

# LAAP BULLETIN 79

## PROVISIONAL

### January 2009

## IMPAIRMENT OF FINANCIAL ASSETS: SUPPLEMENTARY GUIDANCE

This Guidance is PROVISIONAL but will only change if the draft Regulations and Statutory Guidance are amended following consultation

AT THE HEART OF  
PUBLIC SERVICES 

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## BACKGROUND

1. LAAP Bulletin 78, issued in November 2008, provided guidance on accounting for the impairment of financial assets. LAAP Bulletin 78 also highlighted issues that authorities would need to consider when considering their 2009/10 budget. This bulletin updates and extends the guidance contained in LAAP Bulletin 78 to reflect changes that have occurred and issues that have been raised since that bulletin was issued. Authorities should continue to refer to LAAP Bulletin 78 in relation to issues not covered in this bulletin.
2. Examples in this bulletin are for illustrative purposes only, and do not represent CIPFA's view of the proportion of an investment that is likely to be recoverable from the Icelandic banks that went into liquidation in 2008 or any future impairment event.

## INVESTMENTS IN RELATION TO OTHER BODIES / FUNDS

3. Authorities' investment operations may include cash management on behalf of other funds (e.g. the surplus cash of Pension Funds) and other organisations (e.g. other local authorities and local authority companies). These arrangements may raise issues as to which organisation or fund will bear any impairment charge.
4. Responsibility for the impairment charge will be determined by the contract or agreement between the authority and the other fund or organisation. The nature of the contract or agreement, and hence the responsibility for the impairment charge, is likely to depend on local circumstances and authorities will need to determine their own legal position to determine which fund or organisation is responsible for the impairment charge.
5. Pension Fund investments are governed by The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended). Regulation 9 states that "An administering authority must invest any fund money that is not needed immediately to make payments from the fund." Regulation 12 states that "An administering authority must pay interest on the total from day to day of any fund money used by them and not repaid." Authorities will therefore need to determine whether they were acting as an agent for the Pension Fund by making investments or whether they were receiving an investment from the Pension Fund, and subsequently reinvesting the funds received. An arrangement whereby funds are pooled and the net amount is invested (with no investment being identifiable to an individual fund) would be evidence that the administering authority was using Pension Funds money under Regulation 12; this will however be subject to any specific arrangements in place locally, and as discussed in paragraph 4 authorities will need to determine their own legal position. The general arrangement in Scotland is that Pension Funds invest in the Loans Fund; as such the impairment will be the responsibility of the Loans Fund, although there may be an indirect impact on the Pensions Fund in the same way that there can be an indirect impact on the HRA (see paragraphs 49 – 51 of LAAP Bulletin 78).
6. Where an authority's investment operations include cash management on behalf of other funds or organisations, the following scenarios may occur (this list is not exhaustive).
  - The authority is acting as an agent for the other fund or organisation - the impairment will be the responsibility of the other fund or organisation;
  - the authority has received an investment from the other fund or organisation, which it has subsequently chosen to reinvest – the impairment will be the responsibility of the authority;
  - there is a joint arrangement between the other fund or organisation – responsibility for the impairment will be shared, based on each party's share of the joint arrangement; if the arrangement does not specify how responsibility for the

impairment is to be shared, the authority should follow the principles for apportionment set out in the Best Value Accounting Code of Practice.

#### PROPOSED REGULATIONS (ENGLAND AND WALES) AND STATUTORY GUIDANCE (SCOTLAND)

7. The Local Government Minister announced on 26 November 2008 that local authorities in England were to be allowed to defer the impact of any impairment charges relating to impaired investments (specifically the Icelandic Banks) on the General Fund. However, the draft regulations will not allow the impact of interest losses to be deferred. This change is to be effected by way of regulations. The accounting arrangements for 2008/09 and future years, and the impact on the 2009/10 budget are considered below. These arrangements are based on the draft regulations, published for consultation on 10 December 2008. It is possible that, following consultation, the wording of the final regulations will be amended; if this occurs and results in revised accounting requirements, CIPFA will update the guidance in this bulletin.
8. The Welsh Assembly Government announced its intention to implement similar regulations on 2 December 2008. Whilst draft regulations have yet to be issued, discussions with officers at the Welsh Assembly Government indicate that the guidance in the bulletin will be applicable to Wales. It is anticipated that the Welsh Assembly Government will confirm this position when the draft regulations are issued for consultation.
9. The Scottish Government announced its intention to issue statutory guidance on 11 December 2008. Whilst draft guidance has yet to be issued, discussions with officers at the Scottish Government indicate that the guidance in the bulletin will be applicable to Scotland (with references to 'regulations' being read as references to 'statutory guidance'). It is anticipated that the Scottish Government will confirm this position when the draft guidance is issued for consultation.
10. Authorities should note that the draft regulations do not affect the HRA, and the accounting treatment outlined in LAAP Bulletin 78 for the HRA should be followed. This is because the HRA accounting rules do not allow the impairment to be charged to the HRA. The impact of any impairment on the interest credited to the HRA (England and Wales) and interest and expenses charged to the HRA through the Loans Fund (Scotland) is covered in paragraphs 44 – 51 of LAAP Bulletin 78.
11. The regulations also do not apply to investments made for the purposes of an external fund, such as the Pensions Fund; these funds are not permitted to defer the impact of any impairment loss, as the draft regulation specifically excludes these funds from its scope. Pension Funds are required to measure investments at fair value. The impairment of a Pensions Fund investment would automatically be reflected in a reduction of the fair value of the investment, and therefore in the accounts for the financial year in which the impairment occurred.

#### *Accounting Arrangements for 2008/09 and future years*

12. Where an investment has been impaired, the authority should account for the impairment in accordance with proper practice; this is covered in paragraphs 6 – 35 of LAAP Bulletin 78. It is anticipated that the impairment will take place in 2008/09, but it is possible that recognition of the impairment will be deferred until 2009/10 where there is insufficient information on which to base the assessment of the impairment. In such circumstances, a contingent liability would be disclosed in the 2008/09 accounts. Calculation of the impairment is likely to take place after the 2009/10 budgets have been considered, and authorities should refer to paragraphs 25 – 29 of this bulletin for guidance in relation to the 2009/10 budget.

13. In the year in which the impairment is recognised, an authority may take advantage of the proposed regulation and adjust the General Fund to reduce or negate the impact of the impairment charge in that year. This is achieved by transferring an amount no greater than the impairment charge to the Financial Instruments Adjustment Account. This transfer will be recorded in the Statement of Movement on the General Fund Balance.
14. Authorities should note that they may choose not to make such a transfer, or to transfer a lower amount than the impairment charge; in such circumstances, that part of the impairment charge that is not transferred to the Financial Instruments Adjustment Account will remain as a charge to the General Fund, and will need to be taken into account when considering the 2009/10 budget (see paragraphs 25 - 29 of this bulletin).
15. The accounting entries required in the year in which the impairment is recognised are:
- Dr        Financial Instruments Adjustment Account  
Cr        General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)
16. Interest should be credited to the Income and Expenditure Account in accordance with proper practice (see Example 1 in LAAP Bulletin 78). Where the impairment charge has been transferred out of the General Fund in accordance with the proposed regulations, interest credited to the Income and Expenditure Account should also be reversed out of the General Fund and credited to the Financial Instruments Adjustment Account where the interest had not been received at the time the investment was impaired. Example A in Appendix A covers interim receipts of interest.
17. Where an authority has chosen to transfer only a proportion of the impairment charge to the Financial Instruments Adjustment Account, interest credited should be transferred to the Financial Instruments Adjustment Account up to the net amount previously transferred to this account in respect of each investment (see Example B in Appendix A of this bulletin).
18. The accounting entries required in respect of the interest for 2008/09 and 2009/10 are:
- Dr        General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)  
Cr        Financial Instruments Adjustment Account
19. It is possible that an authority will revise its estimate of the impairment as more information becomes available. Where this results in an increase in the impairment, the authority may choose to transfer this amount to the Financial Instruments Adjustment Account. The accounting entries will be the same as for the original impairment (see paragraphs 14 – 15 of this bulletin), provided the revised estimate occurs in either 2008/09 or (more likely) 2009/10.
20. Where the revised estimate results in a decrease in the impairment, the authority must credit this amount to the Financial Instruments Adjustment Account, up to the net amount previously transferred to this account in respect of each investment. The accounting entries will be the same as for the transfer of interest credits (see paragraphs 16 – 18 of this bulletin, and Example C in Appendix A of this bulletin).
21. The draft regulations only defer the impact of the impairment on the General Fund, and require authorities to reverse the transfers at a later date. The net amount of the transfers to the Financial Instruments Adjustment Account will need to be debited to the

General Fund. The regulations require this reversal to be effected in either 2009/10 or 2010/11. Authorities will therefore need to plan to fund the impairment at this point.

22. The accounting entries required to effect the reversal are:

Dr	General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)
Cr	Financial Instruments Adjustment Account

23. Authorities may find it useful to maintain a separate subdivision of the Financial Instruments Adjustment Account (and disclose this separately) as this could make increase the transparency of the accounts, and assist authorities in demonstrating that, at the end of the process, that all remaining balances have been reversed. However, maintaining a separate subdivision is not a requirement of the draft regulations. The Scottish Government has indicated that it would prefer to obtain information on authorities' impairments and use of the Statutory Guidance from their published accounts rather than via a separate return. It is therefore recommended that Scottish authorities maintain a separate subdivision of the Financial Instruments Adjustment Account, and disclose the transactions relating to this subdivision separately in the note to the accounts.

24. The application of the proposed regulations is shown in the example below, which is based on Example 1 in LAAP Bulletin 78. The additional entries required where an authority takes advantage of the proposed regulations are shown in bold text.

**Example 1**

An authority invested £10 million in ABC Bank for six months at 5.5%, repayable on 31 March 2009. At the balance sheet date (31 March 2009), the carrying amount of the investment was £10,275,000 (the interest receivable of £275,000 being recognised in the Income and Expenditure Account). The bank has experienced financial difficulties, and as a result the repayment of the investment has not been made. The administrator has announced (prior to the 2008/09 accounts being closed) that 45% of the principal will be repaid on 31 March 2010 and 45% on 31 March 2011. No interest will be paid. The recoverable amount can therefore be calculated as follows:

Date	Discount Factor	Repayment	Present Value
31 March 2010	0.94787	£4,500,000	£4,265,415
31 March 2011	0.89845	£4,500,000	£4,043,025
<b>TOTAL</b>			<b>£8,308,440</b>

The recoverable amount of the investment is £8,308,440, which is £1,966,560 less than the carrying amount of the investment. An impairment of £1,966,560 would therefore need to be recognised in the Income and Expenditure Account in 2008/09.

The authority has decided that it will take advantage of the proposed regulations to defer the impact of the impairment charge on the General Fund until 2010/11. As a result of this decision, both the impairment charge and the interest credited to the Income and Expenditure Account will be transferred to the Financial Instruments Adjustment Account.

The accounting entries that will be required in 2008/09 are:

Dr	Income & Expenditure Account	£1,966,560
Cr	Financial Assets (or the Allowance Account if one is being used)	£1,966,560

Being the impairment of the investment charged to the Income and Expenditure Account

Dr	Financial Assets	£275,000
Cr	Income & Expenditure Account	£275,000

Being the interest receivable credited to the Income and Expenditure Account

<b>Dr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£1,966,560</b>
<b>Cr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£1,966,560</b>

**Being the application of the draft regulations to transfer the impairment charge to the Financial Instruments Adjustment Account to mitigate the impact on the General Fund balance**

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£275,000</b>
<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£275,000</b>

**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account**

The amortised cost method requires that interest continue to be credited to the Income and Expenditure Account until the financial instrument has been derecognised. This will be the point at which the final payment in respect of the investment is received. As final payment will not be received until 31 March 2011, interest will be credited to the Income and Expenditure Account in both 2009/10 and 2010/11.

Interest credited to the Income and Expenditure Account in 2009/10 will be £456,964 (the carrying amount at 31 March 2009 of £8,308,440 multiplied by the interest rate of 5.5%, applicable for 1 year). The interest credited to the Income and Expenditure Account will be transferred from the General Fund to the Financial Instruments Adjustment Account in accordance with the proposed regulations.

The carrying amount of the investment at 31 March 2010 will be £4,265,404 (opening carrying amount of £8,308,440 plus interest of £456,964 credited to the Income and Expenditure Account less the first payment of £4,500,000 to be received from the administrator on 31 March 2010). The accounting entries in 2009/10 will be:

Dr	Financial Assets	£456,964
Cr	Income & Expenditure Account	£456,964

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account

Dr	Cash	£4,500,000
Cr	Financial Assets	£4,500,000

Being the receipt of the first payment made by the administrator

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£456,964</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£456,964</b>
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**Being the application of the draft regulations to transfer the interest receivable to the Financial Instruments Adjustment Account**

Interest credited to the Income and Expenditure Account in 2010/11 will be £234,596 (the carrying amount at 31 March 2010 of £4,265,404 multiplied by the interest rate of 5.5%, applicable for 1 year). The carrying amount of the investment at 31 March 2011 will be £ nil (opening carrying amount of £4,265,404 plus interest of £234,596 credited to the Income and Expenditure Account, less the final payment of £4,500,000 to be received from the administrator on 31 March 2011).

The net amount previously transferred to the Financial Instruments Adjustment Account (impairment charge of £1,966,560 less interest credited to the Income and Expenditure Account in 2008/09 of £275,000 less interest credited to the Income and Expenditure Account in 2009/10 of £456,964) will be transferred to the General Fund in accordance with the proposed regulations.

The accounting entries in 2010/11 will be:

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£1,234,596</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£1,234,596</b>
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**Being the application of the draft regulations to effect the transfer of the net balance in relation to the impairment from the Financial Instruments Adjustment Account to the General Fund once the protection offered by the draft regulations has expired**

Dr	Financial Assets (interest credited to I&E)	£234,596
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Cr	Income & Expenditure Account (interest credited to I&E)	£234,596
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Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account

Dr	Cash (payment received)	£4,500,000
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Cr	Financial Assets (payment received)	£4,500,000
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Being the receipt of the second payment made by the administrator

[Note: these entries assume the transfer between the General Fund and the Financial Instruments Adjustment Account occurs at the start of 2010/11. An alternative approach would be for the transfer to take place at the end of 2010/11. Where this approach is adopted, it would be logical in accounting terms for the interest credited to the Income and Expenditure Account to be transferred to the Financial Instruments Adjustment Account during the year, although this entry is not strictly required by the draft regulation. Where this entry is made,

the final transfer between the General Fund and the Financial Instruments Adjustment Account would be for £1 million.]

Over the three years, the net amount charged to the Income and Expenditure Account is £1,000,000. This represents the loss of the principal amount, and also recognises no interest will be receivable.

Authorities should note that where interest may be receivable from the administrator, this should be included in the net present value calculations (see Appendix A of LAAP Bulletin 78 for further details)

Further examples, covering different scenarios, are provided in Appendix A of this Bulletin.

### *Impact on the 2009/10 Budget*

25. Paragraphs 40 – 42 of LAAP Bulletin 78 outlined the considerations to be taken into account for the 2009/10 budget. Following the publication of the draft regulations, these considerations are unlikely to apply to the 2009/10 budget; however they will be relevant when considering the 2010/11 budget.
26. As shown in Example 1 above, the effect of the regulations is to allow authorities to defer the impact of the impairment charge until either 2009/10 or 2010/11. However, where advantage is taken of these regulations, authorities will need to plan for the loss of interest income in the years in which the impact of the impairment is deferred.
27. At the point at which the 2009/10 budget is prepared, authorities may not have sufficient information to estimate the impairment and calculate the detailed accounting entries described above. However, the effect of the draft regulations is as follows, and can be taken into account in the 2009/10 budget. It is assumed that authorities planning to take advantage of the draft regulations would plan to defer the impact of the impairment charge on the General Fund until 2010/11, at least until the amount of the impairment charge was known. This assumption is reflected below.
28. The impact of taking advantage of the draft regulations on the 2009/10 budget will be as follows:
  - The impairment charge does not need to be funded in the 2009/10 budget;
  - interest to be credited to the Income and Expenditure Account in 2009/10 in respect of the impaired investment should be excluded from the 2009/10 budget;
  - the balance on the General Fund at 31 March 2009 will exclude interest (in respect of the impaired investment) that has been credited to the Income and Expenditure Account, but not received.
29. The following example demonstrates how the amounts to be taken into account in the 2009/10 budget can be identified.

### **Example 2**

An authority invested £10 million in XYZ Bank for twelve months at 5.5%, repayable on 31 December 2008. At 31 December 2008 the carrying amount of the investment would be £10,550,000 (the interest receivable of £550,000 being recognised in the Income and Expenditure Account, £137,500 in 2007/08 and £412,500 in 2008/09). No interest has been received. The bank has experienced financial difficulties, and the investment is expected to be impaired. At the time the 2009/10 budget is prepared, there is insufficient information available to estimate the impairment.

In its Medium Term Financial Plan, the authority had anticipated that the principal would have been reinvested at 5.25%, and had therefore included income of £525,000 in its plans.

In preparing its budget for 2009/10, the authority plans to take advantage of the draft regulations, and its budget will be prepared on the following basis:

- Budgetary provision for the impairment is not required in 2009/10
- No interest on the investment will be included in the 2009/10 budget
- The authority's estimate of the General Fund balance at 31 March 2009 will assume no interest is credited in respect of the investment after 31 December 2008 (as any interest credited would be reversed under the regulation). In addition, the £550,000 credited to the General Fund in 2007/08 and 2008/09 will be transferred to the Financial Instruments Adjustment Account, and so should be excluded from the estimate of the General Fund balance at 31 March 2009.
- The authority will exclude from its budgeted income the £525,000 it had previously anticipated being received on the reinvestment of the principal amount. [Note that a smaller amount of interest may be included in the budget if the authority is anticipating a payment or part-payment being received part way through the year, and is planning to reinvest this amount.]
- In considering its 2009/10 budget, the authority will assess whether its revised estimate of the General Fund balance is adequate (see LAAP Bulletin 77, published in November 2008).

#### PRESENTATION IN STATEMENT OF ACCOUNTS

30. The SORP (in Chapter 9, glossary of terms) defines an exceptional item as "Material items which derive from events or transactions that fall within the ordinary activities of the authority and which need to be disclosed separately by virtue of their size or incidence to give fair presentation of the accounts." Paragraph 3.33 of the SORP states that "Exceptional items should be included in the cost of the service to which they relate or on the face of the Income and Expenditure Account if that degree of prominence is necessary in order to give a fair presentation of the accounts." Authorities will therefore need to consider whether any impairment loss (and other entries) requires separate disclosure in the Income and Expenditure Account to satisfy the requirements of the SORP.
31. Interest credited to the Income and Expenditure Account should be included in the Income and Expenditure Account in the Interest and Investment Income line. The amount of interest credited but not received in respect of impaired investments should be disclosed in a note to the accounts providing details of the impairment, or as an exceptional item on the face of the Income and Expenditure Account.
32. The impairment charge should be included in the Interest Payable and Similar Charges line, or where material, as an exceptional item in a separate line on the face of the Income and Expenditure Account. In the unlikely event that there is insufficient information on which to base an estimate of the impairment, a contingent liability should be disclosed.
33. Details of the impairment should be disclosed in a note to the accounts. The note should include details of the investment, the basis on which the impairment has been estimated (or that there is insufficient information to do so), and details of interest credited to the Income and Expenditure Account but not received. Where an authority has taken advantage of the draft regulations to defer the impact of the impairment charge on the General Fund, this should be disclosed (including a description of how the regulations will operate). Authorities that are not taking advantage of the draft regulations may wish to consider disclosing this fact. Details of the Financial

Instruments Adjustment Account (where relevant) should also be disclosed in the note to the accounts. A sample note is provided below; authorities should adapt this to their own circumstances.

### Example 3

#### Note to the Accounts - Impairment of Investments

[Note: Separate disclosure as an exceptional item will be required unless the impairment amount is not material]

Investments included in current assets figure in the Balance Sheet include the following investments that have been impaired because of the financial difficulties being experienced by Icelandic Banks.

Bank	Date Invested	Maturity Date	Amount Invested	Interest Rate	Carrying Amount	Impairment
ABC Bank	01/01/08	31/03/09	£10,000,000	5.5%	£ 8,086,072	£ 2,601,428
XYZ Bank	01/04/08	31/03/09	£5,000,000	6.0%	£ 3,666,785	£ 1,633,215

The carrying amounts of the investments included in the balance sheet have been calculated using the present value of the expected repayments, discounted using the investment's original interest rate. The expected repayments have been estimated as follows, based on the statements made by the administrator:

Date	ABC Bank	XYZ Bank
31 March 2010	£0	£2,000,000
31 March 2011	£9,000,000	£2,000,000

[Note: this level of detail may not be appropriate where the information could jeopardise the recovery by the administrator of amounts owed.]

Interest credited to the Income and Expenditure Account in respect of the investments is as follows:

Bank	Credited 2007/08	Received 2007/08	Credited 2008/09	Received 2008/09
ABC Bank	£137,500	£0	£550,000	£0
XYZ Bank	£0	£0	£300,000	£0

#### Note to the Accounts - Financial Instruments Adjustment Account

[Note – details of the Financial Instruments Adjustment Account should form part of the reserves and balances disclosure. It is recommended that disclosures in relation to the Financial Instruments Adjustment Account are shown in two sections – those relating to the impaired investments, and those relating to other routine adjustments. The disclosures shown in this example relate solely to impaired investments.]

Regulations issued in March 2009 allow the authority not to charge amounts relating to impaired investments to the General Fund. Such amounts are instead transferred to the Financial Instruments Adjustment Account, an account that

records the timing differences between charging these amounts to the General Fund in accordance with proper practice and in accordance with the regulations. The authority has taken advantage of the regulations, and has transferred the following amounts to the Financial Instruments Adjustment Account.

Bank	Amount Transferred to Financial Instruments Adjustment Account
ABC Bank	£1,913,928
XYZ Bank	£1,333,215

Under the regulations, the authority must transfer the balance on the Financial Instruments Adjustment Account to the General Fund no later than 31 March 2011, and must also credit the Financial Instruments Adjustment Account with interest earned until such time as the balance has been transferred to the General Fund. The authority estimates that the following credits will be made to the FIAA:

Bank	Balance on FIAA at 31/03/09	Transfers during 2009/10	Transfers during 2010/11	Balance on FIAA at 31/03/11
ABC Bank	£1,913,928	-£444,734	-£1,469,194	£0
XYZ Bank	£1,333,215	-£220,007	-£1,113,208	£0

34. In the unlikely event that an authority does not recognise the impairment in the 2008/09 accounts due to the fundamental uncertainty regarding the value of the investments (see paragraph 18 of LAAP 78), a contingent liability should be disclosed.

## Worked Examples

### **Example A - Interim payment of interest received**

*This example gives details of the accounting treatment required where an authority has decided to take advantage of the draft regulations, and has also received an interim payment of interest prior to the investment being impaired.*

An authority invested £5 million, at 6%, in XYZ Bank at the start of the first quarter of 2007. The investment was due to be repaid at the end of the fourth quarter of 2008. Interest is paid annually, at the end of the fourth quarter. The bank has experienced financial difficulties, and as a result the repayment of the investment has not been made. The investment becomes impaired at the end of the third quarter of 2008. The carrying amount of the investment at this point is £5,225,000 (investment of £5,000,000 plus 7 quarters of interest accrued at £75,000 each, less the repayment of one year's interest of £300,000 made at the end of the fourth quarter of 2007).

The administrator has announced (prior to the 2008/09 accounts being closed) that a repayment of £4.5 million will be made at the end of the third quarter of 2009. The recoverable amount can therefore be calculated as follows:

Date	Discount Factor	Repayment	Present Value
Q3 2009	0.94218	£4,500,000	£4,239,829

An impairment of £985,171 is recognised at the end of the third quarter of 2008. Interest will continue to be credited to the Income and Expenditure Account until the final repayment is received at the end of the third quarter of 2009. The carrying amount of the investment over its life is shown in the table below:

Period	Financial Year	Opening Balance £	Invested £	Interest Credited £	Repaid £	Impaired £	Closing Balance £
Q1 07	2006/07	0	5,000,000	75,000			5,075,000
Q2 07	2007/08	5,075,000		75,000			5,150,000
Q3 07	2007/08	5,150,000		75,000			5,225,000
Q4 07	2007/08	5,225,000		75,000	300,000		5,000,000
Q1 08	2007/08	5,000,000		75,000			5,075,000
Q2 08	2008/09	5,075,000		75,000			5,150,000
Q3 08	2008/09	5,150,000		75,000		985,171	4,239,829
Q4 08	2008/09	4,239,829		63,597			4,303,426
Q1 09	2008/09	4,303,426		64,551			4,367,977
Q2 09	2009/10	4,367,978		65,520			4,433,497
Q3 09	2009/10	4,433,497		66,503	4,500,000		0

The authority decides to take advantage of the draft regulations to defer the impact of the impairment on the General Fund until 2010/11. The accounting entries throughout the life of the investment will be as follows; entries that result from the authority taking advantage of the draft regulations are shown in bold.

2006/07

Dr	Financial Assets	£5,000,000
Cr	Cash	£5,000,000

Being the initial cash investment

Dr	Financial Assets	£75,000
Cr	Income & Expenditure Account	£75,000

Being the interest receivable credited to the Income and Expenditure Account for Quarter 1 of 2007

2007/08

Dr	Financial Assets	£300,000
Cr	Income & Expenditure Account	£300,000

Being the interest receivable credited to the Income and Expenditure Account for Quarters 2 to 4 of 2007 and Quarter 1 of 2008

Dr	Cash	£300,000
Cr	Financial Assets	£300,000

Being the receipt of the interim repayment of interest from the bank made in Quarter 4 of 2007

2008/09

Dr	Financial Assets	£150,000
Cr	Income & Expenditure Account	£150,000

Being the interest receivable credited to the Income and Expenditure Account for Quarters 2 and 3 of 2008

Dr	Income & Expenditure Account	£985,171
Cr	Financial Assets	£985,171

Being the impairment of the investment charged to the Income and Expenditure Account

<b>Dr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£985,171</b>
<b>Cr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£985,171</b>

**Being the application of the draft regulations to transfer the impairment charge to the Financial Instruments Adjustment Account to mitigate the impact on the General Fund balance**

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£225,000</b>
<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£225,000</b>

**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account; this covers the interest receivable for Quarters 1 to 3 of 2008 and therefore includes interest credited in 2007/08**

Dr	Financial Assets	£128,148
Cr	Income & Expenditure Account	£128,148

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account for Quarter 4 of 2008 and Quarter 1 of 2009

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£128,148</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£128,148</b>
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**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account; this covers the interest receivable for Quarter 4 of 2008 and Quarter 1 of 2009**

2009/10

Dr	Financial Assets	£132,023
Cr	Income & Expenditure Account	£132,023

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account for Quarters 2 and 3 of 2009

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£132,023</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£132,023</b>
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**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account; this covers the interest receivable for Quarters 2 and 3 of 2009**

Dr	Cash (repayment received Q3 2009)	£4,500,000
Cr	Financial Assets (repayment received Q3 2009)	£4,500,000

Being the receipt of the payment made by the administrator

2010/11

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£500,000</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£500,000</b>
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**Being the application of the draft regulations to effect the transfer of the net balance in relation to the impairment from the Financial Instruments Adjustment Account to the General Fund once the protection offered by the draft regulations has expired**

Authorities should note that, because the final repayment was received prior to the final transfer from the Financial Instruments Adjustment Account to the General Fund, the balance on the Financial Instruments Adjustment Account immediately prior to the final transfer is equal to the difference between the amount invested and the amount recovered.

## Example B – Partial Transfer to Financial Instruments Adjustment Account

*This example gives details of the accounting treatment required where an authority has decided to take advantage of the draft regulations, but has decided not to transfer the full amount of the impairment to the Financial Instruments Adjustment Account. This example uses the same figures as Example 1 in this Bulletin; however, the initial transfer to the Financial Instruments Adjustment Account in this example is only £600,000, not the maximum amount allowed by the draft regulations and shown in Example 1.*

An authority invested £10 million in ABC Bank for six months at 5.5%, repayable on 31 March 2009. At the balance sheet date (31 March 2009), the carrying amount of the investment was £10,275,000 (the interest receivable of £275,000 being recognised in the Income and Expenditure Account). The bank has experienced financial difficulties, and as a result the repayment of the investment has not been made. The administrator has announced (prior to the 2008/09 accounts being closed) that 45% of the principal will be repaid on 31 March 2010 and 45% on 31 March 2011. No interest will be paid.

The recoverable amount of the investment is £8,308,440 (see Example 1 for the calculation of this amount), which is £1,966,560 less than the carrying amount of the investment. An impairment of £1,966,560 would therefore need to be recognised in the Income and Expenditure Account in 2008/09.

The authority has decided that it will take advantage of the proposed regulations to defer the impact of part of the impairment charge on the General Fund until 2010/11. As a result of this decision, £600,000 of the impairment charge will be transferred to the Financial Instruments Adjustment Account.

The accounting entries that will be required in 2008/09 are:

Dr	Income & Expenditure Account	£1,966,560
Cr	Financial Assets (or the Allowance Account if one is being used)	£1,966,560

Being the impairment of the investment charged to the Income and Expenditure Account

Dr	Financial Assets	£275,000
Cr	Income & Expenditure Account	£275,000

Being the interest receivable credited to the Income and Expenditure Account

<b>Dr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£600,000</b>
<b>Cr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£600,000</b>

**Being the application of the draft regulations to transfer a proportion of the impairment charge to the Financial Instruments Adjustment Account to mitigate the impact on the General Fund balance**

The balance of the impairment charge (less interest credited to the Income and Expenditure Fund) will be borne by the General Fund in 2008/09, and will need to be taken into account when considering the 2009/10 budget.

The amortised cost method requires that interest continue to be credited to the Income and Expenditure Account until the financial instrument has been derecognised. This will be the point at which the final payment in respect of the investment is received. As final payment will not be received until 31 March 2011, interest will be credited to the Income and Expenditure Account in both 2009/10 and 2010/11.

Interest credited to the Income and Expenditure Account in 2009/10 will be £456,964 (the carrying amount at 31 March 2009 of £8,308,440 multiplied by the interest rate of 5.5%, applicable for 1 year). As the interest credited to the Income and Expenditure Account is less than the amount previously transferred to the Financial Instruments Adjustment Account, the full amount of interest credited will be transferred from the General Fund to the Financial Instruments Adjustment Account in accordance with the proposed regulations.

The carrying amount of the investment at 31 March 2010 will be £4,265,404 (opening carrying amount of £8,308,440 plus interest of £456,964 credited to the Income and Expenditure Account less the first payment of £4,500,000 to be received from the administrator on 31 March 2010). The accounting entries in 2009/10 will be:

Dr	Financial Assets	£456,964
Cr	Income & Expenditure Account	£456,964

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account

Dr	Cash	£4,500,000
Cr	Financial Assets	£4,500,000

Being the receipt of the first payment made by the administrator

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£456,964</b>
<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£456,964</b>

**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account**

Interest credited to the Income and Expenditure Account in 2010/11 will be £234,596 (the carrying amount at 31 March 2010 of £4,265,404 multiplied by the interest rate of 5.5%, applicable for 1 year). The carrying amount of the investment at 31 March 2011 will be £ nil (opening carrying amount of £4,265,404 plus interest of £234,596 credited to the Income and Expenditure Account, less the final payment of £4,500,000 to be received from the administrator on 31 March 2011).

In this example, the authority has chosen to transfer the interest credited to the Income and Expenditure Account to the Financial Instruments Adjustment Account prior to transferring the balance on the Financial Instruments Adjustment Account. For this investment, the interest figure of £234,596 is greater than the net amount previously transferred to the Financial Instruments Adjustment Account (initial transfer of £600,000 less interest credit of £456,964 giving a balance of £143,036). The transfer to the Financial Instruments Adjustment Account is therefore that portion of the interest credit required to reduce the balance on the account to zero in respect of that investment. Had the balance on the account been greater or equal to the interest credited, the full amount of interest would have been transferred to the Financial Instruments Adjustment Account, and a final transfer (shown below at nil value for completeness) would also have been required.

The accounting entries in 2010/11 will be:

Dr	Financial Assets (interest credited to I&E)	£234,596
Cr	Income & Expenditure Account (interest credited to I&E)	£234,596

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£143,036</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£143,036</b>
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**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account; only that portion of the interest that is required to clear the net balance of the impairment previously transferred to the Financial Instruments Adjustment Account is required to be transferred**

<b>Dr</b>	<b>Cash</b>	<b>£4,500,000</b>
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<b>Cr</b>	<b>Financial Assets</b>	<b>£4,500,000</b>
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Being the receipt of the second payment made by the administrator

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£0</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£0</b>
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**Being the application of the draft regulations to effect the transfer of the net balance in relation to the impairment from the Financial Instruments Adjustment Account to the General Fund once the protection offered by the draft regulations has expired (nil in this case)**

### Example C – Revised Estimate of Impairment

*This example gives details of the accounting treatment required where an authority has decided to take advantage of the draft regulations, and subsequently revises the estimate of the impairment. This example uses the same initial figures as Example 1 in the Bulletin.*

An authority invested £10 million in ABC Bank for six months at 5.5%, repayable on 31 March 2009. At the balance sheet date (31 March 2009), the carrying amount of the investment was £10,275,000 (the interest receivable of £275,000 being recognised in the Income and Expenditure Account). The bank has experienced financial difficulties, and as a result the repayment of the investment has not been made. The administrator has announced (prior to the 2008/09 accounts being closed) that 45% of the principal will be repaid on 31 March 2010 and 45% on 31 March 2011. No interest will be paid. The recoverable amount can therefore be calculated as follows:

Date	Discount Factor	Repayment	Present Value
31 March 2010	0.94787	£4,500,000	£4,265,415
31 March 2011	0.89845	£4,500,000	£4,043,025
TOTAL			<u>£8,308,440</u>

The recoverable amount of the investment is £8,308,440, which is £1,966,560 less than the carrying amount of the investment. An impairment of £1,966,560 would therefore need to be recognised in the Income and Expenditure Account in 2008/09. The authority has decided that it will take advantage of the proposed regulations to defer the impact of the impairment charge on the General Fund until 2010/11. As a result of this decision, both the impairment charge and the interest credited to the Income and Expenditure Account will be transferred to the Financial Instruments Adjustment Account.

The accounting entries that will be required in 2008/09 are:

Dr	Income & Expenditure Account	£1,966,560
Cr	Financial Assets (or the Allowance Account if one is being used)	£1,966,560

Being the impairment of the investment charged to the Income and Expenditure Account

Dr	Financial Assets	£275,000
Cr	Income & Expenditure Account	£275,000

Being the interest receivable credited to the Income and Expenditure Account

<b>Dr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£1,966,560</b>
<b>Cr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£1,966,560</b>

**Being the application of the draft regulations to transfer the impairment charge to the Financial Instruments Adjustment Account to mitigate the impact on the General Fund balance**

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£275,000</b>
<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£275,000</b>

**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account**

The amortised cost method requires that interest continue to be credited to the Income and Expenditure Account until the financial instrument has been derecognised. This will be the point at which the final payment in respect of the investment is received. As final payment will not be received until 31 March 2011, interest will be credited to the Income and Expenditure Account in both 2009/10 and 2010/11.

Interest credited to the Income and Expenditure Account in 2009/10 will be £456,964 (the carrying amount at 31 March 2009 of £8,308,440 multiplied by the interest rate of 5.5%, applicable for 1 year). The interest credited to the Income and Expenditure Account will be transferred from the General Fund to the Financial Instruments Adjustment Account in accordance with the proposed regulations.

At the same time as the first payment of £4,500,000 is made, the administrator announces that the final payment (to be made on 31 March 2011) will be increased to 47.5% (i.e. £4,750,000 for this investment). The authority will therefore revise the carrying amount as at 31 March 2010 based on this revised information. The revised recoverable amount can therefore be calculated as follows:

Date	Discount Factor	Repayment	Present Value
31 March 2011	0.94787	£4,750,000	£4,502,370

The previous estimate of the carrying amount at 31 March 2010 would have been £4,265,404 (opening carrying amount of £8,308,440 plus interest of £456,964 credited to the Income and Expenditure Account less the first payment of £4,500,000 to be received from the administrator on 31 March 2010). The authority would therefore show a gain of £236,966 in its Income and Expenditure Account. The gain credited to the Income and Expenditure Account will be transferred from the General Fund to the Financial Instruments Adjustment Account in accordance with the proposed regulations.

The accounting entries in 2009/10 will be:

Dr	Financial Assets	£456,964
Cr	Income & Expenditure Account	£456,964

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account

Dr	Cash	£4,500,000
Cr	Financial Assets	£4,500,000

Being the receipt of the first payment made by the administrator

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£456,964</b>
<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£456,964</b>

**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account**

Dr	Financial Assets	£236,966
Cr	Income & Expenditure Account	£236,966

Being the gain (recognised following the revised estimate of the recoverable amount of the investment) credited to the Income and Expenditure Account

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£236,966</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£236,966</b>
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**Being the application of the draft regulations to transfer the gain following a revised estimate of the recoverable amount to the Financial Instruments Adjustment Account**

Interest credited to the Income and Expenditure Account in 2010/11 will be £247,630 (the carrying amount at 31 March 2010 of £4,502,370 multiplied by the interest rate of 5.5%, applicable for 1 year). The carrying amount of the investment at 31 March 2011 will be £nil (opening carrying amount £4,502,370 plus interest of £247,630 credited to the Income and Expenditure Account, less the final payment of £4,750,000 to be received from the administrator on 31 March 2011).

Unlike in Example 1, the authority chooses to transfer the interest credited to the Income and Expenditure Account to the Financial Instruments Adjustment Account prior to transferring the balance on the account to the General Fund. [Note: the timing differences will depend on when authorities make the transfer; different timing is assumed here so authorities can compare the accounting entries in both cases.]

The accounting entries in 2010/11 will be:

Dr	Financial Assets	£247,630
Cr	Income & Expenditure Account	£247,630

Being the interest receivable (based on the revised carrying amount) credited to the Income and Expenditure Account

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£247,630</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£247,630</b>
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**Being the application of the draft regulations to transfer the interest receivable (but not received at the time of the impairment) to the Financial Instruments Adjustment Account**

Dr	Cash	£4,750,000
Cr	Financial Assets	£4,750,000

Being the receipt of the first payment made by the administrator

<b>Dr</b>	<b>General Fund Balance (and shown as a reconciling item in the Statement of Movement on the General Fund Balance)</b>	<b>£750,000</b>
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<b>Cr</b>	<b>Financial Instruments Adjustment Account</b>	<b>£750,000</b>
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**Being the application of the draft regulations to effect the transfer of the net balance in relation to the impairment from the Financial Instruments Adjustment Account to the General Fund once the protection offered by the draft regulations has expired**