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APPENDIX 1

Local Authority (Scotland) Accounts Advisory Committee

Accounting Practices for Scottish Local Authorities

LASAAC Guidance Note No 2

STATEMENT on the CALCULATION and ALLOCATION of LOANS FUND INTEREST and EXPENSES

Issued March 1991

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PREFACE

In response to the need for uniformity of treatment, LASAAC established a Working Group to produce guidance for Scottish local authorities. The Working Group which produced this Guidance Note were as follows:

John Lindsay (Chairman)	East Lothian District Council
Bill Hughes	Strathclyde Regional Council
Ian McLellan	Accounts Commission
John Winter	Accounts Commission

LASAAC would like to record its appreciation of the work of the above Group in producing this publication.

Local Authority (Scotland) Accounts Advisory Committee

Accounting Practices for Scottish Local Authorities

Guidance Note No 2

STATEMENT on the CALCULATION and ALLOCATION of LOANS FUND INTEREST and EXPENSES

(Issued March 1991)

1 INTRODUCTION

The purpose of this Guidance Note is to ensure that the Loans Fund average interest rates and expense rates are calculated on a common basis and to ensure that the practice of separately identifying interest on revenue balances and interest on capital balances is followed.

This statement should be read in conjunction with Schedule 3, paragraphs 12 to 21 of the Local Government (Scotland) Act 1975.

Loans Fund accounts should be kept on an income and expenditure basis.

2 THE COMPUTATION

The computation can be divided into four basic steps:

Step 1 Calculation of average temporary loan interest rate (daily, weekly or monthly rests or some other acceptable method) and allocation using this rate to average revenue and fund balances including Loans Fund revenue account. *(see glossary of terms)*

Step 2 Re-allocate Loans Fund revenue account interest to average revenue and fund balances on the basis of average capital advances.

Step 3 Allocation of remaining Loans Fund interest after Steps 1 and 2 to borrowing accounts on the basis of average capital advances.

Step 4 Allocation of Loans Fund expenses on basis of average capital advances

3 INTEREST, BALANCES and ADVANCES

a. Interest on the Loans Fund Revenue Account - to charge or not to charge?

Some authorities have suggested that the question of calculating interest on the Loans Fund Revenue Account should be re-examined. The possibility of abandoning this part of the calculation was criticised on the basis that the resulting change could result in significant changes in interest being charged/credited to various accounts, notably the General Fund and the Housing Revenue Account. Having examined the matter LASAAC recommends that the option of calculating interest on the Loans Fund Revenue Account should be adopted.

The arguments **for** calculating interest on the Loans Fund Revenue Account are:

i) Loans Fund interest is not allocated until the year end and therefore balances on other revenue accounts are understated. A more accurate split between capital and revenue interest therefore results from this procedure.

ii) It is inconsistent to allocate revenue interest to all the authority's funds and accounts and omit the Loans Fund.

iii) For district authorities, interest on revenue balances in the HSG formula is part of "other income" ascertained from actual HSG returns. For authorities still in receipt of HSG, non allocation of interest on Loans Fund Revenue Account could lead to an increase in income expected to be raised locally.

The arguments **against** calculating interest are:

iv) Simplicity - the elimination of the interest on Loans Fund Revenue Account step makes for a more straightforward calculation of Loans Fund (LF) interest rates. More frequent calculations can then be made.

v) The overall amount of interest does not change - only the allocation as between revenue account and capital account.

vi) There is no distinction between interest on revenue balances and interest on capital balances for RSG purposes.

vii) The allocation of interest on the Loans Fund Revenue Account based on **capital balances** is confusing and means that some large **revenue only** balances receive no adjustment. This is contrary to the principle in (i) above.

viii) In relation to (i) above, a similar argument could be made in relation to debt redemption which is not normally allocated until the year end which means that revenue balances are understated and capital balances are overstated.

ix) Materiality - for regional councils there is an insignificant impact between revenue and capital accounts when the calculation is excluded.

x) Charging further interest to the Loans Fund Revenue Account is superfluous since a deficit on the Loans Fund Revenue Account will have been financed by borrowing on which interest will have been charged.

b. Average Revenue and Fund Balances

An attempt has been made to provide as complete a list as possible of the major revenue and fund balances - see para 3(ii). However, this may not be exhaustive and authorities will wish to add to, or subtract from the list as appropriate.

c. Average Capital Advances

The Sub Group felt it would be impracticable to list every possible capital advance but felt that a definition should be provided which would attempt to standardise the calculation.

d. Pro formae

Attached are pro formae dealing with:

1. Method of calculation of average temporary loan interest rate
2. Method of calculation of average revenue and fund balances
3. Method of calculation of average capital advances for year
4. Method of calculation of average LF interest rate and expenses rate

The above methods of calculation attempt to incorporate the best prevailing practice.

e. Transferred Debt

Inter-authority debt is diminishing but still exists for some authorities. It should be charged directly to the borrowing accounts and not form part of the calculation of average Loans Fund interest.

4 GLOSSARY OF TERMS

i. Average Capital Advances for Year

Capital advances outstanding at the end of the financial year preceding are added to the weighted average of capital advances (monthly rests) made during the year to determine the average capital advances for the year.

(Note: Consistent practice should be adopted from year to year. An exhaustive list is not provided)

ii. Average Revenue and Fund Balances

Defined as the net balances with or due to the Loans Fund (ie: taking separate account of debtor, creditor, stock items), calculated on a weighted average basis (monthly rests) and, where applicable, added to the revenue and/or fund balance outstanding at the end of the preceding financial year.

Revenue and Fund balances consist of eg:

Superannuation Funds
Other Funds*
Housing Revenue Account
Other Housing Account
Water Undertaking Account
Non Domestic Water Rate Account
Community Water Charge Account
Non Domestic Sewerage Account
Trading Accounts
DLO Accounts
DSO Accounts
General Fund
Other Revenue Balances
Loans Fund Revenue Account

*"Other Funds" is defined as any account or reserve invested in or financed by the Loans Fund, other than those scheduled above (eg: Capital Fund, Repairs and Renewals Fund, Common Good Accounts, Charities and Trusts Accounts).

iii. Temporary Loans

Defined as loans borrowed for less than one year.

iv. Average Temporary Loan Interest Rate

Defined as the average of the interest rate on the authority's temporary loans, calculated over the financial year at daily, weekly or monthly rests or some other acceptable method.

v. Monthly Rests

Defined as either calendar monthly or four weekly.

5 CONCLUSION

LASAAC is of the opinion that the advice given in this Guidance Note represents reasonable and practical practice which should be applied by Scottish local authorities in terms of computation and accounting treatment.

6 DATE FROM WHICH EFFECTIVE

It is intended that this guidance should be put into operation as soon as practicable and should be applied in respect of accounting periods starting on or after 1 April 1991.

Pro forma 1

STEP 1

Calculation of average temporary loan interest rate

	(1) Temp Loans Outstanding	(2) Interest Rate daily, weekly or monthly rests or other accept-able method	(3) Assumed Annual Interest (1) x (2)	(4) Average Interest Rate for period (3) - (1) x 100
Period 1 Call	£	%	£	
2 Day				
7 Day				
3M + 7				
Others				
Total	£		£	%
Period 2 do				
Period 3 do				
Period 4 do				
Period 5 do				
Period 6 do				
Period 7 do				
Period 8 do				
Period 9 do				
Period 10 do				
Period 11 do				
Period 12 do				
Totals	£		£	%

Notes

1. The annual average is the summation of Column (3) divided by Column (1) multiplied by 100. This rate should then be applied to the average revenue and fund balances to give interest on revenue balances figure for the year.
2. The base date need not be the 1st of the month/week etc but consistency should apply throughout the year.

Pro form 3

STEP 3

Average Capital Advances for Year

Capital Account _____ **Year** _____

Ledger Balances* as at (Net Cumulative Total)

Month	1	× 12	£
Month	2	× 11	
Month	3	× 10	
Month	4	× 9 ETC	
Month	5		
Month	6		
Month	7		
Month	8		
Month	9		
Month	10		
Month	11		

* Net Cumulative Total £ _____

(a) WEIGHTED Average balance = $\frac{\text{Net Cumulative Total}}{12}$ = £ _____ dr/cr

(b) Balance at beginning of year being capital debt outstanding = £ _____ dr/cr

(c) Average balance for year (a) + (b) = £ _____ dr/cr

(d) Interest on (c) at LF rate % = £ _____ dr/cr

* **Note** It is normal practice to omit Month 12 from this calculation

* THIS SHOULD BE LEDGER ADVANCES IE MONTHLY ADVANCES IN WHICH CASE WEIGHTING MUST BE INCORPORATED IN THE CALCULATION

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Pro forma 2

STEP 2

Average Revenue and Fund Balances

Revenue Account _____ **Year** _____

Ledger Balances as at		(Net Cumulative Total) £
Month	1	
Month	2	
Month	3	
Month	4	
Month	5	
Month	6	
Month	7	
Month	8	
Month	9	
Month	10	
Month	11	
	* Net Cumulative Total	£ x

(a) Average balance = $\frac{\text{Net Cumulative Total}}{12}$ = £ Av Bal dr/cr

(b) Balance at beginning of year = £ of Bal dr/cr

(c) Average balance for year (a) + (b) = £ Av Bal for yr dr/cr

(d) Interest on (c) at average temporary loan rate % (from pro forma 1) = £ _____ dr/cr

* **Note** It is normal practice to omit Month 12 from this calculation

Pro forma 4

STEPS 3 and 4

Calculation of CLF Average Interest Rate and Average Expenses Rate

(a) Total External Loans Fund Interest with accruals = £ _____

(b) **Add/deduct**: Interest charged or received on average revenue and fund balances at average temporary loan interest rate %

Superannuation Fund	£
Other Funds	
Housing Revenue Account	
Water Undertaking Account	
Non Domestic Water Rate Account	
Community Water Charge Account	
Non Domestic Sewerage Account	
Trading Accounts	
DLO Accounts	
DSO Accounts	
General Fund	
Other Revenue Balances	
Loans Fund	**note only**

(c) **Deduct** Interest on Loans Fund Revenue Account allocated to (b) on the basis of average capital advances

(d) Balance (a + b) - c being total interest on capital advances = £ _____

(e) Total average capital balances for year - Total of pro formae 3c = £ _____

(f) CLF average interest rate = $\frac{(d)}{(e)} \times 100$ = %

(g) Total loans fund expenses with accruals = £ _____

(h) CLF average expenses rate $\frac{(g)}{(e)} \times 100$ = %

LOCAL AUTHORITY (SCOTLAND) ACCOUNTS ADVISORY COMMITTEE

Statement of Recommended Local Authority Accounting Practice

Statement No. 7

Calculation and Allocation of Interest on Revenue Balances

For any Local Authority the incidence of loans charges is a significant item in its revenue expenditure. Not merely is the item significant in total but the determination of the level of loans charges to each separate revenue account of the Authority can have important consequences in such matters as the determination of house rents and the calculation of charges to be made for services. It is therefore of paramount importance that the determination of the correct amount of interest to be charged in total by a Local Authority and the allocation to each separate account should be on a standard basis so far as possible, and should follow certain agreed principles.

The calculation and allocation of interest on revenue balances has had the consideration of the Chartered Institute of Public Finance Accountants (Scottish Branch, Directors of Finance) and has had the further consideration of this Committee. It is recommended that the bases set out in this statement should be applied in all circumstances where the advance is made out of a Loans Fund even if that advance is in turn used by the borrowing account to finance a loan at a pre-determined rate of interest, e.g. a loan to an industrial concern or to a house purchaser.

The method of calculating loans fund average interest rates and expenses rates to be used for the financial years 1980/81 onwards should be as follows:—

Capital Advances Outstanding at beginning of year		A
Average Net Capital Expenditure during year	(Monthly Rests)	B
Average Capital Advances for year	(A + B)	C
Average Revenue and Fund Balances —		
Superannuation Funds	(Weekly Rests)	D
Other Funds	(Monthly Rests)	E
Housing Revenue Accounts	(Monthly Rests)	F
Non-Relevant Accounts	(Monthly Rests)	G
(1) Housing (excluding Revenue Account and Grants)		
(2) Water Undertaking		
(3) Trading Accounts		
(4) Direct Works Department		
(5) Internal Transport Department		
(6) Domestic Water Rate Account		
(7) Transferred Debt		
Loans Fund Revenue Account	(Monthly Rests)	H
Other Revenue Balances	(Monthly Rests)	J
Average Temporary Loan Interest Rate	(Weekly or Monthly Rests)	K
Total Loans Fund Interest for year (with accruals)		L
Deduct: Interest charged or received:		
(1) Superannuation Funds	D x K	
(2) Other Funds	E x K	
(3) Housing Revenue Account	F x K	
(4) Non-Relevant Accounts	G x K	
(5) Loans Fund Revenue Account (Re-allocate to F, G and J on basis of C)	H x K	
(6) Other Revenue Balances	J x K	
Total Interest on Capital Advances		M
Loans Fund Average Interest Rate	$\frac{M}{C}$	P%
Total Loans Fund Expenses		R
Loans Fund Expenses Rate	$\frac{R}{C}$	S%

15 June 1980