CIPFA SE & SW Regions Public Finance in Wessex Conference

8th March 2018

YOUR INTEREST
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- MiFID II
- Prudential Code
- Treasury Management Code of Practice
- HDCLG Investment Guidance
- IFRS9

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MiFID II

The **Markets in Financial Instruments Directive** is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' and the venues where those instruments are traded.

For a Local Authority to transact across one of these venues, with a investment intermediary, they will be required to opt up from their default 'retail' status to a 'professional' counterparty. This requires the Authority and key personnel to satisfy specific qualitative and quantitative criteria.

QUALITATIVE TEST - The "qualitative test" requires a firm to undertake an assessment of the **expertise, experience and knowledge** of the local authority, in order for the firm to be reasonably assured, in light of the nature of the transactions or services envisaged, that the local authority is capable of **making its own investment decisions** and **understanding the risks involved**.
In order for a firm to undertake the assessment required for the purposes of the qualitative test, certain information must be received from local authorities.

QUANTITATIVE TEST - The size of the local authority's financial instruments portfolio (including both cash deposits and financial instruments) **exceed GBP 10,000,000**? The local authority has carried out transactions (in significant size) on the relevant market, at an average frequency of at least **10 per quarter** for the **previous four quarters** (i.e. at least 40 investments on the relevant market in the last year)?

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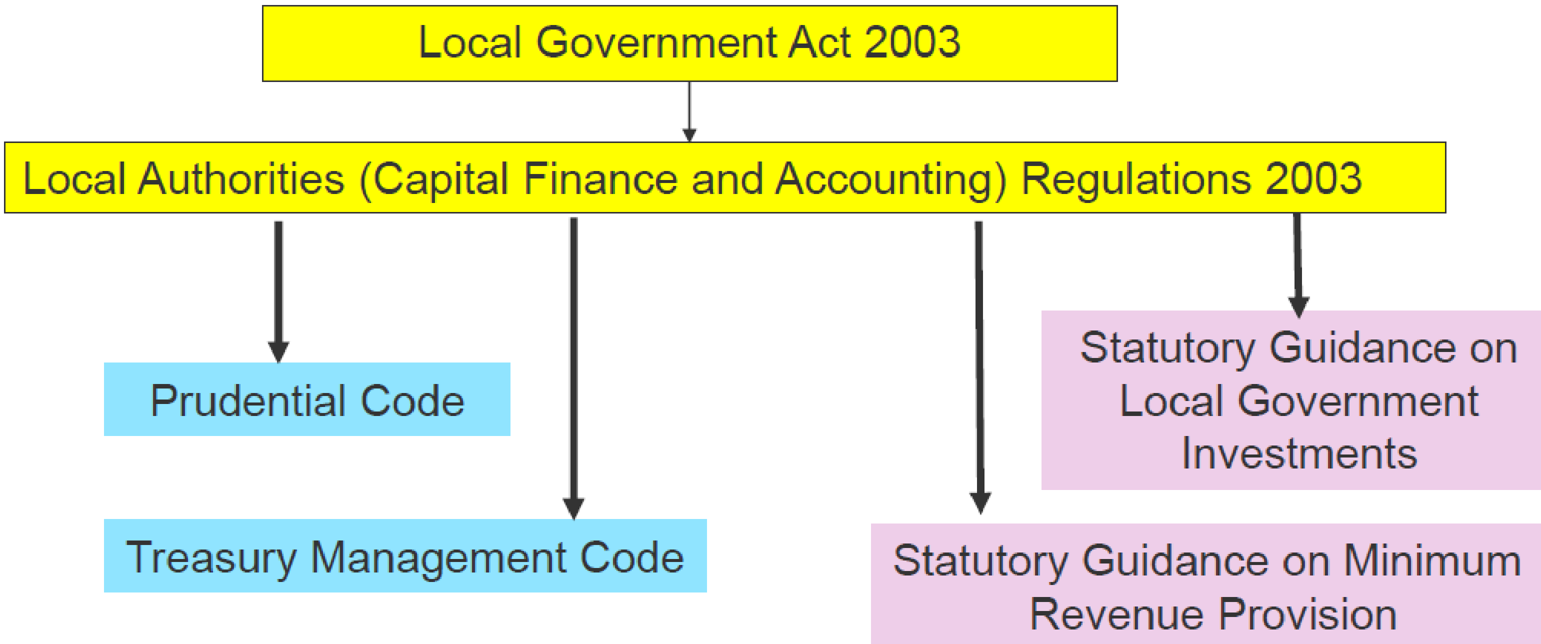
The Prudential Framework



Published by CIPFA

Published by DCLG

Source: Worth Technical Accounting Solutions

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Consultation 2017

Both DCLG and CIPFA have consulted on the Prudential Framework in 2017:

- DCLG consultation is now closed
- Revised guidance published 2 February 2018
- Implementation - investment guidance 1 April 2018
  - MRP guidance 1

DCLG recognises:

- Increasingly diverse nature of local government investments
- Increasing importance of alternative (non-specified) investments
- Dependence of revenue budgets on investment income

Source: Worth Technical Accounting Solutions

Investment Definition

An investment covers all of the financial assets as well as other non financial assets the LA holds primarily or partially to generate profit; for example, investment property portfolios.

This may therefore include investments that are not managed as part of normal treasury management processes or under treasury delegations

New Guidance on Investments

New Guidance (published February 2018) now requires:

- greater transparency - “explaining why as well as what”
- integrated capital spending, borrowing and investment strategies
- measurement and reporting of investment performance
- adequate training for officers and members making investment decisions

Investment strategies and PIs need to cover ALL assets not being used to deliver Council services , NOT just those involving the Treasury Management team

New guidance **PERMITS** borrowing to finance acquisition of investment assets **BUT** retains Capital Financing Requirement (CFR) so:

- **Borrowing should still = capital spend over the longer term**
- **Borrowing to invest should still create an “asset”**

Source: Worth Technical Accounting Solutions

Investment Strategies

Investment Strategy must be:

- approved by Full Council at the start of each year
- published on website
- linked to Capital Strategy which states clearly whether proposed expenditure is for operational or investment purposes

Investment Strategy must cover:

- all non-cash investments eg
- land and investment property
- loans to 3rd parties

Investment Strategy must explain:

- Risk exposure arising from investment decisions
- How all investments are funded
- Opportunity cost of investments
- Rates of return being achieved

Source: Worth Technical Accounting Solutions

New Investment PIs

Indicator	Purpose of calculation
Target income returns	Investment income compared to portfolio value
Loan to value ratio	Loan debt compared to asset value where borrowing has taken place for investment purposes
Benchmarking returns	Comparison by category and against other Councils' portfolios
Gross v net income	Investment costs as a % of income over time
Investment cover	Net income compared to interest costs
Vacancy levels/voids	To ensure property portfolios are managed productively
Investment income as % of NSE	Measures core services' dependence on income generated by investment decisions
Debt cost as % of NSE	Debt cost as % of NSE where borrowing is for investments which in turn support core services

Source: Worth Technical Accounting Solutions

Minimum Revenue Provision

"Loopholes" closed

- MRP **cannot** be a negative charge to the accounts
- Overpayments **cannot** be calculated retrospectively but **can** be offset against MRP charges in future years
- Asset lives used for MRP should be a **maximum** of 50 years **unless** a qualified valuer considers them to have a longer useful life
- MRP for leased/PFI assets should be based on **contract term**
- MRP requirement **applies** to investment assets financed by borrowing

MRP policy can be changed at any time **BUT**
- Must be approved by **Full Council** at the start of each year
- Any **changes** to policy must also be approved by Full Council

Source: Worth Technical Accounting Solutions

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IFRS 9 – What, Why, When?

What?

- Re-categorisation of assets and liabilities classed as “financial instruments”
- Write-down of investment values based on future expectations
- Specific disclosures on credit risks and unrealised losses or gains

Why?

More transparency about:

- Market value of investments
- Method of valuation
- Expected/unrealised losses and gains

When?

- Implementation date 1 April 2018
- Effective from 1 April 2018 – no restatement of 2017/18

Continues trend of using estimates and judgements in year-end financial reporting

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Source: Worth Technical Accounting Solutions

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Accounting issues

Discuss external audit requirements early in terms of:

- Proposed classification
- Valuation method and level 1-3 classification
- Other disclosure requirements

Practitioners will need to document:

- impairment calculation methods
- all key assumptions and judgements made
- the rationale for continuing to hold impaired investments.

No statutory override to IFRS 9 so:

- impairments are a real charge to Council Tax and revenue budgets
- build impairment forecasts into budgets for 2018/19 and beyond.

Source: Worth Technical Accounting Solutions

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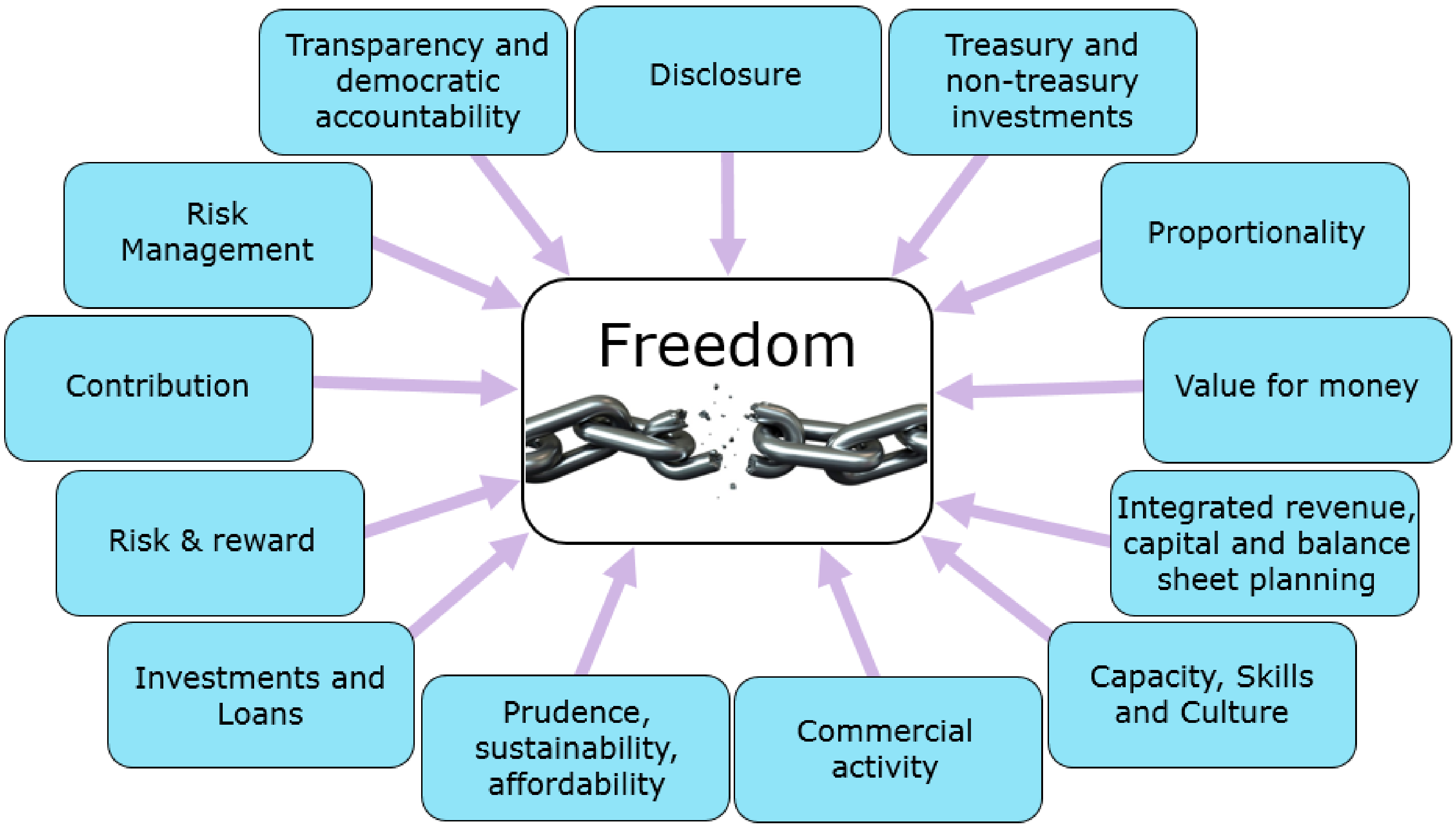
In Summary...



Question: Count the F's in the sentence below:

FINISHED FILES ARE THE RESULT OF YEARS OF SCIENTIFIC STUDY COMBINED WITH THE EXPERIENCE OF YEARS

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Answer: 6

FINISHED FILES ARE THE RESULT OF YEARS OF SCIENTIFIC STUDY COMBINED WITH THE EXPERIENCE OF YEARS


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Diversifying Investments

(Asset Backed Treasury or Non-Treasury Options)

Green:
- Renewable Energy
- Waste to Energy

Business Support:
- Pooled Investment Funds
- Business Investment

Responsible:
- Forestry
- Carbon Reducing Tech.

Localism:
- Leisure
- Fuel Poverty

Regeneration:
- Crematoria
- Residential Property

Treasury returns:
Tenor: 3 – 7 years
Yield: 4.00% - 8.00%

Non-Treasury returns:
Tenor: 5 – 30 years
Yield: 5.00% - 12.00%

"Governance is an enabler, not a straight jacket"

Former CIPFA President – John Mathieson

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