The Chartered Institute of Public Finance & Accountancy

Guidance on Prudential Indicators and the impact of Local Government Reform

1. Background and purpose of Guidance

On the 1st April 2015, the existing 26 district councils in Northern Ireland will reform into 11 new councils. By the 15th February 2015, each of the 11 new councils will need to set and agree a level of rates for the 2015/16 financial year. This process will also include reviewing and setting the new councils prudential indicators, its minimum revenue policy and charge to rates and its treasury management policy and strategy.

The aim of this document is to provide councils with guidance on the issues that surround setting and reviewing the prudential indicators for the newly formed council.

2. Aims of the Prudential Framework

The prudential framework provides support to local strategic planning, local asset management planning and proper option appraisal. Its main objective is to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

To demonstrate local authorities are fulfilling these objectives, the prudential code sets out the indicators that must be used, and the factors that must be taken into account. The framework does not suggest indicative limits or ratios. These will be for the local authority to set itself, subject to any imposed limits under section 14 of the Local Government Finance Act (Northern Ireland) 2011 (to date no such limits have been imposed).

3. Matters to consider as a result of Reform

Reform of local government in Northern Ireland will require new councils to review their full range of indicators taking account of the make-up of the new body from 1 April 2015.

The table at Annex A provides guidance relating to each indicator required by the Prudential Code, the implication of Reform and the potential impacts to be considered.

Councils will be aware that assets and liabilities will be transferring from other bodies outside of local government as well as from existing councils. Assets transferring from central government bodies to local government bodies are due to transfer on a fully funded basis. For such transfers, there will be no impact on the level of the Capital Financing Requirement (CFR) as the accounting entry for the transfer would be:

Dr Property, Plant and Equipment

Cr The Capital Adjustment Account

Assets transferring in to a new council as a result of boundary changes (for example, assets transferring from Castlereagh Council to the New Belfast Council) will require assessment of the impact on the prudential indicators of the new body. In this case, as well as the assets transferring, any associated outstanding loans may also transfer. This would have an impact on the level of the CFR, and an assessment of the level of MRP required to finance the remaining unfinanced balance for those assets would need to be made. The accounting entry for these types of transfers would be:

Dr Property, Plant and Equipment

Cr The Revaluation Reserve - with any associated balance

Cr Long-term Liabilities - with outstanding loans transferring

Cr The Capital Adjustment Account – with amounts already financed, (charged to the general fund)

The Capital Adjustment Account balance will be difficult to breakdown by asset, but should represent the amounts previously charged to the General Fund for asset financing.

NOTE: in both cases above the debit to property plant and equipment will be broken down to include the gross carrying amount and accumulated depreciation balances on transfer to arrive at the net carrying value being transferred or merged.

You can therefore see from the above summary that the reform transaction will have impacts on the level of the CFR, the level of debt for the new council (and therefore impacts on the maturity structure of borrowing), operational and authorised limits for borrowing for the new council and the ratio of debt to the CFR. All of this will need consideration by the new council prior to setting a rate for 2015/16 in February 2015.

The council will also need to consider its medium term financial plan in respect of its capital investment and treasury strategy as the prudential indicators look forward to the forthcoming year and following two years as a minimum. In other words, in February 2015 for example, the plans for the council will need to consider as a minimum indicators for:

Actual for 2013/14	*Outturn for 2014/15*	Estimate for 2015/16	Estimate for 2016/17	Estimate for 2017/18

NOTE: The new council would only be required to produce indicators for the 2015/16 years onwards as comparative information would not be available for the council in its new form for the previous year and 2014/15 outturn.

Further advice:

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Annex A: Impact of Local Government Reform on Prudential Indicators

Prudential Indicator	Reform Implications	Potential Impacts	Notes and Comments
External Debt Indicators			
Operational Boundary	Reform will consolidate external debt from merging councils and/or any debt from assets transferred to/from councils with boundary changes.	Debt includes the sum of borrowing and other credit arrangements (e.g. finance leases)[1]. There is a need to ensure all of this is captured. The new debt level for the new council will have impacts on financing costs.	This is not a matter of policy for the new councils; consolidation will dictate the level of the operational boundary. Councils should ensure they have full details on all debts (borrowing and any other relevant liabilities).
Authorised Limit	New Councils will need to set their authorised limit.	The CFO will need to consider what is affordable and make the appropriate recommendations to Council.	This is a matter of policy and decision for the Council within the context of the Prudential framework.
Actual External Debt	This is the result of actual consolidation.	Councils may need to consider the make-up of its total debt and the revenue implications of the associated financing costs.	Actual debt will be the result of consolidation in the new council. Councils need to capture all the external debt in order to set the Operational Boundary and consider

[1] See Sections 66 and 68 of the Prudential Code for Capital Finance in Local Authorities (2011 edition)

Prudential Indicator	Reform Implications	Potential Impacts	Notes and Comments
			the Authorised Limit. Councils also need to consider the financing sources for future capital investment to set these limits going forward.
Capital Expenditure Indicators			
Actual/Estimates of the Capital Financing Requirement[2] (CFR)	The CFR is central to the prudential framework. New Councils must ensure they capture all the relevant data for assessing and calculating the CFR.	Councils must consider the CFR against the actual level of debt and also for setting the appropriate level of Minimum Revenue Provision in the Rates.	Issues can arise through Councils classification of items relevant to the CFR, such as sinking funds and other reserves set aside to pay future debt. Councils should ensure the calculation of the CFR considers these issues.
Actual/Estimates of Capital Expenditure	The prior year actual figures will result from consolidation. When estimating forward, Councils will need to have a consolidated Capital programme and plan in outline.	Councils will need to link the Capital plans to their sources of finance and make an assessment of affordability and prudence. This will impact on the setting of the Authorised Limit and Operational Boundary.	Councils should ensure ALL capital decisions are considered, e.g. any items decided in Shadow form or through the STC.
Affordability Indicators			

[2] For the definition of the Capital Financing Requirement – see section 67 of the Prudential Code for Capital Finance in Local Authorities (2011 edition)

Prudential Indicator	Reform Implications	Potential Impacts	Notes and Comments
Actual/Estimates of the Ratio of Financing Costs to Net Revenue Stream	The revised debt figures for the new council will require a new assessment of the level of financing costs being incurred.	Reform and consolidation will generate a new position regarding financing costs compared to net revenue. Not only will the level of financing costs be new, the estimate of future net revenue, i.e. taxation and non-specific grant income, will also need to be estimated.	This new position cannot be considered in isolation and needs to be set in the context of the new council's capital plans, their potential impact on financing costs, debt levels and what the council deem is prudent and affordable.
Estimate of the impact of Capital Investment Decisions on the Councils Rates	Actual figures for the prior year result from consolidation. Estimates going forward link to the above assessment of future financing costs linked to capital plans.	This area is totally within the remit of the new Council in terms of what is considered affordable. This indicator will reflect the incremental impact of any decisions and recommendations on investment and borrowing.	Indicator is a calculation of the incremental impact of the capital investment decisions on rates.
Prudence Indicators			
Gross Borrowing and the Capital Financing Requirement	Gross borrowing for the new council needs to be assessed. This provides an assessment on first consolidation of what the council's position is in respect of internally financed capital. Where	On consolidation, councils will need to take account of the position of gross borrowing in relation to the CFR in order to ensure that over the medium term debt will only be for a capital purpose, i.e. the council has	This consolidation may throw up some queries and/or unusual results. Councils should consider if all the relevant transactions and balances have been appropriately considered, e.g. sinking funds, capital fund reserves etc.

Prudential Indicator	Reform Implications	Potential Impacts	Notes and Comments
	there is a significant difference between the two figures, councils should understand the risks and benefits associated with a strategy towards internally financed capital investment.	not borrowed in advance of need.	
Treasury and External Debt Indicators			
Compliance with the CIPFA Code of Practice for Treasury Management	None, this is an explicit statement of compliance.	None	None
Interest Rate Exposures	This is a matter dictated by council policy.	It is for the council to consider the level of financing it requires and in what portions it considers it appropriate to have that borrowing in fixed rates or variable rate loans.	This is a risk assessment, taking account of the councils view on interest rate movements over the longer term.
Maturity Structure of Borrowing	The new council will have a different risk profile in relation to interest rate exposure and the timing of maturity of loans than any one individual previous council.	There may be a greater risk associated with the new body in terms of its exposure to potential adverse re-financing impacts through changing interest rates and the timing of its requirements to re-finance.	Councils need to be aware of this and also factor in consideration of potential re-financing of existing debt, if there is benefit in doing so, and the future timing and length of loans resulting from future capital investment. The aim of these measures should be to minimise any re-financing risks.
Total Principal Sums Invested for	This is a matter dictated by	The new council may have	This indicator reflects the approach

Prudential Indicator	Reform Implications	Potential Impacts	Notes and Comments
periods longer than 364 days	council policy.	to review any previous established positions here to harmonise a policy in the new body.	of the council regarding liquidity of its funds.

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