

APPENDIX A ACKNOWLEDGEMENTS

A1 CIPFA wishes to thank the members of the Prudential Code Steering Group that has overseen the development of the [draft] Prudential Code.

Tony Knights	Lyn James
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Ken Barnes	Peter Martin
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Lisa James	

and in particular Maureen Wellen and Peter Morley who have undertaken much of the detailed drafting, Tony Redmond who chaired the Steering Group from its inception to the publication of the first exposure draft of the Prudential Code and Tony Knights who has chaired the Steering Group since that date.

A2 CIPFA also wishes to thank the local authorities that have road tested the draft Code during 2002:

England

Barrow-in-Furness Borough Council
Bedford Borough Council
Birmingham City Council
Broxtowe Borough Council
Cleveland Police
Corporation of London
Darlington Borough Council
Devon County Council
Hambleton District Council
Humberside Fire Authority
Huntingdonshire District Council
Kent County Council
Lancashire County Council
London Borough of Hammersmith and Fulham
London Borough of Southwark
Medway Council
Nottinghamshire County Council
Reading Borough Council

Sheffield City Council
Teignbridge District Council
Wolverhampton City Council

Wales

Bridgend County Borough Council
Denbighshire County Council
Powys County Council
Torfaen County Borough Council

Scotland

Aberdeen City Council
Aberdeenshire Council
City of Edinburgh Council
Glasgow City Council
Highland Council
Lothian and Borders Joint Fire Brigade
Renfrewshire Council
South Lanarkshire Council
Strathclyde Fire Brigade
West Dunbartonshire Council.

APPENDIX B DEVELOPMENT OF THE CODE

- B1 CIPFA has developed the [draft] *Prudential Code for Capital Finance in Local Authorities* in order to underpin and flesh out the system of capital finance [being] introduced through the Local Government [Bill] in England and Wales and the Local Government in Scotland [Bill].
- B2 CIPFA was asked by the ODPM to develop the Prudential Code as a professional code of practice to support local authorities in taking their decisions on capital investment. The ODPM has part funded the development of the Code.
- B3 The Prudential Code [is being] developed under CIPFA's governance arrangements as a professional code. The Code's development falls within the work programme of the CIPFA Treasury Management Panel. The Code [needs to be] approved by the Institute Council in order to come into effect.
- B4 In 2001, the Treasury Management Panel established the Prudential Code Steering Group to oversee the development of the CIPFA Prudential Code. The Prudential Code Steering Group has representatives from:
- CIPFA groups
 - Local authority treasurers' societies
 - Local government associations
 - Government departments and devolved administrations
 - Audit Commission and Audit Scotland
 - Local authority treasury management advisers
 - CIPFA Secretariat
- and includes representatives from England, Wales and Scotland.
- B5 The Treasury Management Panel, to whom the Prudential Code Steering Group reports, includes representatives from:
- senior finance professionals from throughout the public services
 - Bank of England
 - British Bankers Association
 - Association of Corporate Treasurers
 - Local government associations.
- B6 In addition, the exposure drafts of the Code [have been] approved for publication by the Institute's Public Finance and Management Board (previous to the review of Committee structure in 2002 by the Technical Committee). The final Code [has been] approved by the Steering Group, the Treasury Management Panel, Public Finance and Management Board and the Institute Council.
- B7 The Prudential Code Steering Group initially developed a first exposure draft of the Code for consultation, which was published in December 2001, with a consultation period that ran until 4 March 2002. The foreword to that consultation draft stated:

“Because of the interaction with statute, a second exposure draft of the Code may be necessary before implementation, when the detailed interaction between the Prudential Code and any national limits to local authority debt, the Housing Revenue Account, any ‘ring fenced’ services and local authority companies have been finalised. However, the overall framework of the Prudential Code is clear at this stage and your comments on this exposure draft will be invaluable to its future development.”

- B8 Over 100 responses were received to the first exposure draft of the Code. These were over-whelmingly supportive of the objectives and fundamentals of the draft Code. It was clear, however, that further work was necessary on the detail of the prudential indicators within the draft and on the interface, in particular, with the HRA as secondary legislation developed. Respondents were also concerned about the method of support for future capital investment by the government and devolved administrations, and the operation of any national limits. These are important issues for local government, but are matters for the government and devolved administrations not for the Code. It is important that the Code operates whatever the method of government support for capital investment, which may change over time.
- B9 CIPFA invited local authorities to road test the draft Code during 2002. The letter of invitation said

“Having developed the theoretical framework we now want to evaluate the practicality and robustness of our model, from both strategic and technical perspectives. CIPFA is therefore looking for volunteers to ‘road test’ the *Prudential Code for Capital Finance in Local Authorities*. I am writing to ask whether you would be interested in participating in such an exercise.”

The response was phenomenal, with over 70 local authorities offering to road test the Code. The road testing was completed with 35 authorities, comprising different types of authorities, with differing capital programmes, throughout Great Britain. A full list of authorities is included within Appendix A.

- B10 The road testing took the form of attendance at two workshops, held for groups of authorities in May and November in York, London, Cardiff and Edinburgh; road testing over a period of several months; and the completion of a proforma on the experience. The phrase ‘road testing’ is used rather than ‘undertaking pilots’ because participating authorities remained subject to their existing control frameworks, ie they did not set their own prudential limits for capital investment during the road testing. Rather, the road testing was based on the local authorities’ plans within the then existing centralised control frameworks. The version of the draft Code used for road testing was the 2001 exposure draft with the revised prudential indicators in respect of treasury management proposed by the July 2002 meeting of the Prudential Code Steering Group in response to comments received.
- B11 Local authorities were asked to document their experiences of road testing. The results of road testing have been extremely valuable to the development of the second exposure draft of the Code. CIPFA [will be] publishing the full reports from the road

testing authorities separately. They demonstrate the wide range of indicators, in respect for example of outstanding debt, that have resulted within the [current], heavily centrally prescribed systems of capital controls.

B12 During the period of the development of the Prudential Code, CIPFA has kept in liaison with central government and devolved administrations over the developing legislation with respect to capital finance. This has been achieved through membership of the ODPM, National Assembly for Wales, Scottish Executive and HM Treasury on the Prudential Code Steering Group; and through CIPFA's membership of the technical advisory groups that are inputting to the development of the secondary legislation

- Capital Programmes Working Party (England)
- Capital Programmes Working Party Technical Sub-Group (England)
- Local Government Capital Finance System Task and Finish Group (Wales)
- Local Government Finance in Scotland Capital Reforms Implementation Group.

B13 The following significant changes were made between the first exposure draft and the second exposure draft of the Prudential Code as a result of comments made to the first consultation, the road testing and the developing legislation:

clarity – the Code has been restructured, so that process and governance issues, and the matters to be taken into account including key indicators of affordability and prudence, appear before the sections on the detailed prudential indicators for capital expenditure, external debt and treasury management. This is helpful in setting the detailed indicators within the wider context.

an executive summary – has been added.

impact on the Council Tax¹ – prudential indicators for the impact of capital investment on the Council Tax have been added.

forward prudential indicators for levels of debt – these have been reduced from three separate indicators to two, now called the 'operational boundary' and the 'authorised limit'. Both must be consistent with the authority's plans. Risk analysis and risk management strategies must be taken into account. The operational boundary is based on the authority's estimate of most likely, prudent but not worst case scenario and equates to the maximum level of external debt projected by this estimate. The authorised limit provides over and above the operational boundary for unusual cash movements.

interface with the HRA – the arrangements for the HRA are matters for the UK Parliament, Welsh Assembly Government and the Scottish Executive. At the time of the publication of the second exposure draft of the Code, the arrangements under the prudential framework were not finalised. However, officers at the ODPM, National Assembly for Wales and Scottish Executive had indicated that it would not be necessary to separate HRA and non-HRA debt, but that the means of separating HRA

¹ Or precept, or levy, as appropriate.

and non-HRA items for the purposes of the prudential framework will be undertaken through distinguishing between HRA and non-HRA capital expenditure and capital financing and the second exposure draft reflected this. Within the second exposure draft, the separation of the relevant indicators into HRA and non-HRA elements [is] required to be undertaken as determined under statute. It [is intended that] once finalised, cross references between the relevant regulation/code/guidance and the Prudential Code [will be] made.

FRS 17 – issues relating to FRS17 and the Prudential Code were initially discussed at a separate meeting between CIPFA, HM Treasury, ODPM and the Audit Commission, and then by the Prudential Code Steering Group. It was agreed that the Prudential Code should: highlight that the revenue consequences of retirement benefits will be taken into consideration when a local authority considers the affordability of its capital plans; exclude the pension reserve from the definition of ‘other long term liabilities’ for the prudential indicators in relation to external debt.

treasury management (1) – the Prudential Code Steering Group carefully considered but did not agree with comments made that there is no need for prudential indicators for treasury management other than a linkage to the CIPFA *Code of Practice for Treasury Management in the Public Services* (the TM Code). They did, however, agree that the detail of the indicators should be reviewed. The second exposure draft would require each authority to set its own limits for treasury management activities in respect of variable and fixed interest rate exposures, the maturity structure of borrowing and total principal sums invested for periods longer than 364 days. These indicators address key areas of risk for public money.

treasury management (2) – the Steering Group and the Treasury Management Panel also considered whether the treasury management indicators should be within the TM Code or the Prudential Code and decided that they should be within the Prudential Code. In taking this decision, they took into consideration that

- the TM Code deals with treasury management issues
- the TM Code is cross sectoral whereas the Prudential Code will apply to local authorities
- the current statutory framework in England and Wales (Part IV of the Local Government and Housing Act 1989) requires authorities to set limits in relation to treasury management; the Prudential Code will only come into force when the old system ends whereas the TM Code is current.

capital financing requirement – the term ‘capital financing requirement’ replaces the term ‘capital expenditure unfinanced’ that was used in the first exposure draft .

definitions – further guidance has been added to some of the detailed definitions, particularly the capital financing requirement, other long term liabilities, the treatment of premiums on the early repayment of debt, and transferred debt.

risk and uncertainty – greater emphasis has been placed on risk and uncertainty.

related entities – where a local authority has interests in companies or other similar related entities, the authority will need to have regard to its financial commitments and obligations to those companies/entities.

- B14 *[Paragraphs on the results of the second exposure draft for consultation will be inserted.]*
- B15 Copies of papers considered by the Prudential Code Steering Group and minutes of the meetings can be found on the CIPFA website http://www.cipfa.org.uk/panels/treasury_management/prudential_code.ihtml

APPENDIX C ILLUSTRATIVE EXAMPLE OF PRUDENTIAL INDICATORS

Illustrative example of an extract from Xford City Council's budget and rent setting reports for 20x4/x5

- C1 The actual capital expenditure that was incurred in 20x2/x3 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

	Capital Expenditure				
	20x2/x3	20x3/x4	20x4/x5	20x5/x6	20x6/x7
	£000	£000	£000	£000	£000
	Actual	Estimate	Estimate	Estimate	Estimate
Education					
Social Services					
.....					
Total non-HRA	14,998	15,000	20,000	17,000	21,000
HRA	14,102	14,000	18,000	18,000	19,000
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total	29,100	29,000	38,000	35,000	40,000
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

- C2 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 20x2/x3 are:

	Ratio of financing costs to net revenue stream				
	20x2/x3	20x3/x4	20x4/x5	20x5/x6	20x6/x7
	Actual	Estimate	Estimate	Estimate	Estimate
Non-HRA	4.22%	4.23%	5.15%	6.10%	6.00%
HRA	18.63%	18.60%	20.11%	21.00%	21.50%

The estimates of financing costs include current commitments and the proposals in this budget report.

- C3 Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual capital financing requirement at 31 March 20x3 are:

	Capital financing requirement				
	31/03/x3	31/03/x4	31/03/x5	31/03/x6	31/03/x7
	£000	£000	£000	£000	£000
	Actual	Estimate	Estimate	Estimate	Estimate
Non-HRA	123,706	123,000	127,000	126,000	128,000
HRA	117,503	118,000	123,500	123,000	123,500

- C4 The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, Xford City Council does not associate borrowing with particular items or types of expenditure. The authority has an integrated treasury management strategy² and has adopted the *CIPFA Code of Practice for Treasury Management in the Public Services*. Xford City Council has, at any point in time, a number of cashflows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.
- C5 CIPFA's *Prudential Code for Capital Finance in Local Authorities* includes the following as a key indicator of prudence:

“In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.”

The Director of Finance reports that the authority had no difficulty meeting this requirement in 20x2/x3, nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this budget report.

- C6 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt gross of investments for the next three financial years, and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. These limits separately identify borrowing from other long term liabilities such as finance leases. The Council is asked to approve these limits and to delegate authority to the Chief Finance Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Council at its next meeting following the change.

² The authority's treasury management strategy and annual plan for 20x4/x5 was agreed by the Council at its meeting on xx/xx/x3.

	Authorised limit for external debt			
	20x3/x4	20x4/x5	20x5/x6	20x6/x7
	£000	£000	£000	£000
Borrowing	280,000	289,000	289,000	291,000
Other long term liabilities	25,000	25,000	35,000	35,000
	_____	_____	_____	_____
Total	305,000	314,000	324,000	326,000
	_____	_____	_____	_____

C7 The Director of Finance reports that these authorised limits are consistent with the authority's current commitments, existing plans and the proposals in this budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Director of Finance confirms that they are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account; as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

C8 The Council is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the Director of Finance's estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring by the Director of Finance. Within the operational boundary, figures for borrowing and other long term liabilities are separately identified. The Council is also asked to delegate authority to the Chief Finance Officer, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit. Any such changes will be reported to the Council at its next meeting following the change.

	Operational boundary for external debt			
	20x3/x4	20x4/x5	20x5/x6	20x6/x7
	£000	£000	£000	£000
Borrowing	250,000	257,000	257,000	259,000
Other long term liabilities	20,000	20,000	30,000	30,000
	_____	_____	_____	_____
Total	270,000	277,000	287,000	289,000
	_____	_____	_____	_____

- C9 The Council's actual external debt at 31 March 20x3 was £220.3 million, comprising £202.1 million borrowing and £18.2 million other long term liabilities. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time.
- C10 In taking its decisions on this budget report, the Council is asked to note that the authorised limit determined for 20x4/x5 (see paragraph 6 above) will be the statutory limit determined under [clause] 3(i) of the Local Government [Bill].

or

In taking its decisions on this budget report, the Council is asked to note that the estimate of capital expenditure determined for 20x4/x5 (see paragraph 1 above) will be the statutory limit determined under [clause x] (i) of the Local Government in Scotland [Bill].

- C11 The Band D Council Tax that would result for Xford City Council for 20x4/x5 from the totality of the capital and revenue plans recommended in this budget report is £1,018.10p.
- C12 Forward estimates for the Band D Council Tax for 20x5/x6 and 20x6/x7 are £1,068.00p and £1,110.00p respectively. These forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the totality of the capital and revenue plans recommended in this budget report. There are no known significant variations beyond this timeframe that would result from past events and decisions or the proposals in this budget report.
- C13 With respect to the HRA, the average weekly rent that would result for 20x4/x5 from the totality of the capital and revenue plans recommended in this budget report is £64.12p.
- C14 Forward estimates for housing rents for 20x5/x6 and 20x6/x7 are £66.00p and £68.00p respectively. Again, these forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the totality of the capital and revenue plans recommended in this budget report. There are no known significant variations beyond this timeframe that would result from past events and decisions or the proposals in this budget report.

Consideration of options for the capital programme

- C15 In considering its programme for capital investment, the Council is required within the Prudential Code to have regard to:
- affordability, eg implications for Council Tax
 - prudence, eg implications for external borrowing
 - option appraisal

- asset management planning
- strategic planning for the authority
- achievability of the forward plan.

C16 A key measure of affordability is the impact on the Council Tax, and the Council could consider different options for its capital investment programme in relation to their differential impact on the Council Tax.

Illustrative example of an extract from Xford City Council’s treasury management strategy and annual plan for 20x4/x5

C17 Xford City Council has adopted the CIPFA *Code of Practice for Treasury Management in the Public Services*.

C18 It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 20x4/x5, 20x5/x6 and 20x6/x7 of 90% of its net outstanding principal sums.

C19 It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 20x4/x5, 20x5/x6 and 20x6/x7 of 30% of its net outstanding principal sums.

C20 This means that the Director of Finance will manage fixed interest rate exposures within the range 70% to 90% and variable interest rate exposures within the range 10% to 30%. This is a continuation of current practice.

C21 It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	Lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	25%

C22 There are no proposals for the Council to invest sums for periods longer than 364 days.

NB The figures used in this appendix are for illustrative purposes only and do not constitute recommendations for the level at which prudential indicators should be set. This is a matter for local authorities and will vary between authorities. Where the Prudential Code offers alternative indicators, the indicators used here do not constitute recommendations as to which of these alternatives is appropriate to a particular local authority’s circumstances.

APPENDIX D CAPITAL FINANCING REQUIREMENT

INTRODUCTION

- D1 Local authorities have available to them a number of ways of financing traditionally procured capital investment. In all cases, cash will be paid over. The term ‘financing’ does not refer to the payment of cash but the resources that are applied to ensure that any underlying amount arising from capital payments is dealt with absolutely, whether at the point of spend, or over the longer term.
- D2 A number of financing options that are available to local authorities involve resourcing the investment at the time that it is incurred. These are:
- the application of useable capital receipts
 - a direct charge to revenue for the capital expenditure
 - the application of a capital grant
 - securing an up-front contribution from another party towards the cost of a project.
- D3 Capital expenditure that is not financed up front by one of the above methods will increase the capital financing requirement of the authority. It has often been referred to as ‘capital expenditure financed by borrowing’. However, there are two difficulties with this term. First, borrowing does not finance capital expenditure: it provides the cash but it does not provide the resource, since the borrowing has to be repaid. Second, the use of the term ‘borrowing’ in this context does not necessarily infer external debt since in accordance with best practice, the local authority will have an integrated treasury management strategy. The local authority will not, and should not, associate borrowing with particular items of expenditure (unless required to under statute). The local authority will, at any point in time, have a number of cashflows both positive and negative and will be managing its position in terms of its borrowings and investments in accordance with its treasury management strategy and practices.
- D4 In measuring external debt, the [draft] Prudential Code encompasses all borrowing whether for capital or revenue purposes. In day to day cash management no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the local authority and not simply those arising from capital spending.
- D5 In contrast, the capital financing requirement will reflect the local authority’s underlying need to borrow for a capital purpose.
- D6 In summary:
- the capital financing requirement of a local authority will increase whenever capital expenditure is incurred
 - where capital expenditure is resourced immediately (from useable capital receipts, direct charge to revenue or capital grant/contributions), then the

capital financing requirement will reduce at the same time that the capital expenditure is incurred, resulting in no net increase to the capital financing requirement

- where capital expenditure is not resourced immediately this will result in a net increase to the capital financing requirement that represents an increase in the underlying need to borrow for a capital purpose. This will be the case whether or not external borrowing actually occurs
- the capital financing requirement may be reduced over time by future applications of capital receipts or capital grants/contributions; or by future charges to revenue.

CALCULATION OF CAPITAL FINANCING REQUIREMENT

D7 The [draft] Prudential Code requires the calculation of the capital financing requirement from the balance sheet as follows:

“Actual figures for capital financing requirement for previous years should be taken from the local authority’s consolidated balance sheets for those years, by consolidating

- fixed assets
- deferred charges
- fixed asset restatement reserve
- capital financing reserve
- government grants deferred.

In addition, any other items on the local authority’s consolidated balance sheet that relate to capital expenditure incurred should be included (see in particular the definition of other long term liabilities in paragraph 91 [of the Code]). Any items on the balance sheet that relate to prepayments for revenue items should not be included. Useable capital receipts that have not been applied to finance capital expenditure should also not be included.”

D8 The following sample journal entries demonstrate how capital transactions will impact on the capital financing requirement.

(a) *To capitalise accrued capital expenditure for the year*

	£000	£000
Dr Fixed assets	25,000	
Cr Cash		24,500
Cr Creditors		500

Result – capital financing requirement is increased by £25,000,000.

(b) *To write out the net book value of fixed assets sold during the year*

Dr	Fixed assets restatement reserve	10,000	
Cr	Fixed assets		10,000

Result – capital financing requirement is unchanged.

- (c) *To account for income from the disposal of fixed assets during the year*

Dr	Cash	11,000	
Cr	Useable capital receipts		11,000

Result – capital financing requirement is unchanged.

- (d) *To reflect the revaluation of fixed assets*

Dr	Fixed assets	40,000	
Cr	Fixed asset restatement reserve		40,000

Result – capital financing requirement is unchanged.

- (e) *To finance capital expenditure from useable capital receipts*

Dr	Useable capital receipts	17,000	
Cr	Capital financing reserve		17,000

Result – capital financing requirement reduced by £17,000,000.

- (f) *To finance capital expenditure directly from revenue*

Dr	Consolidated revenue account	1,000	
Cr	Capital financing reserve		1,000

Result – capital financing requirement is reduced by £1,000,000.

- (g) *To charge amount required under statute and any additional voluntary contributions to the revenue account in respect of past capital expenditure*

Dr	Consolidated revenue account	8,000	
Cr	Capital financing reserve		8,000

Result – capital financing requirement is reduced by £8,000,000.

ESTIMATING THE FUTURE CAPITAL FINANCING REQUIREMENT

D9 The [draft] Prudential Code requires that

“Estimates for capital financing requirement for current and future years should be calculated in a manner consistent with the definition given above.” (see paragraph 7 of this appendix)

D10 The following sample calculation shows how the required calculations could be made at budget setting time in 20x4.

(a) *Actual capital financing requirement at 31 March 20x2*

Calculated from the Council's consolidated
balance sheet = £500,000,000.

(b) *Revised estimate of capital financing requirement at 31 March 20x3,
ie for the current year*

	£000
Actual capital financing requirement at 31 March 20x2	500,000
Estimate of capital expenditure for 20x3	38,000
Estimate of application of useable capital receipts in 20x3	(15,000)
Estimate of application of capital grants/ contributions in 20x3	(5,000)
Statutory charge to revenue in 20x3 for past capital expenditure	(20,000)
Additional voluntary contribution in 20x3 (ie additional charge to revenue for past capital expenditure ³)	(1,000)
Estimate of capital financing requirement at 31 March 20x3	497,000

(c) *Estimate of capital financing requirement at 31 March 20x4, ie for
the forthcoming year*

Estimate of capital financing requirement at 31 March 20x3	497,000
Estimate of capital expenditure in 20x4	42,000
Estimate of application of useable capital receipts in 20x4	(12,000)

³ The local authority has decided to buy computer equipment and to charge it to revenue over a 3 year period. It then plans to replace the equipment.

Estimate of application of capital grants/contributions in 20x4	(7,000)
Statutory charge to revenue in 20x4 for past capital expenditure	(19,880)
Additional voluntary contribution in 20x4	(1,000)
Estimate of capital financing requirement at 31 March 20x4	499,120

(d) *Estimate of capital financing requirement at 31 March 20x5*

Estimate of capital financing requirement at 31 Mar 20x4	499,120
Estimate of capital expenditure in 20x5	50,000
Estimate of application of useable capital capital receipts in 20x5	(10,000)
Estimate of application of capital grants/contributions in 20x5	(7,000)
Statutory charge to revenue in 20x5 for past capital expenditure	(19,965)
Additional voluntary contributions in 20x5	(1,000)
Estimate of capital financing requirement at 31 March 20x5	511,155

(e) *Estimate of capital financing requirement at 31 March 20x6*

Estimate of capital financing requirement at 31 March 20x5	511,155
Estimate of capital expenditure in 20x6	45,000
Estimate of application of capital receipts in 20x6	(10,000)
Estimate of application of capital grants/contributions in 20x6	(7,000)

Statutory charge to revenue in 20x6 for past capital expenditure	(20,446)
Additional voluntary contributions in 20x6 ⁴	(1,100)

Estimate of capital financing requirement at 31 March 20x6	517,609

QUESTIONS AND ANSWERS ABOUT THE CAPITAL FINANCE REQUIREMENT

- D11 **Q.1.** Do deferred charges feed into the calculations for the capital financing requirement?
- A.1.** Yes.
- Q.2.** Even if the expenditure was classified as a deferred charge through ministerial or Assembly determination?
- A.2.** Yes.
- Q.3.** The local authority has an old deferred purchase scheme. It has an item for the long term liability separately identified on its balance sheet. Should this be included in the calculation for the capital financing requirement?
- A.3.** Yes.
- Q.4.** The local authority has an old covenant scheme (Scotland). It has an item for the long term liability separately identified on its balance sheet. Should this be included in the calculation for the capital financing requirement?
- A.4.** Yes.
- Q.5.** The local authority has identified on its balance sheet a capital contributions deferred account separately from its government grants deferred account. Should this be included in the calculation for the capital financing requirement?
- A.5.** Yes.
- Q.6.** The local authority has identified on its balance sheet a grants/contributions unapplied balance, for capital grants/contributions that have not yet been applied to meeting capital investment. Should this be included in the calculation for the capital financing requirement?

⁴ The authority plans to buy new computer equipment in 20x5/20x6 and to charge it to revenue over a 3 year period.

A.6 No.

Q.7 In England and Wales will the capital financing requirement be the same value as the credit ceiling?

A.7. Probably not. The credit ceiling and the capital financing requirement are similar in concept. However, the credit ceiling [was] statutorily determined and the capital financing requirement [is] balance sheet driven. Some local authorities have undertaken past transactions, for example deferred purchase schemes, where there will be entries on the balance sheet and relevant to the capital financing requirement but no inclusion within the credit ceiling. On the other hand, some types of transactions resulted in no balance sheet items but did result in changes to the credit ceiling under the 1989 Act, for example certain types of credit arrangement.

Q.8. In Scotland will the capital financing requirement be the same value as the outstanding balance on the loans fund?

A.8. It is expected that it will be. If for any reason it is not, then the definition in the Prudential Code takes precedence for the purpose of the calculation of the capital financing requirement.

NB **The figures used in this appendix are for illustrative purposes only and do not constitute recommendations for the level at which the figures should be set.**

APPENDIX E PARTICULAR ISSUES ON WHICH COMMENTS ARE INVITED

Your comments on any aspect of the second exposure draft of the Prudential Code are invited, and particularly on the questions listed below.

Q.1 Paragraph 1 of the draft Code explains the objectives of the draft Code.

The objective of the [draft] Code is to provide a framework for local authority capital finance that will ensure for individual local authorities that:

- (a) capital expenditure plans are affordable
- (b) all external borrowing and other long term liabilities are within prudent and sustainable levels
- (c) treasury management decisions are taken in accordance with professional good practice

and that in taking decisions in relation to (a) to (c) above the local authority is

- (d) accountable, by providing a clear and transparent framework.

Further, the framework established by the [draft] Code should be consistent with and support:

- (e) local strategic planning
- (f) local asset management planning
- (g) proper option appraisal.

In exceptional circumstances the objective of the [draft] Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the authority can take timely remedial action.

Do you consider that the draft Code achieves the objective of providing a framework for local authorities to demonstrate these matters when they take their decisions within the prudential framework?

Q.2 Do you have any comments on the process and governance issues in paragraphs 8-23 of the draft Code? In particular, are the respective roles of the Council and of the Chief Finance Officer correctly designated?

Q3 Do you agree with the approach taken in paragraphs 28 and 29 of the draft Code?

The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within

sustainable limits, and in particular to consider its impact on the local authority's 'bottom line', its impact on the Council Tax¹. Affordability is ultimately determined by a judgement about acceptable Council Tax levels and, in the case of the Housing Revenue Account, acceptable rent levels.

In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it/ estimated for the future, together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the following two years. The authority is also required to consider known significant variations beyond this timeframe.

- Q4** Is the meaning and definition of the capital financing requirement now clear? See in particular its use in paragraphs 45, 53-58 and 85 of the draft Code.
- Q5** Do you have any further comments on the detail of the prudential indicators in the draft Code?

This second exposure draft of the Prudential Code is issued for comment. It should be noted that the draft may be modified in the light of comments received, before the Code is finalised.

Comments should be sent to CIPFA by xx/xx/xx, addressed to Maureen Wellen, Policy and Technical Manager (Capital and Treasury), CIPFA, 3 Robert Street, London, WC2N 6RL or by e-mail to prudential.code.comments@cipfa.org.

Responses will be regarded as on the public record unless confidentiality is specifically requested and may be copied for consideration by CIPFA panels and groups.

¹ Or precept, or levy, as appropriate.