

Technical Enquiry Service- Frequently Asked Question

Does it matter if a local authority has a negative net worth?

A number of authorities are already in a negative net worth position. This doesn't mean they are not a going concern. Local authorities are required to operate within the framework set out in the Local Government Acts. They will therefore need to budget for a positive General Fund balance, but are not required to maintain a positive net worth. It will be important that this position is presented effectively to the readership of the financial statements in accordance with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

Regulations determine what councils can charge to the General Fund - and hence against income - in a particular year. The most significant of these statutory accounting requirements under the regulations for most local authorities are the IAS 19 (Employee Benefits as adopted by the Code) pension reserve position and/ or the statutory accounting entries for capital finance with the capital adjustment account. The effect of these regulations can be to defer the funding of some expenditure, which may give rise to a negative net worth. The local authority balance sheet is based on IFRS (as adopted by the Code) and includes liabilities that local authorities are effectively prevented from settling until a future date.

When an authority has a negative net worth, this indicates that future taxpayers (whether through Council Tax or indirectly through government grants) will be funding some of the cost of providing services in the past.

In terms of the going concern basis, authorities are legally required to settle these liabilities in accordance with the regulations, not in accordance with the accounting requirements in the IFRS based Code i.e. those accounting requirements in the Code that are based on IFRS only (the Code also includes the statutory accounting requirements). This approach should ensure liabilities such as the pension's liability are met in the long run. The future funding of these liabilities will be met mainly by a combination of council tax (which authorities have a legal power to raise), and local government finance settlements. It is expected that future cash flows, aligned with authorities' budget processes, will provide sufficient resources to finance future liabilities, and hence a going concern basis is appropriate. Notwithstanding these general comments the authority will need to consider whether the effect of the authority's negative net worth results in any going concern issues for any part of the authority, this is normally unlikely to be the case if the negative net worth position is as a result of the timings of the statutory requirements as outlined above.

DISCLAIMER

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