

LAAP bulletin 82

guidance on the impairment of deposits with Icelandic Banks

Update No. 6

*May 2012 Updated June 1 2012 for
Landsbanki*

The Local Authority Accounting Panel issues LAAP Bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting, SeRCOP and Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but are not prescriptive and do not have the formal status of the Code, SeRCOP or Prudential Code.

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BACKGROUND

1. LAAP Bulletin 82 provided advice on estimating the impairments to be recognised in relation to deposits in Icelandic banks. This guidance was based on published information at the date the bulletin was issued, and since then five updates have been issued. The last update was issued in September 2011. Since that date, further information has become available. This update sets out the position at May 2012 and provides advice on estimating the impairments based on the latest position.
2. The Code requires the Statement of Accounts to be adjusted for events that occur after the balance sheet date, and which provide evidence of conditions that existed at the Balance Sheet date:
 - 3.8.2.1 *Events after the reporting period are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:*
 - a) *those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period), and*
 - b) *Those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).*
 - 3.8.4.1 *An authority shall disclose the following:*
 - ...
 - 2) *If an authority receives information after the reporting period, but before the financial statements are authorised for issue, about conditions that existed at the end of the reporting period, the authority shall update disclosures that relate to these conditions, in the light of the new information.*
 - ...
3. However, the Statement of Accounts need not be adjusted for immaterial amounts:
 - 2.1.2.7 *... An authority need not comply with the Code, as to both disclosure and accounting principles, if the information is not material to the true and fair view of the financial statements and to the understanding of users.*
4. The amounts to be recognised in the accounts in respect of the value of the deposits, and the impairments to be charged to the Comprehensive Income and Expenditure Statement are accounting estimates.
5. The spreadsheet accompanying this Bulletin has been amended to reflect the recommended treatment and it should be noted that there are now three separate sheets, one for Heritable Bank plc and Kaupthing Singer & Friedlander Ltd, and separate ones for Glintrir and Landsbanki.

FOREIGN EXCHANGE IMPLICATIONS

6. The settlements for the Iceland domiciled banks that are detailed in this bulletin involve the local authorities in foreign exchange transactions for which IAS 21 The Effects of Changes in Foreign Exchange Rates is relevant.
7. The Code requires foreign exchange transactions to be translated into sterling as at the date of the transaction:
 - 3.4.3.66 *In the rare event that cash flows of a local authority (or Group Accounts) arise from transactions in a foreign currency, the cash flows shall be recorded in pounds*

sterling by applying to the foreign currency amount the exchange rate at the time of the cash flow.

8. In addition IAS 21 requires:

23 At the end of each reporting period:

*a) foreign currency monetary items shall be translated using the closing rate.....”
(where the closing rate is the spot exchange rate at the end of the reporting period)*

.....

and also:

28 Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise, except as described in paragraph 32.

9. This means that for ongoing foreign currency monetary items, such as investments held in Icelandic kroner in escrow accounts, these should be revalued on the balance sheet at the year end based on the exchange rate at the 31 March of the year in question. Any differences in value due to differences in exchange rate between the date of the transaction and the end of the financial year should be taken to the Comprehensive Income and Expenditure Statement in that period.
10. Exposure to exchange rate risk should be considered in Financial Instrument and Icelandic Bank disclosures in an authority's Statement of Accounts.

UPDATED ESTIMATES

11. The following paragraphs set out the latest information in respect of each bank.

Heritable Bank plc

12. At the time LAAP Bulletin 82 Update 5 was issued, the total amount to be received was estimated to be between 86% and 90% of the claim and the ninth interim dividend was due in October 2011 with no estimate as to the amount of this payment. The tenth progress report from the administrators was issued on 4 November 2011¹. A further report covering the three months to 31 December 2011 was issued in February 2012. These reports have not provided a revised estimate of the base case return which therefore remains at the level estimated in Update 5. Since then the following interim payments have been made; the ninth interim payment was made in October 2011, and was for 4.18% of the claim, the tenth interim payment was made in January 2012 and was for 3.32% of the claim and the eleventh payment was made in April 2012 and was for 3.79% of the claim.
13. In view of the above information, LAAP recommends the estimate of the recoverable amount is based on a total repayment of 88% based on the mid point of the base case return and that subsequent repayments are profiled equally with the exception of the final repayment. This will produce a revised repayment schedule as follows:

Date	Repayment	Date	Repayment
April 2012	3.79%	January 2013	3.50%
July 2012	3.50%	April 2013	5.81
October 2012	3.50%		

¹ http://www.heritable.co.uk/Uploads/Documents/news/tenth_report.pdf

14. At the time LAAP Bulletin 82 Update 5 was issued, the total amount to be received was estimated to be between 78% to 86% of the claim. The estimated recoverable amount was the mid point 82%. Since then, the seventh dividend, 5% of the claim, was paid on 5 October 2011 and the eighth dividend, 10% of the claim, was paid on 2 May 2012. The Administrators' Progress report to creditors for the six month period from 8 Oct 2011 to 7 April 2012² estimated that the total amount to be received was 81% to 86%.
15. In view of the above information, LAAP recommends the estimate of the recoverable amount remains at the mid point, which is now 83.5%. The payment schedule is therefore as follows:

Date	Repayment	Date	Repayment
May 2012	10.00%	January 2014	5.50%
January 2013	5.00%		

Iceland-domiciled banks

16. At the time LAAP Bulletin 82 Update 5 was issued the Supreme Court appeals in relation to Glitnir and Landsbanki had yet to be concluded. On 28 October 2011 the Icelandic Supreme Court ruled that UK local authorities' claims in the administrations of Glitnir and Landsbanki qualified as priority claims under Icelandic bankruptcy legislation, confirming the earlier decision of the Reykjavik District Court. The position as to the status of interest on UK local authorities' deposits maturing between 6 October 2008 and 22 April 2009 has also been fully resolved for Glitnir depositors and resolved for all but a handful of Landsbanki depositors. This means that the values of local authorities' claims in the Icelandic administrations qualifying for priority settlement are now final and will, at the very least, be equal to the value of the original deposit plus interest accrued to 22 April 2009 or, if earlier, the maturity date.

Glitnir Bank hf

17. After the decision of the Icelandic Supreme Court had been delivered, the Winding Up Board of Glitnir made a distribution proposal to priority creditors. This was accepted by all UK local authorities and implemented on 16 March 2012. Under the terms of the distribution proposal, payment of each depositor's claim (measured in ISK terms as at 22 April 2009) was made in a basket of currencies with conversions made using Central Bank of Iceland selling rates as at 22 April 2009. The distribution currencies were Icelandic kroner, Euros, US dollars, pounds sterling, and Norwegian krona. The weightings for the distribution currencies were determined based on the currencies of the adjusted assets held by Glitnir as at 30 September 2011.
18. The amounts received by local authorities in currencies other than Icelandic kroner were converted into sterling when received. Authorities should therefore establish and account for the final amount of any impairment charge by comparing the carrying value of the impaired deposit with the sum of the amount actually received in sterling and from conversion of Euro, US dollar and Norwegian krona receipts, including the amount of Icelandic kroner which the Glitnir Winding Up Board has transferred to the escrow account it is maintaining on local authorities' behalf. The Icelandic kroner amount should be translated into sterling at the official Central Bank of Iceland selling rate as at 16 March 2012, namely £1 = 200.92 ISK³.

² http://www.kaupthingsingers.co.uk/media/1411/administrators_progress_report_april_2012_2.pdf

³ Exchange rates are detailed at <http://www.sedlabanki.is/?PageID=286>

19. The ISK amounts that have been distributed by the Glitnir Winding Up Board are held in escrow because, under the applicable currency controls operating in Iceland, the permission of the Central Bank of Iceland is required to release Icelandic kroner payments held within the Icelandic banking system⁴. The money held in the Glitnir Winding Up Board escrow account is, however, earning interest for the benefit of local authorities at a rate of 3.4%. Whilst this was not an arm's length transaction, the interest rate appears to reflect market rates in Iceland and hence there is no requirement to use a different discount rate. Given that the money held is not readily convertible to known amounts of cash it is not recommended that the sum is treated as a cash equivalent. The Icelandic kroner element of the Glitnir distribution to UK local authorities should therefore be considered to be a new short-term investment that should be accounted for in its own right. Accruing interest should be credited to the Comprehensive Income & Expenditure Statement and any foreign exchange difference arising at 31 March 2012 (£1 = 202.95 ISK) reflecting changes in the Central Bank of Iceland selling rate should also be taken to the Comprehensive Income and Expenditure Statement.
20. In summary, the overall impact of these transactions at the year end will:
- Reduce the carrying value on the Balance Sheet of the original Glitnir investment to zero
 - Create an impairment charge (or a reversal of an impairment charge) to the Comprehensive Income and Expenditure Statement which will be the difference between the carrying value of the original investment and the sterling amount of the settlement (including the escrow)
 - Create a new investment for the amount held in escrow in Icelandic kroner
 - Require the accrual of the interest due in the period in relation to the escrow account
 - Require any exchange rate difference between the value of the escrow investment at its start and at the end of the accounting period to be taken directly to the Comprehensive Income and Expenditure Statement.
21. Details of the accounting entries in relation to the escrow account are shown in Appendix A

Landsbanki Islands hf

22. At the time LAAP Bulletin 82 Update 5 was issued, the total payment was estimated to be 94.85% if local authority deposits enjoyed priority status. After the decision of the Icelandic Supreme Court had been delivered, the Winding Up Board of Landsbanki made a distribution to priority creditors. This was implemented on 7 December 2011 for those local authorities whose deposits had been the subject of the test cases litigated in the Supreme Court, and on 17 February 2012 for all other local authority deposits. The February payments attracted interest from 7 December 2011 as the Winding Up Board of Landsbanki had held the relevant amounts in escrow since then. Under the terms of the distribution proposal, payment of each depositor's claim (measured in ISK terms as at 22 April 2009) was made in a basket of currencies with conversions made using Central Bank of Iceland selling rates as at 22 April 2009. The distribution currencies were Icelandic kroner, Euros, US dollars and sterling. A total of £740m, €1,100m, \$710m and ISK 10bn was distributed to qualifying priority creditors. The amount distributed is close to one-third of each qualifying creditor's priority claim as determined⁵ by the Winding Up Board
23. The Winding Up Board announced on 9 March 2012⁶ that it anticipated that recoveries in the Landsbanki Administration would exceed the book value of recognised priority

⁴ see the Central Bank of Iceland announcement at <http://www.sedlabanki.is/?PageID=287&NewsID=3123>

⁵ <http://www.lbi.is/home/news/news-item/2011/12/07/First-partial-payments-in-the-winding-up-proceedings-of-Landsbanki-Islands-hf/>

⁶ <http://www.lbi.is/home/news/news-item/2012/03/09/LBIs-Financial-Situation-in-Q4-2011/>

claims by around ISK 121bn, taking into account the sale of its holding in Iceland Foods. Estimated recoveries are some 9% higher than the value of priority claims and it is therefore now considered likely that UK local authorities will recover 100% of their deposits, subject to potential future exchange rate fluctuations.

24. Following the Iceland Foods sale, the Landsbanki Winding Up Board authorised a further distribution to priority creditors on 24 May 2012. The distribution was made wholly in sterling and the amount distributed was £850m. Taken together with the first distribution at the end of 2011, this raises the total amount distributed to approximately 43% (distribution percentages quoted by the Landsbanki Winding Up Board are based on the Board's understanding of Icelandic law, which may be subject to future legal challenge). The future pattern of distributions by the Landsbanki Winding Up Board is not known, although the Winding Up Board has published on its website an estimated schedule of recoveries by year, based on the position as at 31 December 2011.
25. Based on the above information, LAAP therefore recommends that the estimate of the recoverable amount is based on a total repayment of 100% with a payment schedule as follows for the amount representing approximately 57% that has yet to be distributed:

Date	Repayment	Date	Repayment
December 2012	7.00%	December 2016	7.00%
December 2013	7.00%	December 2017	7.00%
December 2014	7.00%	December 2018	7.00%
December 2015	7.00%	December 2019	8.80%

26. As with Glitnir, Icelandic kroner distributions already made to authorities have been placed into escrow which should be treated as a new short term investment. This is earning interest at a rate of 3.35%, which should be accrued and credited to the Comprehensive Income and Expenditure Statement. Authorities should account for an exchange difference based on the ISK exchange rate at 31 March 2012 (£1 = 202.95 ISK) as against that as at 7 December 2011 (£1 = 185.97 ISK) in respect of the change in value of the ISK element of their distribution, which should also be taken to the Comprehensive Income and Expenditure Statement.
27. The summary of the impact of the transactions will be the same as those required for Glitnir and detailed in paragraph 18, except that for Landsbanki investments the carrying value of the original investment will not be reduced to zero.
28. The accounting entries for the escrow account for Landsbanki are the same as those for Glitnir and are detailed in Appendix A.

STATUTORY PROVISIONS

29. It should be noted that there are no statutory provisions for 2011/12 for authorities to defer the impact to the General Fund for England and Wales. There should therefore be no balances held at the end of 2011/12 in the Financial Instruments Adjustment Account in relation to the impairment of deposits in Icelandic banks.
30. For Scotland, The Scottish Government has issued statutory guidance (in Finance Circular 5/2011) on the amount of impairment that is chargeable to fund balances in respect of Icelandic banks. The Scottish statutory guidance permits a local authority to limit the charge to the General Fund to the cash loss position (ie the final anticipated

cash loss for a relevant investment) rather than any impairment charge calculated using the amortised cost method. The cash loss position is specified as:

- the difference between the claim (or deposit amount) and the expected cash recovery, or
- if there is a claim which has been accepted by the administrator, the claim value less the amount the authority estimates that it will receive from the administrator.

31. The difference between the accounting impairment and the statutory charge is to be reflected in an Icelandic Bank Statutory Adjustment Account in unusable reserves. The statutory guidance sets out that the accounting requirements in Finance Circular 4/2009 must be fully completed before this circular is applied. The statutory guidance also requires disclosure of the transactions in the Icelandic Bank Statutory Adjustment Account that rely on the statutory guidance. The guidance is applicable from 1 April 2010.

This appendix shows the transactions required in relation to the escrow accounts. The transactions relating to the repayment of the original investment are not covered here as they have been covered in earlier guidance.

1. Creation of escrow account

The monies in the escrow account are a repayment of the original investment and belong to the Local Authority whilst held in escrow. They gain interest and hence should be treated as a new investment.

Dr Financial Asset (new short term investment)
Cr Financial Asset (original investment)

With the sterling value of the ISK monies held in the escrow account, based on the exchange rate at the date of the transaction

2. Accrue interest on the escrow account

The new investment is earning interest which should be accounted for in the year to which it relates as with any investment.

Dr Financial Asset (new short term investment)
Cr Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement

With the amount of interest from the date of the commencement of the deposit to the end of the financial year

3. Value the balance in the escrow account as at 31 March 2012

Given that the investment in the escrow account is held in a foreign currency it must be valued at the end of the year and any difference due to exchange rate movements be taken directly to the Comprehensive Income and Expenditure Statement.

Dr/Cr Financial Asset (new short term investment)
Cr/Dr Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement

With any difference arising from exchange rate movements between the date of the deposit and the end of the financial year.