The Chartered Institute of
Public Finance & Accountancy

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# Report

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| **To:** | CIPFA LASAAC |
| **From:** | Alan Bermingham, Technical Manager - CIPFA |
| **Date:** | 07 March 2022 |
| **Subject:** | Scottish Government letter to CIPFA/LASAAC regarding Service Concession Flexibility. |

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**Purpose:**

This report provides CIPFA/LASAAC members with relevant information and recommendations in order to respond to the specific request received from the Scottish Government's Cabinet Secretary for Finance and Economy, Kate Forbes MSP. A copy of that letter is being circulated with this report in for members information.

The request from the Scottish Government is regarding flexibilities in accounting for Service Concession arrangements. The main queries raised in the request, and addressed in this report, are noted below: The full request should be read to provide further context.

*I write to request that CIPFA LASAAC give consideration as to whether retrospectively applying the annuity approach to re-profile debt repayments, ignoring grant funding, in line with the useful life of the asset is compatible with accounting standards, as interpreted by the CIPFA Code of Practice on Local Authority Accounting.*

*If this is not the case, then I would request that CIPFA LASAAC consider whether an amendment to the Code or adaptation of International Financial Reporting Standards is required on this point.*

**Report:**

**1. Background**

1.1 Background to the request for Financial Flexibilities

Financial flexibility on service concession arrangements, currently outstanding, was part of three flexibilities proposed by local government back in 2020 to support extra resources for COVID funding pressures. The other two flexibilities being flexibility of the use of capital receipts and loans fund principal repayment holidays, both granted.

1.2 Following discussions between Local Government and the Scottish Government, agreement has been currently reached on the following principles points within the overall request on service concession arrangements.

- Intervention to the existing accounting treatment to allow the debt to be repaid over the life of the asset rather than the contract period, applying proper accounting practices

- Longer term and permanent use of annuity for service concessions, reflecting that this is permitted in England and Wales.

1.3 The remaining issues to be agreed relate to retrospective application for accounting for the change from contract period to asset life for debt repayment. Also, the treatment of related grants and grant repayment period. It is these remaining issues that the Scottish Government are seeking input on from CIPFA/LASAAC.

## 2. Initial CIPFA thoughts provided to the Scottish Government and Directors of Finance representatives in Scotland

2.1 Members of CIPFA's Policy and Technical team met with the Scottish Government and Scottish Directors of Finance on 10 February to discuss initial feedback and the way forward on the request. Following that meeting it was agreed to bring the matter forward to the next CIPFA/LASAAC meeting for consideration and CIPFA's Policy and Technical team provided the following points as initial thoughts from CIPFA.

- CIPFA noted that as the loans fund policy is set out in regulation and guidance, this is not in the gift of CIPFA/LASAAC or LASAAC to change. The Scottish Government will need to amend regulation to reflect their wishes. CIPFA/LASAAC will be able to provide comment only.
- CIPFA's view is that statutory mitigation in its current form should be retained based on the current local government funding mechanism, given the evidence it would cause an impact on council tax setting and hamper the 'smoothing' mechanism it provides.
- Retrospective application could be applied, with caution. Noting the importance that the 'credit' or 'holiday' from loans fund payments, should be ring-fenced and offset against future loans fund repayments and clearly demonstrated in any related policy.
- CIPFA would also add that when considering retrospective application, it is important to have due regard to prudential aspects and intergenerational equity.
- CIPFA would like to do further research and consideration on the question of matching grant income to asset life.

## 3. Accounting comparisons

3.1 Appendix 1 provides summary comparison of practice in Scotland and England across the headings of basic accounting, capital financing and funding arrangements. The key differences are in the methods of statutory repayment of debt. In England this takes place through the minimum revenue provision charges while in Scotland authorities operate a loans fund. Basic accounting and other matters are broadly similar.

3.2 Currently in both Scotland and England, loan fund repayments are MRP tend to follow the contract period and retrospective adjustment of a change in calculation are not allowed.

## 4. Conclusions and considerations

4.1 There appears to be some confusion in the request between what is an accounting issue and what is a capital funding/financing issue. CIPFA would conclude that under the current local government frameworks, funding and accounting are distinct issues. Accounting dealt with under the Code of Practice and capital funding dealt with under the Prudential and Treasury Management Codes. Any statutory mitigation for the impact of accounting arrangements on the authorities' general fund is a matter for the Scottish Government to agree and put in place.

4.2 Regarding the question of repayment of capital debts/borrowing, Scottish authorities operate a loans fund in line with applicable regulations. This is the key difference between Scottish Local Government and Local Government across England, Wales, and Northern Ireland where arrangements for Minimum Revenue Provision are in place.

4.3 Currently the Scottish Governments Local Government Finance Circular (07/2016) covering loans fund accounting allows four options for prudent repay of loans fund advances. These are:

a. Option 1 – Statutory Method

b. Option 2 - Depreciation Method.

c. Option 3 – Asset Life method either (i) Equal Instalment method or (ii) **Annuity method**

d. Option 4 – Funding / Income profile method

*In conclusion, the annuity method of repayment is accepted in the Scottish Governments regulations*.

4.4 Scottish Directors of Finance are asking for retrospective application using the annuity approach to re-profile the loans fund repayments over the life of the assets. As noted in appendix 1, the Scottish Government finance circular restricts loans fund repayments for PFI assets to the contract period.

4.5 CIPFA would note the overriding consideration on making provisions for debt repayment should be that it is a prudent approach. Intergenerational aspects also come into play in this case, as there is an argument that as the asset life is generally longer than the contract period, future generations will benefit from that as the cost to the council taxpayer has been absorbed earlier than the full-service potential of the assets that will return to the council and continue to be used. Therefore, in determining whether to allow retrospective restatement, both a prudent approach and intergenerational equity aspects should be considered and factored into that judgement.

4.6 If a retrospective approach is adopted, this will likely lead to a surplus reserve being created from the recognition of previous over-provision of loans fund advances. To ensure a prudent approach, the Scottish Government could consider how any such reserves are utilised going forward.

4.7 Comparison to the position in England, it should be noted that statutory guidance in England effectively removes the ability to retrospectively apply a change in MRP calculation. It states the calculation of MRP under the new method(s) should be based on the residual CFR at the point the change in method is made (i.e., it should not be applied retrospectively). Further the guidance goes on to state changing the method used to calculate MRP can never give rise to an overpayment in respect of previous years and should not result in a local authority making a reduced charge or a charge of £nil for the accounting period in which the change is made, or in any subsequent period.

4.8 Arguably if retrospection was allowed for this change to service concession arrangements, it would lead to a different approach between Scotland and England. However, this is a matter for the Scottish Government to consider and is not an accounting issue under accounting standards.

4.9 In terms of accounting for these arrangements, they are generally on balance sheet and depreciation is charged to the CIES over the life of the assets. Depreciation charges have no impact on the general fund as it is not an allowable charge to the general fund under regulations. It may be considered that a charge to reflect the consumption of service potential of the asset over a period should also match the charge to the council taxpayer who benefits. In that regard, the retrospective application to re-profile the loans fund charge could be determined an appropriate principle to follow.

4.10 A further question raised in this discussion is that of Grant Funding. Under the Code, capital grants and contributions would be recognised immediately as income, unless any conditions have not been met, in which case they are help in the appropriate usable reserve. In this case the funding is provided to Scottish councils by way of the General Revenue Grant from the Scottish Government. Councils in Scotland use this resource to pay the unitary charges on their service concession arrangement. Effectively this is treated in substance as revenue funding.

4.11 There is a distinct separation between revenue funding and the capital financing framework and therefore there is no requirement to ensure that the grant funding and loans fund accounting need to have matching time periods. This would support view to ignore the grant funding as this is for the purposes of revenue funding and applicable over timeframe of the contract, not the asset life.

## 5. Recommendations and next steps

- CIPFA/LASAAC will need to respond to the request from Kate Forbes, but this should reflect the role and remit of CIPFA/LASAAC and be restricted to accounting matters relevant to the Code and issues to support the prudent application of the capital framework outlined in the Prudential and Treasury Management Codes.

- CIPFA/LASAAC should consider if the proposals represent a prudent approach to the management of loans fund repayments.

- CIPFA/LASAAC may want to make it clear that ultimately the decision on regulation and statutory mitigations rests with the Scottish Government.

- CIPFA/LASAAC should take note of the potential for differing approaches across the different administrations in the UK and whether this has an impact or is merely a reflection of local considerations.

- CIPFA/LASAAC secretariat will compose the response based on the members reflections and agree that response with members prior to responding the Scottish Government.

Appendix 1.

Comparison of Service Concession Accounting

| Practice in Scotland | Accounting and Legislative basis | Practice in England | Accounting and Legislative basis |
|---|---|---|---|
| Basic Accounting | | | |
| Assets are recognised subject to recognition criteria in the Code.<br><br>A corresponding Long-term liability recognised. | Under the Code of Practice | Assets are recognised subject to recognition criteria in the Code.<br><br>A corresponding Long-term liability recognised. | Under the Code of Practice |
| Unitary payments are split between services and financing of the assets, i.e. construction/lifecycle replacement costs.<br><br>Service costs charged to CIES<br><br>Financing costs reduce the long-term liability created on recognition of the PFI asset. | | Unitary payments are split between services and financing of the assets, i.e. construction/lifecycle replacement costs.<br><br>Service costs charged to CIES<br><br>Financing costs reduce the long-term liability created on recognition of the PFI asset. | |
| Capital Financing | | | |

| Practice in Scotland | Accounting and Legislative basis | Practice in England | Accounting and Legislative basis |
|---|---|---|---|
| PFI arrangements are not considered the borrowing of money under the 1975 Act, rather a long-term liability or credit arrangement as identified in the Prudential Code.<br><br>The charge to the General Fund is a sum which recognises the repayment of the principal element of the long-term liability component of the PFI arrangement for the year. This is consistent with the approach taken in the 1975 Act in respect of the statutory borrowing of money. | Local Government (Scotland) Act 1975 and Finance Circular 4/2010 – Accounting for PFI and Similar Arrangements | PFI arrangements are reflected in the need to make Minimum Revenue Provisions (MRP).<br><br>There is statutory guidance on MRP issued by MHCLG (DLUHC) in guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003 | SI 2008/414 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008<br>Capital finance: guidance on minimum revenue provision (fourth edition) updated in 2018, issued by DLUHC |
| The 1975 Act requires each council to establish and maintain a loans fund. Advances from the loans fund are made for any capital expenditure in each financial year that is to be met from borrowing. | Local government finance circular 7/2016: Loans Fund Accounting guidance. | Loans Fund is not applicable. | |

| Practice in Scotland | Accounting and Legislative basis | Practice in England | Accounting and Legislative basis |
|---|---|---|---|
| Advances from the loans fund are required to be repaid over fixed periods, and Scottish Ministers have issued guidance on PFI arrangements requiring the contract period to be applied. | | | |
| Scottish Government guidance adopts the contract period to be the period over which the outstanding liability is charged to the General Fund.<br><br>This matches the period over which funding is provided by the Scottish Government for these arrangements.<br><br>Meaning there is no current mismatch between funding provided and accounting under prudential arrangements. | | Before 2008, the 2003 Regulations (Reg 28 of the 2003 act) contained details of the method that local authorities were required to use when calculating MRP. This has been substituted by the current Regulation 28 which gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'<br><br>DLUHC/MHCLG MRP guidance notes that for a change in the method of calculating MRP, the new | The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 |

| Practice in Scotland | Accounting and Legislative basis | Practice in England | Accounting and Legislative basis |
|---|---|---|---|
| | | calculation should be based on the residual CFR at the point of change,(no retrospective application). | |
| Depreciation costs are charged to the CIES of a council in accordance with proper accounting practices. Depreciation costs are to be excluded when determining the movement on the General Fund balance for the financial year. | | Depreciation costs are charged to the CIES of a council in accordance with proper accounting practices. Depreciation costs are to be excluded when determining the movement on the General Fund balance for the financial year. | |
| Funding Arrangements | | | |
| The Scottish Government provides funding via the General Revenue Grant (GRG).<br><br>Scottish Councils use this funding to pay for the Unitary Charges incurred on the PFI contracts. | | | |