

## **Consultation on Proposed Changes to the Prudential Code**

CIPFA is seeking views on proposed changes to the net debt and capital financing requirement prudential indicator.

### **Background**

The prudential indicator which compares net debt to the capital financing requirement (CFR) is a key indicator of prudence. Its purpose is to “ensure that over the medium term, net debt will only be for a capital purpose”.

The Prudential Code for Capital Finance in Local Authorities was updated in 2011. As part of this update the indicator was changed from comparing net borrowing to comparing net debt. The reason behind this was a technical one. Following the move to IFRS this meant that many authorities now had PFI schemes and finance leases on their balance which were then of course included in the CFR. By comparing this to net borrowing, which did not include the liabilities in relation to such schemes, this meant that the comparison was not on a like for like basis.

Hence, the opportunity was taken to amend the indicator to compare net debt rather than net borrowing. This means that the wider definition of debt, which includes other long term liabilities, such as those relating to PFI and finance leases, enables a more like for like comparison to CFR.

### **Proposed Change**

Given that the purpose of the indicator is to “ensure that over the medium term, net debt will only be for a capital purpose”, it has been questioned whether the indicator as it currently stands is the most effective measure of this. The question raised is whether by comparing the net position, i.e., net of investments, this could potentially mask a position where an authority had borrowed for another purpose and then subsequently invested the surplus funds.

A change to the indicator to compare the gross debt position rather than the net debt position may better fulfil the indicators purpose. The Treasury Management Panel discussed a possible change to the indicator in the 2011 update, but were keen to ensure that there were no unintended consequences of the change.

Hence CIPFA is now consulting more widely on the proposed change from net debt to gross debt. Subject to the consultation response and usual CIPFA approval process, any amendment to the Prudential Code would be planned during 2012. At this stage it is anticipated that this would be an addendum to the 2011 version rather than full revision.

Authorities are reminded that they are able to set their own local indicators and hence may wish to consider trialling this change locally in order to inform the consultation process.

### **Timescales**

Any changes to the Code will become effective once issued, however, CIPFA recognise that this will be after the 2012/13 Prudential Indicators will have been approved. Local authorities will therefore be expected to seek approval for any amended indicators at the next available opportunity.

## **Consultation Questions**

1. Do you agree that the change from net to gross debt will better meet the purpose of the indicator, i.e. to ensure that over the medium term net debt will only be for a capital purpose?
2. Do you see any potential problems with the change? If so, please describe them in more detail.

## **Consultation Responses**

Please send your responses to the consultation questions to [mandy.bretherton@cipfa.org.uk](mailto:mandy.bretherton@cipfa.org.uk) by Wednesday 29 February 2012.