1 April 2023 should be charged to the Revenue budget in full. The impact of this could give rise to significant additional and immediate charges to the Revenue budget and may be completely unaffordable and unfair to current taxpayers (both Council Tax and Rent). Furthermore this will potentially impact the ability of Councils to do

Community Asset Transfers where assets are transferred to community organisations for a nominal sum and where there are remaining loans fund advances still to be repaid.

I hope that these comments are both helpful and will be taken seriously when considering the next steps.

Yours sincerely

Martin Booth

Chair of CIPFA Directors of Finance Section

Local Authority (Scotland) Accounts Advisory Committee

LASAAC response to the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024.

26 February2024

Status of LASAAC:

The Local Authority (Scotland) Accounts Advisory Committee [LASAAC] is established as a voluntary independent committee.

LASAAC's Role reflects the Local Government in Scotland Act 2003 (Section 12) which states "It is the duty of a local authority to observe proper accounting practices." This includes "those which, whether by reference to any generally recognised, published code or otherwise, are regarded as proper accounting practices to be observed in the preparation and publication of accounts of local authorities."

The Code of Practice on Local Authority Accounting in the United Kingdom (the Code) is generally recognised as proper accounting practice for Scottish local government. LASAAC represents Scottish local government financial reporting requirements through its joint operation of the CIPFA/LASAAC Local Authority Accounting Code Board, principally in the development of the Code.

Overview:

LASAAC welcomes the opportunity to contribute its views on the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024. Given LASAAC's role, our response will focus on any issues arising from the regulations that have an impact on accounting practice within Scottish Authorities that report under the Code and the existing prudential framework for borrowing that operates in Scotland.

LASAAC notes that a key focus of the amended regulations is that of the period over which loans fund repayments are made and the issue of re-profiling the life of assets.

Specific Points:

The original consultation document on the amendments to the 2016 regulations (para 22) noted that loans fund repayments are akin to depreciation requiring an annual charge against revenue to reflect the consumption of the asset's economic benefits or service potential.

Paragraph 4.1.2.46 of the Code states that where assumptions differ from previous estimates in relation to the useful life or there has been a significant change in the pattern of consumption of the future economic benefits or service potential, the changes shall be accounted for as a change in an accounting estimate (as opposed to a change in accounting policy). This means that changes to the level of depreciation would be made prospectively, and no retrospective adjustment would take place.

LASAAC believes that the 2024 amendment regulations bring loans fund repayments patterns into line with the above accounting arrangements for changes in an assets useful life and therefore represents a prudent approach to charging repayments to revenue. These changes eliminate the position moving forward where an authority could re-profile the life of assets and adjust the repayment schedule for the loans fund over the full life of the asset potentially creating a credit or negative position on loans fund repayments made to date.

LASAAC would like to highlight that depreciation is an accounting concept to represent the consumption of an asset's economic benefit or service potential. Under the current prudential and loans fund arrangements in Scotland, loans fund repayments do not need to be linked directly to individual assets and loans fund repayments do not need to be matched to actual external debt. This is to facilitate a system where treasury management policy and arrangements dictate the need for external borrowing while prudent charges are made continually to revenue reflecting the underlying need to borrow.

The proposal to set a maximum 50-year life span where a useful asset life cannot reasonably ascertained could be seen as a potential restriction on certain classes of asset. For example, land that has been funded by borrowing where land may have an indefinite life and is not subject to depreciation. This may need further clarity on where and when the maximum 50-year life limit is applied.

As noted above, loans fund repayments do not need to be linked to individual assets and their specific useful life's. The proposed regulations in this regard do not reflect that capital accounting under accounting standards and capital financing under the prudential framework are two separate processes and have two sets of rules. Examples of this in the regulations are as follows:

The amended regulations state - *Paragraph (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.*

Also, paragraph 6 in the regulations states - *for the purposes of paragraphs (4) and (5), the useful life of an asset is to be determined in accordance with proper accounting practices.”.*

LASAAC would note that it is not uncommon for local authorities to set 60 year plus life spans for many existing assets. However, more relevant is that the regulations clearly link depreciation of assets with the authorities repayment period for loans fund charges. This link creates a restriction on the ability of an authority to manage its loans fund arrangements locally through the prudential processes already in place.

The existing prudential framework is designed to ensure that revenue charges for the authorities' debt remain prudent, affordable, and subject to regular review and assessment. Further detailed prescriptions and limits on repayment methods may eventually undermine the ability of authorities to operate the prudential framework in a manner that offers some flexibility in supporting their long-term capital investment plans.

Further information about LASAAC can be found at:

https://www.cipfa.org/policy-and-guidance/local-authority-scotland-accounts-advisory-committee

LASAAC secretariat is provided by CIPFA and can be contacted at lasaac@cipfa.org