

EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE – 2 OCTOBER 2003

PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES

Report by Director of Finance

1. PURPOSE OF REPORT

- 1.1** To advise Members of the arrangements for Capital Finance which replace the existing Section 94 consent arrangements from 1 April 2004.

2. BACKGROUND

- 2.1** Section 35 of The Local Government in Scotland Act 2003 provides that “It is the duty of a local authority to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure. In discharging that duty, the local authority shall comply with regulations made by the Scottish Ministers for the purposes of this section”. This is effective from 1 April 2004 and replaces the current “Section 94” Capital Controls from that date. The regulations will include a requirement to comply with the CIPFA Prudential Code for Capital Accounting in Local Authorities (The Prudential Code).

3. PRUDENTIAL CODE

- 3.1** The basic principle of the new system is that the Council will be free to set its own level of capital investment so long as the Capital Spending Plan can shown to be affordable, prudent and sustainable. The Prudential Code sets out the indicators to be used and the factors to be taken into account to demonstrate that these objectives are fulfilled.
- 3.2** The Prudential Code sets out a governance procedure for setting and revising the prudential indicators. This should be done by the same body that takes the budget decisions, in our case the full Council and the Director of Finance is responsible for ensuring that all matters which require to be taken into account are reported and that procedures to monitor performance are established.

The areas where indicators apply include: -

(a) Affordability

Affordability will essentially be determined by a judgement by Members about acceptable levels of revenue funded services and council tax levels and, in the case of the Housing Revenue Account, acceptable rent levels. Whilst it will be possible to significantly increase the level of capital spending so long as other principles in the Prudential Code are observed, the repayment of the funds borrowed to facilitate this will fall on the annual revenue accounts. There will be no additional government grant to support this and so the cost will require to be met either from efficiency savings or from increased council tax or rent.

The basic mechanism for making these decisions is already in place in the Council's budget setting process which includes determining budget strategy, public consultation and consideration of the impact on the Community Plan and departmental service priorities.

The new arrangements will also mean that schemes which save money over time and provide better services but which previously could not proceed because of the limits placed on annual capital spending can now be taken forward if they at least save the cost of borrowing over the life of the asset.

(b) Prudence

This relates mainly to the level and management of external debt. There is a requirement to ensure that over the medium term net borrowing will only be for a capital purpose and to ensure that Treasury Management is carried out in accordance with good professional practice.

The essential elements of this are already in place and appropriate indicators will be proposed during the council's budget process for 2004/05.

(c) Capital Planning

The Prudential Code recognises that a soundly formulated capital programme must be driven by the desire to provide high quality, value for money services. There is a requirement that in making its capital investment decisions the council must have explicit regard to option appraisal, asset management planning, overall strategic plans and the achievability of the forward plan. Although the Code does not specify the means of doing this it points to good practice guidance previously published by CIPFA and other authoritative sources.

Whilst many of these matters have been taken into account in compiling capital programmes in the past it is considered that the introduction of the Prudential Code presents an opportunity to refine and codify the processes in order to demonstrate conformance with the requirements. It is apparent from discussion with auditors that this is likely to be the main area which will be

tested for compliance and the existence of a clear, methodical and approved approach will validate the level of capital spending determined by the Council not only to auditors but also to council tax payers and other stakeholders. It is proposed therefore that the Corporate Governance Committee with its general oversight of the Council's property portfolio be asked to establish guidance on these matters in advance of this Committee determining the General Services Capital Programme for 2004/05 – 2006/07. It may also be appropriate for the Housing Committee to take similar action to ensure that the Housing Capital Planning process also conforms with the principles of the Prudential Code.

4. DEFINITION OF CAPITAL EXPENDITURE

- 4.1** Under the Section 94 regulations, the definition of capital expenditure was set out in Scottish Executive circulars. Under the new arrangements charges to Capital must comply with national accounting guidance approved by the professional accounting bodies. This defines capital expenditure as expenditure on the acquisition of a fixed asset or expenditure which adds to and not merely maintains the value. Under this definition improvement works and structural repairs should be capitalised whilst expenditure to ensure the asset maintains its previously assessed standard of performance is a revenue expense. This has implications for the Council as some expenditure which is legitimately chargeable to capital at present under Section 94 rules will require to be treated as revenue under the new system. This will require to be taken account of in formulating both the Revenue Estimates and the Capital Programme.

5 RECOMMENDATION

It is recommended that Members:

- 5.1** request the Director of Finance to bring forward proposals for the various indicators referred to in the Prudential Code as part of the budget process;
- 5.2** request the Director of Development Services to present a report detailing proposals for asset management planning and related General Services capital investment planning for consideration by the next meeting of the Corporate Governance Committee and the Director of Homes and Technical Services to present a similar report to the Housing Committee in respect of Housing Capital plans ; and
- 5.3** otherwise note the contents of this report.

Alex McPhee
Director of Finance

AMcP/DMW
11 September 2003

LIST OF BACKGROUND PAPERS

1. The CIPFA Prudential Code for Capital Accounting in Local Authorities