Public Service Reform Directorate
Local Government Division

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The Scottish Government

Finance Circular 4/2009

By email:
To: Local Authority Directors of Finance/ Finance Officers

Our ref: B2724831

17 March 2009

Dear Director of Finance / Finance Officer,

LOCAL AUTHORITY DEPOSITS HELD WITH ICELANDIC BANKS

The Scottish Government recently consulted on Statutory Guidance to allow local authorities with funds deposited in Icelandic banks that are in administration or receivership, to postpone the impact of the impairments required by accounting practice to 2010-11.

The Statutory Guidance has now been finalised and is now formally issued by Scottish Ministers under section 12(2)(b) of the Local Government in Scotland Act 2003.

The main change to the guidance from the consultation draft is to permit local authorities to retain accrued interest on affected deposits within the General Fund balance where a local authority considers it is prudent to do so.

The guidance is time limited and is restricted to the Icelandic bank situation. It is not an on-going intervention to cover any potential future failure of individual banks. Statutory intervention is only appropriate in exceptional circumstances and Scottish Ministers would wish to assess each situation as it occurs in deciding whether statutory intervention is an appropriate response.

Any enquiries about the guidance should be addressed to me at: hazel.black@scotland.gsi.gov.uk

Yours sincerely

Hazel Black

Head of Local Authority Accounting
Local Government Division

GUIDANCE ON PROPER ACCOUNTING PRACTICES - IMPAIRMENT OF CERTAIN INVESTMENTS

Scottish Government

Contents

Part 1 of this document gives informal advice only and is not part of the guidance itself, which is contained in Part 2.

PART 1 - BACKGROUND AND COMMENTARY

Policy Background

1. In his Statement to the Scottish Parliament on 11 December 2008 regarding the provisional local government finance settlement for 2009-10, Mr Swinney, the Cabinet Secretary for Finance and Sustainable Growth, announced that the Government proposed to issue statutory guidance. This guidance would, exceptionally, allow local authorities with funds deposited in Icelandic banks that are in administration or receivership, to postpone the impact of the impairments required by accounting practice, from 2008-09 to 2010-11. This will allow time for the position to become clearer as to what, if any, losses local authorities will actually incur as a result of these investments.

2. The immediate practical benefit is that authorities will not need to make provision in their budgets for 2009-10 for any possible loss on these deposits other than the loss of interest – see below. The local authority accounts will continue to show the impairments in accordance with proper accounting practice, but authorities will be permitted to make offsetting credits to prevent any impact on budget calculations for 2009-10.

3. The statutory guidance to achieve this result will be made under section 12(2)(b) of the Local Government in Scotland Act 2003.

Accounting Guidance

4. The statutory guidance needs to be considered in the context of the Code of Practice on Local Authority Accounting – the SORP. I also draw your attention to guidance issued by CIPFA's Local Authority Accounting Panel on the accounting treatment of possible investment losses – see LAAP Bulletins 78 and 79. In view of the SORP and CIPFA guidance, this informal commentary uses certain accounting concepts without further explanation.

Application

5. The statutory guidance will apply to any deposit made by a local authority in a bank for treasury management purposes which is subject to a loss event in the period commencing 1 October 2008 and ending on 31 March 2009 These deposits are described in the guidance as relevant investments.

6. The statutory guidance allows a local authority to make a statutory credit to their General Fund to postpone the effects of any impairment loss arising due to a default on a relevant investment. A local authority may make such an adjustment but is not required to do so.

7. The statutory guidance applies to General Fund investments. The Housing Revenue Account (HRA) is an account which forms part of the General Fund. As such the statutory guidance applies to the HRA.

8. The statutory guidance does not apply to investments made on behalf of local authority pension funds, the Common Good or Trust funds managed by the local authority.

Impairment

9. The statutory guidance deals with the treatment of an investment impairment loss in respect of a loss event which is recognised in the local authority's accounts for the financial years 2008-09 or 2009-10. The statutory guidance covers only investments which are subject to a loss event between the dates 1 October 2008 and 31 March 2009. This is to limit the application of the guidance to those deposits held by Icelandic banks and their UK subsidiaries that are now in Administration or Receivership. The dates are based on information provided to the Scottish Government on the maturity dates for the deposits held with the Icelandic banks. The loss event is anticipated to be a breach of contract, such as default or delinquency in interest or principal payments. The authority will have discretion to make a credit in its accounts in the year the impairment loss is recognised for an amount up to the amount of the impairment loss.

10. If, in 2009-10, an authority has to recognise an increase in the value of the impairment loss already recognised in 2008-09, it may make a credit up to an equivalent amount. Conversely, should a local authority recognise a reduction in the impairment loss already recognised in 2008-09 then a debit of an equivalent amount will require to be made. The effect of these adjustments is to neutralise the impairment losses required by accounting practice across the financial years 2008-09 and 2009-10.

11. The statutory intervention is only for a limited period. In 2010-11 the local authority will have to reverse any statutory credits made, that is make a reversing debit in 2010-11 equivalent to the total cumulative credit made across the financial years 2008-09 and 2009-10. Authorities will therefore need to plan to fund any impairment at this point.

Interest

12. The impairment charge recorded in the accounts will typically include elements relating to both the principal of the deposit and to interest. The Scottish Government does not consider it appropriate to defer the impact of any loss of interest specific to a financial year, unless the local authority can demonstrate that it is considers it prudent to continue to reflect the accrued interest within its General Fund (HRA) balance. The statutory guidance permits local authorities to defer the impact of any potential loss of interest where they feel it is prudent to do so.

13. LAAP Bulletin 78 advises that authorities will continue to credit interest to the Income and Expenditure account until the financial instrument is derecognised. This is because the amortised cost method recognises the loss in the impairment of the principal amount rather than removing interest earned altogether. Where the statutory guidance has been used to neutralise the impairment loss to the General Fund, the interest credit will remain within the Income and Expenditure account and hence the General Fund balance. The statutory guidance requires the local authority to make a debit, reducing the statutory credit by a sum equal to the value of any interest accrued for the deposit that they do not consider prudent to recognise in the General Fund balance. Local authorities will therefore need to consider the value of interest credited to the Income and Expenditure account in accordance with proper accounting practice, the value of accrued interest to the natural maturity date of the investment, the banks administrator's instructions regarding interest when submitting claims, together with any other information available to them, when assessing the value of any interest that they consider should remain within the General Fund balance.

14. This means that authorities may not use the statutory guidance to avoid all losses of interest on the investment but are likely to need to take some losses into account in setting their budgets for 2009-10.

Reporting

15. Scottish authorities should maintain a separate subdivision of the Financial Instruments Adjustment Account, and disclose the transactions relating to this subdivision separately in the note to their accounts. In 2010-11 the accounts should clearly demonstrate that a debit equal to all statutory credits made to the accounts across the financial years 2008-09 to 2009-10 have been eliminated. The Scottish Government will rely on the statutory accounts and associated notes to identify the value of any statutory credits made as permitted by the statutory guidance. This will avoid the need to ask for a separate return.

[PART 2]

GUIDANCE ON PROPER ACCOUNTING PRACTICES – IMPAIRMENT OF CERTAIN INVESTMENTS

Issued by Scottish Ministers under section 12(2)(b) of the Local Government in Scotland Act 2003

DEFINITIONS

1. ***Local Authority*** means a council constituted under section 2 of the Local Government etc. Act 1994 (c.39) and other bodies to which section 12 of the 2003 Act applies.

2. ***General Fund*** means the fund as detailed in section 93(1) of the Local Government (Scotland) Act 1973. The Housing Revenue Account is a statutory account forming part of the General Fund.

3. A ***Relevant Investment*** is a deposit made by a local authority in a bank for treasury management purposes which is subject to a loss event in the period commencing 1 October 2008 and ending on 31 March 2009, other than an investment made on behalf of a local authority pension scheme, the Common Good or other Trust Funds managed by local authorities.

4. A ***Loss Event*** is an event which requires a local authority to recognise an impairment of the relevant investment in the statutory accounts in accordance with proper accounting practices.

5. ***Statutory Credit*** is the sum of all the credits and debits made to the General Fund over the period commencing 1 April 2008 and ending 31 March 2010 as permitted by this statutory guidance.

6. ***Proper accounting p.ractices*** are those practices as set out by section 12 of the Local Government in Scotland Act 2003

APPLICATION

This guidance applies in relation to the financial years 2008-09, 2009-10 and 2010-11. It applies only in Scotland. It applies to all local authorities.

IMPAIRMENT OF CERTAIN INVESTMENTS

7. Where, in relation to a relevant investment, and in accordance with proper accounting practices –

   a. an impairment loss is recognised in the statutory accounts of the local authority for the financial year beginning 1 April 2008;

b. an impairment loss is recognised in the statutory accounts of the local authority for the financial year beginning 1 April 2009; or
c. the value of an impairment loss is recognised in the statutory accounts for the financial year beginning 1 April 2008 and is increased in the statutory accounts for the financial year beginning 1 April 2009,

the local authority may credit to the General Fund a sum up to the impairment loss recognised in the accounts for that year.

8. Where, in relation to a relevant investment, and in accordance with proper accounting practices –

a. the value of an impairment loss is recognised in the statutory accounts for the financial year beginning 1 April 2008 and is decreased in the statutory accounts for the financial year beginning 1 April 2009, and
b. the local authority has credited the General Fund in the year beginning 1 April 2008 for the impairment loss

the local authority must debit the General Fund a sum equal to the decrease amount recognised in the accounts for that year, but not exceeding the statutory credit.

9. Where, in reliance on this statutory guidance, a local authority has credited to the General Fund a sum for the impairment loss, and this impairment includes a sum for interest due but not yet received, the local authority must debit to the General Fund a sum which represents a prudent reduction to the interest recognised in the Income and Expenditure Account.

10. To the extent that a credit made under paragraph 7 has not been fully reversed by debits made under paragraphs 8 or 9, a local authority must debit to the General Fund for the financial year beginning 1 April 2010 an amount equal to the value of the statutory credit remaining.

REPORTING

11. The accounting records of the local authority must be maintained in a way that demonstrates that the statutory credit has been fully reversed in the financial year beginning 1 April 2010.

12. Credits and Debits made to the General Fund as permitted in this guidance must be shown as a reconciling item in the Statement of Movement on the General Fund balance in the local authority's statutory accounts.

13. The statutory accounts of the local authority should clearly identify the statutory amendments made to the accounts in reliance on this statutory guidance. A note to the accounts must clearly demonstrate that the statutory credit is fully reversed in 2010-11.

Scottish Government ***17 MARCH 2009***
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