POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Update on handling appeals risk under 100% rates retention

The problem

Local authorities are currently required by IAS 37 to make provision against changes to a ratepayer's business rates liability, principally as a result of appeal loss.

Under the 50% rates retention scheme, authorities were provided with funding for provisions. Effectively, this was done by "top-slicing" an amount - £1.8bn – from the initial calculation of the business rates that would be collectible in the first year of the scheme (and hence, every subsequent year).

Appeal loss varies significantly between authorities. At the end of 2014-15 (the last year for which published data is available), excluding outliers, 90% of authorities held provisions as a percentage of collectible rates ranging from 2.5% to 23.2%. The way the "top-slice" was effectively distributed to authorities under the rates retention system, has meant that some authorities' provisions have exceeded their share of the top-slice, thereby reducing their income under the scheme. Whilst for others, the share of the top-slice has exceeded the provisions they have had to make. Moreover, because forecasting appeal loss (and hence, calculating provisions) is inherently difficult, the impact of "getting it wrong", risks there being higher income volatility year-on-year than would be the case if losses were more predictable.

We have been exploring options for dealing with appeal losses (or some proportion of them) at national level. The basic proposition would be to compensate authorities directly for RV changes that are backdated to the first day of the rating list.
The funding for compensation payments would be "top-sliced" from the quantum of business rates on the first day of the new 100% scheme, in much the same way as under the 50% scheme.

However, of itself, guaranteed funding for a proportion of appeal losses would not remove the IAS 37 requirement for authorities to make provisions against <u>all</u> losses that fell within the IAS 37 definitions. Unless therefore, provisions are to impact on authorities business rates income, we would need to take a further top-slice at the outset of the scheme. This would reduce still further the "quantum" of business rates in the scheme on day 1 and reduce the value of new responsibilities that are to be devolved. It would effectively "double" the value of the top-slice made at the outset of the scheme and would have a resource cost to central government.

If therefore, we want to pursue the idea of centrally-funding a proportion of appeal losses, we need to find a way of operating the new system that allows authorities to recognise as "income" in any year, that part of any provision for which ultimately they will be compensated, albeit perhaps many years down the line.

Using an "adjustment" account

A small group of local authority representatives and CIPFA met to discuss the issues, and agreed that a possible approach might be to have the charge to the revenue account "switched" into an adjustment account – leaving the General Fund balance as if the provision (at least insofar as the first-day backdated element is concerned) had not been made. The amount thus debited to the adjustment account would later be credited at the point that change to the rating list was made and the compensation payment was due from "central government".

This is broadly the approach that was adopted in the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2014 (SI 2014/1375) - see attachment A - to allow authorities to spread the cost of the initial backdated appeal provisions under the current 50% rates retention scheme.

The group agreed that to test this further, we should:

i. Highlight this solution to the Systems Design Working Group to gather any further thoughts on this solution;
ii. Test out how this would work in practice by working through the accounting steps required;
iii. Highlight this favoured approach to the Accounting and Accountability Working Group to test the practical impact;
iv. Identify the data (proxies) that would be required from the VOA and local authorities under this solution;
v. Meet again as a small group to discuss progress.