

# Response to the consultation on mitigating the impact of fair value movements on pooled investment funds on local authority budget

September 2018



## About the Local Government Association

The Local Government Association (LGA) is the national voice of local government. We work with councils to support, promote and improve local government.

We are a politically-led, cross party organisation that works on behalf of councils to ensure local government has a strong, credible voice with national government. We aim to influence and set the political agenda on the issues that matter to councils so they are able to deliver local solutions to national problems. The LGA covers every part of England and Wales, supporting local government as the most efficient and accountable part of the public sector.

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

## General points

Local government is currently under severe financial pressure. We calculate that by the end of the decade councils will have had funding reductions equivalent to £16 billion while facing increases in demand for their services. By the middle of the next decade cost pressures on services will mean that councils will face a funding gap of £7.8 billion. In these circumstances, any changes to regulations that cause further pressures would be particularly unwelcome and more likely to result in reductions in services. The changes in treatment of changes in values of pooled investments fall into this category and this is why we called for the statutory override for this. Therefore we welcome the consultation on the proposals. There are precedents for a similar statutory override approach. It has been applied to accounting for pensions to avoid changes in the valuations of pension fund assets directly affecting resources available for services. The case for a statutory override for pooled investment funds is similar and at a smaller scale.

## Response to specific Consultation Questions

*Question 1 Do you agree that local authorities should be allowed to reverse out the impact of fair value movements on pooled investment funds to unusable reserves? If not, why not and what alternative approach would you propose?*

We have identified that if local authorities are not allowed to reverse out the impact of fair value movements on pooled investments funds, then, if and when those movements are negative, there will potentially be a serious negative impact on the amount of revenue funding available to fund services. Therefore we are in strong agreement that local authorities should be able to make this reversal and have called for it before.

This consultation itself implies that if the statutory override is applied then local authorities will be "obliged" to reverse out the impact of fair value movements on pooled investment funds to unusable reserves, rather than being "allowed" to do it. Some of our members have expressed the view that reversing out the impact should be a local discretionary decision.

Submission

*Question 2 Do you agree that the statutory override should be time limited? If not why not? If it is time limited, is a three year period appropriate.*

We disagree that the statutory override should be time limited. The argument is made in the consultation that the statutory override should come to end as it is desirable that that local authorities should account in the same way as other reporting entities in the private sector. But the accounts of local authorities are already different from the accounts of other entities and the tax and funding regimes that underpin them are different. The override will not affect the transparency of valuations or of transactions, just how changes in paper values impact on funding for services. We believe there is a strong case for the statutory override to be permanent.

According to Revenue Outturn statistics, in 2017/18 council investments earned over £730 million.<sup>1</sup> This is a valuable source of income at a time when council budgets are under great pressure. Although the proportion of this relating to pooled investments is not published, the ability to diversify investments and spread risks through use of pooled funds is a significant factor in achieving a return.

One of the arguments made for the override to be temporary is that it will give councils time to divest themselves of the affected assets. It does not make sense for councils to divest themselves of one type of investment that provides positive returns over time in order to manage the risk of having to fund an unrealised loss in any one year. If councils are forced to divest themselves of such investments this will result lower returns and in less money being available for services. The override should be made permanent.

If the statutory override is to be time limited 3 years is too short a timescale and 5 years would be preferable. The period to April 2021 is a period of great financial uncertainty for local authorities with a number of changes and possible pressures already being identified. For example, councils will have had to implement 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. A timescale of 5 years would therefore be more practical.

*Question 3 If you agree that local authorities should be allowed to reverse out the impact of fair value movements on pooled investment funds should this be limited to pooled property funds or apply to all pooled investment funds, and why?*

Although the consultation identifies that pooled property funds are a major investment made by councils that is affected by this, there seems to be no logical reason why other pooled investments should be treated differently. Applying it to all pooled funds will ensure consistency of treatment. Other pooled investment funds (one example quoted to us is short dated bond funds) are similar to property funds, but just backed by a different asset class.

*Question 4 Do you agree that local authorities should be required to disclose the net profit/loss reversed out of the general fund to mitigate the impact of the introduction of IFRS 9, as separate line in the Unusable Reserves note? If not please explain why not and detail the alternative approach you would prefer.*

The LGA agrees with this. We believe that by and large this is very similar in effect to current practice. The annual paper valuation and movements on it should already be known and be transparent. The aim of the statutory override should be that paper

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<sup>1</sup> [Local authority revenue expenditure and financing England: 2017 to 2018 individual local authority data - outturn - GOV.UK](#)

movements do not impact on real services. Transparency should not be diminished by the override.

*Question 5 Do you agree that the Government should not create a statutory override to protect local authorities from the impact of the move to the expected loss model to calculate impairments on loans and debt? If you disagree please explain why with case study examples if relevant.*

We agree there should be no statutory override on the impact of the move to the expected loss model on loans and debt. This is very different from pooled investments. With loans and debts it is prudent for local authorities to make immediate revenue provision for expected losses when they become apparent. Pooled investments are long term holdings the value of which will fluctuate up and down, so any gains or losses in any one year will be paper only and may change the following year.

*Question 6 Do you agree that the Government should not create a statutory override for any of the disclosure requirements introduced by the new standard?*

We agree with this. As with the answer to question 4 we support full disclosure and transparency. The call for the override is to mitigate the real impact on real services of paper movements in values.

*Question 7: Do you agree with the proposal to extend the regulations allowing local authorities not to charge back-pay awards for equal pay claims for a further two years to 2020? If not please explain why not.*

This is supported. This will give local authorities some additional local flexibility which they can then choose to use if that is appropriate and is therefore welcome.

*Question 8: Do you agree that the updated regulations should take effect for the 2018-19 financial year and what would be the implications of not doing so.*

Local authorities have been planning for the implementation of all the aspects of IFRS 9 for some time now and it seems sensible to implement on the planned date as this should help avoid confusion and uncertainty, so long as a statutory override is in place to mitigate the effects of changes in the valuation of pooled investments.