Update on options for centralising appeals and other valuation only changes

1. The Government remains committed to mitigating the impact of appeals and other valuation changes on the local government finance system and will continue to investigate the optimal technical way to implement this.

2. However, there are questions around the viability of options currently being scoped. The two central issues are:

    i. How the money is dealt with through accounting arrangements; and
    ii. How to measure the compensation due to local authorities.

3. The Department has gratefully received further email responses to the questions posed in Technical paper 3: Spreading the Risk of Valuation Losses across the Local Government Sector to Reduce Volatility and will consider all suggestions made.

4. The possible approaches put forward by the Department, and suggested by SDWG members, either concern dealing with issues raised by proxies and accounting from an implementation perspective, or attempt to side-step them.

Progressing our work on the accounting solution

5. The Department is looking at four options to centralise list alterations. The issues associated with each are outlined below. These options are:

    a. Accounting through the Movement In Reserves Statement;

    b. Alternative accounting solution;

    c. Reimbursement to authorities for provisions made; and

    d. Using ‘line 6’ of NNDR3 forms.

Accounting through the Movement In Reserves Statement (MIRS)

6. The Department is working with CIPFA to develop an accounting model, allowing authorities to switch their provisions for valuation only changes into an adjustment account. This would allow authorities to spend money on services in year, which they would not otherwise have been able to because it would have been tied-up in the provision. This has been a long term piece of work that first begun before the (now fallen) LGF Bill was introduced into Parliament, when CIPFA informed the Department that despite the Bill taking a power for the SoS allowing loss payments to be made, authorities would retain the IAS 37 obligation to make provisions against list alterations.

7. The main focus of the work on this option is building a spread-sheet model which allows this idea to be tested. The model has been completed to show a scenario where all predictions are perfect (i.e. valuation change is equal to the estimate made in provisions to cover it). Work remains to be done on modelling other scenarios, which correspond to likely real-world experiences of authorities. The Department is working with CIPFA colleagues in developing this.

8. This full accounting model means accounting for numbers that are never "fixed" but are constantly changing as authorities revise their view of the provisions they need. Its deliverability is therefore the main challenge and even if deliverable it looks likely to be extremely complex.

<u>Alternative accounting solution</u>

9. Following the System Design Working Group's discussion of technical paper 3, the Department received a suggestion from an SDWG member that an alternative solution could be to allow authorities to simply show MHCLG as a debtor in their accounts for the amount of their provision. However, this is unlikely to be acceptable under proper practices. This is because the operative event for an authority recognising a debtor and MHCLG recognising a liability remains the point that an award is made following an appeal, not the point at which the billing authority provides. The Department is scoping this in collaboration with CIPFA.

<u>Reimbursement to authorities for provisions made</u>

10. It was suggested when the System Design Working Group discussed technical paper 3; that the Department should simply reimburse authorities for provisions made by paying S31 grant into their Collection Funds (the Department is scoping whether this will require additional legislation). All relevant authorities would then take their share of the grant and it would appear in their General Fund. At the point of charging the provision it would be paid into the Collection Fund and redistributed to relevant parties, including Central Government.

11. The advantages of this approach are that we would not need to know how the provision was calculated; the operative event is paying the section 31 grant so there would be no need to wait for the appeal to be heard; and it appears relatively easy to administer.

12. However, from a central Government perspective, the Department would be making payments in advance of need. Managing Public Money defines payments in advance of need as novel and contentious, requiring specific Treasury approval. In addition, this approach would mean that the Department would pay a cash grant to offset a non-cash expense that may never be realised, which would be very difficult to justify on value for money grounds. A further concern for the Department is that this approach would incentivise overestimating

provisions and there would be no incentive to bring the provision back. It would also not make a distinction between the different types of list alterations (valuation only and developmental). Finally, this approach may not be permissible under proper practices (we are working with CIPFA to come to a detailed view).

<u>Using 'line 6' of NNDR3 forms</u>

13. A method in consideration is the use of "line 6" 'RV list amendments charged against the provision for appeals' (Part 2, Losses on Appeal) of NNDR 3 forms. This could be split out into 6A and 6B, allowing for a broad separation of valuation only changes (those backdated to the first day of the list) and physical changes (not backdated).

14. It would still be necessary to employ a "proxy" – namely, all changes backdated to the first day of a list would be classified as "valuation only"; anything backdated to a later date would be classified as "physical change".

15. The line 6 numbers currently vary in their reliability and so we would need software suppliers to make changes to their IT systems to deliver a more robust number against which we could confidently pay out reimbursement. What we would need to know would be:

    a. The change in liability resulting from the RV change for both "valuation" and "physical" list changes, and for "valuation" to be broken down to give the amounts for the current and each prior year.

16. This should be a relatively straightforward change to IT systems, allowing one of two flags to be put against each RV change by billing authorities and then allowing the system to be interrogated to produce the necessary information on the change in liability that results. It will be necessary to work with software providers to establish whether this can be done for a reasonable cost.

17. For "valuation" changes, authorities will need to be given a one-off payment to cover the backdated change in liability and the Department will then use the current year change (uprated by the change in the multiplier) to adjust the following year's tariff and top-up.

Calculating the amount due

<u>Progressing our work on the proxy</u>

18. We are continuing to work with the VOA on the proxy[i] backdating to first day of list. The VOA also suggested at the SDWG that Transitional Relief Certificates could be used to cross reference list alterations and sense check that we have come to the right answer. There is further work to be done on scoping this idea.

19. Our working presumption remains that if we are going to centralise appeals and other list alterations that the proxy (potentially alongside TR certificates) is:

a) The only available option; and

b) A good proxy.

20. The Department's next step will be to understand the distributional impact of the use of this proxy. We have therefore requested the relevant list alteration data for all authorities from the VOA.

21. As outlined in the original paper on the proxy *Calculating compensation for valuation changes,* which was presented to the SDWG on 14 October 2016, we can not go straight from establishing rateable value reduction to compensation due and will have to deploy a second proxy. This would operate alongside the first proxy discussed above and would measure percentage change on the first day of the list and apply this percentage to income in every year for which compensation is needed. The Department is continuing work on this.

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[i] As described in Calculating compensation for valuation changes, 14 October 2016.