



## REPORT

Committee	PRUDENTIAL CODE STEERING GROUP		
Venue	Robert Street	Date	16 October 2002
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Subject	Depreciation		

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### PURPOSE

**To receive the notes of the meeting of the PCSG reference group on depreciation held on 14 August and to consider issues arising.**

### REPORT

- 1 CIPFA's discussion paper on the role that depreciation could play in local government finance was published in June.
- 2 The July meeting of the PCSG agreed that this paper would be considered by a meeting of the PCSG reference group on depreciation on 14 August and that the results of that discussion would be brought back to this meeting of the PCSG.
- 3 Attached to this report are:
  - (a) The notes of the meeting held on 14 August 2002.
  - (b) A copy of the discussion paper on depreciation.

### RECOMMENDATION

**The PCSG is asked to receive the notes of the meeting of the PCSG reference group on depreciation held on 14 August and to consider issues arising.**

**NOTES OF MEETING OF PCSG REFERENCE GROUP ON DEPRECIATION  
HELD ON 14 AUGUST 2002**

INTRODUCTION

- 1 The following were present at the meeting: Nick Buxton, Tim Day, Trevor Emmott, Graham Fletcher, Lisa James, Iain Richardson, Paul King, Stephen Sheen, Peter Swaby and Maureen Wellen.
- 2 In addition, comments have been received from the following members of the PCSG: Paul Bannister, Ronnie Hinds and David Thomas.
- 3 It was agreed that the meeting would be conducted under Chatham House rules, with a summary of the conclusions published.

**The potential role of depreciation in local authority finance**

- 4 The majority view of the meeting was that the potential role of depreciation in local authority finance is as outlined in the discussion paper; in particular that the full application of depreciation in local authorities would be of great benefit to asset management, would assist decision making and would be more consistent than the current system with respect to inter-generational equity. However, that this would have major implications for affordability that would need to be addressed. If the decision were taken to do so, the full application of depreciation would most probably need to be brought in incrementally.
- 5 There was a minority view that the particular circumstances of local authorities make the full application of depreciation inappropriate and that, instead, the focus should be on repaying debt over appropriate periods.
- 6 There was also a minority view that the focus, in terms depreciation hitting the bottom line, should not be on depreciation based on current valuations but on historical cost depreciation.
- 7 It was stressed that it is important for action in respect of depreciation in the local authority sector to be cognizant of, and move in tandem with, developments elsewhere in the public sector.
- 8 It was noted that the discussion paper, and in particular the executive summary, had been written with the non specialist in mind, and could serve as an explanation of the meaning of depreciation for the lay person.

*Action agreed*

- 9 *It was agreed that Nick Buxton would confirm whether the depreciation referred to in the golden rule<sup>1</sup> refers to depreciation based on values in the balance sheets of public sector organisations (where assets are generally held at current values) or historical cost depreciation*
- 10 *It was agreed that the ‘reserves’ and ‘cash balance’ options outlined in the discussion paper offer potential ways to take forward the issue of depreciation whilst retaining a separation between capital and revenue resources and/or introducing the charging of depreciation to the bottom line in an incremental way, if policy decisions are taken to do this. It was agreed that the detailed format would be dependant upon any such policy decisions by central and local government and would need to await such decisions.*

**Points of detail**

- 11 The following detailed comments were made on the paper and should be read with the paper:
- (a) In paragraph 1.10(e) add – “Where borrowing is not required, then the authority will be utilising cash from its own internal resources and will need to assess the impact of the consequential loss of income from the interest that would otherwise be receivable on the investment of that cash.”
  - (b) In paragraph 1.12(c) “net” instead of “not”
  - (c) In respect of the issues of affordability, there is a further factor that needs to be taken into consideration. Therefore add a new item (h) to paragraph 9.4 as follows – **“Government and devolved administration support.** The government and devolved administrations currently support capital investment by local authorities through a mixture of capital grants and revenue funding through the SSA. The difference between the total amount of such support currently given and the amount that would be given through supporting depreciation instead would also need to be considered when addressing the issue of the affordability of the full application of depreciation in the local authority sector.
  - (d) The details of the ‘reserves’ and ‘cash balance’ options would need to be reviewed and revised if the capital accounting review currently being conducted by the CIPFA/LASAAC Joint Committee results in a “Schedule 1 / schedule 2” approach, similar to that adopted within central government. Such a change would, arguably, simplify and make more transparent any adjustments for policy / taxation purposes.

CONCLUSION

- 12 **The CIPFA discussion paper was welcomed as a contribution to the debate. Other stakeholders should consider, with CIPFA, the affordability and policy issues raised.**

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<sup>1</sup> The golden rule – that over the economic cycle the government will borrow only to invest and not to fund current spending, where the current budget is defined as the difference between current receipts and current expenditure including depreciation.