



Local Government Policy Division

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Date: 14 March 2011

Dear Consultee

CONSULTATION ON GUIDANCE TO BE MADE UNDER PART 1 OF THE LOCAL GOVERNMENT FINANCE BILL – GUIDANCE ON MINIMUM REVENUE PROVISION FOR DISTRICT COUNCILS IN NORTHERN IRELAND

Further to the Consultation that issued on 17 December 2010 on the regulations and guidance to be made under Part 1 of the Local Government Finance Bill, the Department is now seeking views on the Guidance on Minimum Revenue Provision for District Councils in Northern Ireland.

Comments should be sent to the Department by **3 June 2011**.

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Aims of the Guidance on Minimum Revenue Provision

1. Part 1 of the Local Government Finance Bill ('the Bill') will modernise the legislative framework for local government finance.
2. The guidance which issued on 17 December 2010 to support Part 1 of the Bill provided details on the proposed capital finance regime, investment and capitalisation procedures. As part of the introduction of the new prudential capital finance system, the Department also intends to issue guidance on Minimum Revenue Provision (MRP). This draft guidance is attached at Annex A.

Background

3. The Bill was introduced in the Assembly on 19 April 2010 and completed the Final Stage on 15 February 2011.
4. The Department has the power to issue guidance or to make subordinate legislation regarding financial administration, including the power to specify codes of practice to be followed by councils. Most of the detail for the proposed capital finance regime is provided in the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011.
5. The essence of the financial element of the Bill and subordinate legislation is to modernise the existing local government financial framework to ensure that councils, as autonomous bodies, have

increased financial flexibility and responsibility which also results in greater accountability. The Bill relaxes the Departmental controls for the financial management of council affairs to place more clearly that responsibility direct with elected local representatives and the Bill places additional obligations on councils to ensure a robust financial framework.

6. Two significant sets of guidance that form part of this new regime are the Chartered Institute of Public Finance & Accounting (CIPFA) Prudential Code on Capital Finance and the CIPFA Treasury Management Code. The Prudential Code is at the heart of the new system of control on councils' capital investment and reserves requiring councils to demonstrate that its plans are prudent, affordable and sustainable.

Human Rights

7. The Human Rights Act 1998 implements the European Convention on Human Rights. The 1998 Act makes it unlawful for any public authority to act in a way that is incompatible with these rights. We believe that the proposals in this consultation document are compatible with the Human Rights Act, but would welcome any views that you might have.

Equality

8. Under the terms of section 75 of the Northern Ireland Act 1998, the Department carried out screening for equality

impact and is satisfied that the proposed guidance will not lead to discriminatory or negative differential impact on any of the section 75 groups. A copy of the screening form can be viewed on the Department's website.

<http://www.doeni.gov.uk/index/information>

Regulatory Impact Assessment

9. The Department has not conducted a regulatory impact assessment as the proposed guidance does not give rise to any associated costs or savings on business, charities, social economy enterprises or the voluntary sector.

Rural Proofing

10. The Department has assessed the proposed measures and considers that there would be no differential impact in rural areas or on rural communities.

Freedom of Information Act 2000 – Confidentiality of consultations

11. The Department may publish a summary of responses following completion of the consultation process. Your response, and all other responses to the consultation, may be disclosed on request. The Department can only refuse to disclose information in exceptional circumstances. Before you submit your response, please read Annex B on the confidentiality of consultations. It gives guidance on the legal

position about any information given by you in response to this consultation.

Alternative format

12. This document may be made available in alternative formats. Please contact us to discuss your requirements, using any of the following methods.

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Textphone: 028 9054 0642

Facsimile: 028 9025 6080

E-mail: Lizanne.kennedy@doeni.gov.uk

Consultation – how to respond

13. I would be grateful if you could forward any comments you may have on the proposed legislation and guidance to Local Government Policy Division at the address on page one or by e-mail to Lizanne.kennedy@doeni.gov.uk by Friday 3 June 2011.
14. This consultation is also available to view at:
http://www.doeni.gov.uk/index/local_government/local_government_consultations.htm

15. This Consultation Document is being circulated to persons and bodies listed in Annex C.

Yours faithfully

Lizanne Kennedy

Lizanne Kennedy
Local Government Policy Division

DRAFT GUIDANCE ON MINIMUM REVENUE PROVISION FOR DISTRICT COUNCILS IN NORTHERN IRELAND

NOTE ON THE GUIDANCE

[This note is not part of the guidance]

BACKGROUND

As part of the introduction of the new prudential capital finance system, the Department has issued this guidance on Minimum Revenue Provision (MRP). Part 1 of this document gives informal advice only and is not part of the statutory guidance itself, which is contained in Part 2.

Section 25 of the Local Government Finance Act 2011 states that councils have a statutory duty to have regard to the guidance in Part 2.

Councils normally set aside each year some of their revenues as provision for debt. More precisely, the provision is in respect of capital expenditure financed by borrowing or credit arrangements but, both in this commentary and in the statutory guidance, the term "debt" is used as shorthand.

APPLICATION

This guidance is operational for the financial year 2012-2013 and should take account of new capital expenditure incurred in the financial year 2010-2011. Therefore councils will need to have regard to this guidance when establishing their Annual Budgets for the financial year 2012-2013.

*Any queries about this document should be addressed to:
John.Small@doeni.gov.uk*

PART 1

Department of the Environment

INFORMAL COMMENTARY ON MINIMUM REVENUE PROVISION GUIDANCE

[References to paragraphs in the formal guidance are in square brackets]

1. MRP CALCULATION REGULATION

- 1.1 The duty to make revenue provision is set out in regulation 6 of the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011. Under this regulation a council has a duty to charge to its general fund an amount of MRP which it considers to be “prudent”. The regulation does not define “prudent” however this guidance makes recommendations on how this term should be interpreted.
- 1.2 Regulation 6 will be operational for the financial year 2012-2013; therefore councils will need to have regard to this guidance when establishing their Annual Budgets for that year.

2. ANNUAL MRP STATEMENT [paragraph 4]

- 2.1 An annual statement of the council’s policy on making MRP should be approved by the council. This mirrors the requirement for a council to determine and keep under review its affordable borrowing limit. The aim is to give elected Members the opportunity to scrutinise the policy. **The MRP statement should be submitted to the council for approval before the start of the financial year.**
- 2.2 If during the year it is proposed to review the original policy, a revised statement should be put to the council at that time. It is for each council to consider with its officers the preferred format of the statement. The Department will not be issuing any advice on this matter.

3. MEANING OF “PRUDENT PROVISION” [paragraph 5]

- 3.1 The main part of the guidance is concerned with recommendations on the interpretation of the term “prudent provision” as used in regulation 6. The guidance includes two examples of options for making “prudent provision”.
- 3.2 In particular it explains that provision for the borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.

4. OPTIONS FOR PRUDENT PROVISION

- 4.1 Two ready-made options are included in the guidance. The options are those likely to be most relevant but other approaches are not meant to be ruled out, provided that they are fully consistent with the statutory duty to make prudent revenue provision. Councils must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified. That could involve taking account of detailed local circumstances, including specific project timetables and revenue-earning profiles. Councils may wish to consult their legal advisers and Local Government Audit about their approach to MRP if it involves a significant departure from the guidance or relates to any large, complex or novel scheme. However, the decision on what is prudent is for the council and it is not for the Department to say in particular cases whether any proposed arrangement is consistent with the statutory duty.

4.2 OPTION 1: Asset Life Accounting [paragraph 6.1]

- 4.2.1 Option 1 is to make provision over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 2).
- 4.2.2 There are two methods for Asset Life Accounting. The first of these, the **equal instalment method**, allows the use of the simple formula in paragraph 6.1.1(a) of the guidance. This will normally generate a series of equal annual amounts over the estimated life of the asset. The original amount of expenditure (“A” in the formula) remains constant. The cumulative total of the MRP made to date (“B” in the formula) will increase each year.
- 4.2.3 The outstanding period of the *estimated life* of the asset (“C” in the formula) reduces by 1 each year. For example, if the life of the asset is originally estimated at 25 years, then in the initial year when MRP is made, C will be equal to 25. In the second year C will be equal to 24, and so on. The original estimate of the life is determined at the outset

and should not be varied thereafter, even if in reality the condition of the asset has changed significantly (paragraph 6.1.3).

- 4.2.4 The formula allows a council to make *voluntary extra provision* in any year. This will be reflected by an increase in amount B and will automatically ensure that in future years the amount of provision determined by the formula is reduced.
- 4.2.5 The alternative is the **annuity method**, which has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. It may be particularly attractive in connection with projects where revenues will increase over time. Guidance on the calculation method is given by CIPFA in Chapter 6 of its publication "Practitioners' Guide to Capital Finance in Local Government (CIPFA 2008) (ISBN 978 1 84508 175 1).
- 4.2.6 *Freehold land* (paragraph 6.1.4) cannot properly have a life attributed to it, so for the purposes of Option 1 it should be treated as equal to a maximum of 50 years. Where there is a structure on the land which the council considers to have a life longer than 50 years, that same life estimate may be used for the land.
- 4.2.7 Provision for debt under Option 1 will normally commence in the financial year following the one in which the expenditure is incurred [paragraph 6.1.2], but paragraph 6.1.5 of the guidance highlights an important exception to this rule. In the case of the provision of a new asset, MRP would not have to be charged until the asset came into service and would begin in the financial year following the one in which the asset became operational. This *MRP holiday* would be perhaps 2 or 3 years in the case of major projects, possibly making them more affordable. There would be a similar effect in the case of Option 2 under normal depreciation rules.

4.3 OPTION 2: Depreciation Accounting [paragraphs 6.2]

- 4.3.1 Option 2 is to make MRP in accordance with the standard rules for depreciation accounting. Councils will normally need to follow the standard procedures for calculating depreciation provision. However, the guidance identifies some necessary exceptions [paragraph 6.2.2]:
- (a) MRP continues until the total provision made is equal to the original amount of the debt and may then cease.
 - (b) The capital receipt from the disposal of the asset may not be used for revenue spending, since that would run counter to the Government's "golden rule". Capital receipts may be used only as specified in regulation 18 of the 2011 regulations.
 - (c) If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

5. ARRANGEMENTS FOR IMPLEMENTING MRP [paragraph 7]

- 5.1 With regard to the transition to these arrangements and preparation of annual MRPs, councils need to determine MRPs on or before 31 March each year taking account of new debt incurred in the preceding financial year. For example on or before the 31 March 2012 councils will need to have determined MRPs for the first financial year of operation, 2012-2013, this will take into account new debt incurred in the financial year 2010-2011.
- 5.2 The MRP statement, as outlined above, should be submitted for council approval before the start of each financial year.
- 5.3 If it is ever proposed to vary the terms of the original MRP statement during the year, a revised statement should be submitted for council approval at that time.

6. APPLICATION

- 6.1 Regulation 6 will be operational for the financial year 2012-2013; therefore councils will need to have regard to this guidance when establishing their Annual Budgets for that year.

7. CAPITALISED EXPENDITURE [paragraph 8]

- 7.1 Councils may borrow to meet expenditure which is treated as capital expenditure by virtue of either a capitalisation direction (section 19 of the 2011 Act) or regulation 12 of the 2011 Regulations. The guidance recommends that MRP in such cases is determined under Option 1. However, since the expenditure does not relate (directly at least) to an asset for which a life can be estimated, guidance is given on how to determine the value of the variable "C" in the formula in paragraph 8.2 of the guidance.
- 7.2 The table in paragraph 8.2 gives the value of "C" for each of the categories listed in regulation 12. The basic principle is that, where the capitalised expenditure can be indirectly linked to an asset, the estimated life of that asset should be used.
- 7.3 In other cases, 25 years is proposed as a reasonable default. However, for the acquisition of **share or loan capital** (regulation 12(1)(d)), the slightly shorter period of 20 years is specified, because the aim of that regulation is to discourage the use of those particular forms of investment.

- 7.4 Similarly, 20 years is specified in the case of expenditure ***capitalised by direction***, since the Government again does not wish to encourage reliance upon that practice.
- 7.5 It should be noted that the value of “C” given in each case applies only in the initial year of making MRP. Subsequently the value will decrease by 1 in each successive year.

PART 2

Department of the Environment

GUIDANCE ON MINIMUM REVENUE PROVISION

Issued under section 25(1) of the Local Government (Finance) Act (Northern Ireland) 2011 and effective from 1 April 2012

1. POWER UNDER WHICH THE GUIDANCE IS ISSUED

- 1.1 The following guidance is issued by the Department under section 25(1) of the Local Government Finance Act (Northern Ireland) 2011 which states that councils have a statutory duty to have regard to this guidance.

2. DEFINITIONS OF TERMS

- 2.1 In this guidance:

2011 Act means the Local Government Finance Act (Northern Ireland) 2011;

2011 Regulations means the Local Government (Capital Finance and Accounting) (Northern Ireland) Regulations 2011 [SI 2011/X];

Council means a District Council in Northern Ireland;

MRP means Minimum Revenue Provision;

Prudential Code means the code of practice referred to in regulation 7 of the 2011 Regulations;

Department means the Department of the Environment; and

Credit arrangement has the meaning given in section 17 of the 2011 Act.

3. INTRODUCTION

- 3.1 Under regulation 6 of the 2011 Regulations, a council has a duty to charge to its general fund an amount of MRP which it considers to be "prudent".
- 3.2 Regulation 6 will be operational for the financial year 2012-2013; therefore councils will need to have regard to this guidance when establishing their Annual Budgets for that year.

4. ANNUAL MRP STATEMENT

- 4.1 The Department recommends that before the start of each financial year a council prepares a statement of its policy on making MRP in respect of that financial year and submits it to the council for approval. The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year.
- 4.2 If it is ever proposed to vary the terms of the original statement during the year, a revised statement should be put to the council for approval at that time.

5. MEANING OF “PRUDENT PROVISION”

- 5.1 Regulation 6 of the 2011 Regulations requires a council to calculate for the current financial year an amount of MRP which it considers to be prudent. The Department recommends that, for the purposes of regulation 6, the prudent amount of provision should normally be determined in accordance with paragraphs 5.2 and 5.3 below.
- 5.2 The broad aim of prudent provision is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.
- 5.3 The Department considers that the methods of making prudent provision include the options set out in paragraph 6, subject to the conditions in paragraph 7. Approaches differing from those exemplified are not ruled out.

6. OPTIONS FOR PRUDENT PROVISION

6.1 Option 1: Asset Life Accounting

- 6.1.1 Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset. There are two main methods by which this can be achieved, as described below. Under both variations, councils may in any year make additional voluntary revenue provision, in which case they may make an appropriate reduction in later years' levels of MRP.

(a) Equal instalment method

MRP is the amount given by the following formula:

$$\frac{A-B}{C}$$

where-

- A** is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements
- B** is the total provision made before the current financial year in respect of that expenditure
- C** is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

(b) Annuity method

MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing or credit arrangements. The council should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during the repayment period (eg by the application of capital receipts) should be made as necessary.

- 6.1.2 **Commencement of provision** Subject to paragraph 6.1.5 below, MRP should normally commence in the financial year following the one in which the expenditure was incurred.
- 6.1.3 **Asset Life** The estimated life of the asset should be determined in the year that MRP commences and not subsequently revised.
- 6.1.4 **Freehold land** If no life can reasonably be attributed to an asset, such as freehold land, the life should be taken to be a maximum of 50 years. However, in the case of freehold land on which a building or other structure is constructed, the life of the land may be treated as equal to that of the structure, where this would exceed 50 years.
- 6.1.5 **MRP commencement** When borrowing to provide an asset, the council may treat the asset life as commencing in the year in which the asset first becomes operational. It may postpone beginning to make MRP until the financial year following the one in which the asset becomes operational. "Operational" here has its standard accounting definition.

6.2 Option 2: Depreciation Accounting

- 6.2.1 MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment.
- 6.2.2 For this purpose standard depreciation accounting procedures should be followed, except in the following respects:

- (a) MRP continues until the cumulative amount of such provision is equal to the expenditure originally financed by debt. Thereafter the council may cease to make MRP.
- (b) On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. But this does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.
- (c) Where the percentage of the expenditure on the asset financed by debt is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

7. CONDITIONS FOR USING THE OPTIONS

- 7.1 For expenditure incurred on or after 1 April 2012, prudent approaches for non-capitalised capital expenditure include Options 1 or 2.
- 7.2 For all capitalised expenditure incurred on or after 1 April 2012, councils should use Option 1, adapted in accordance with paragraph 8 below.

8. CAPITALISED EXPENDITURE

- 8.1 Where on or after 1 April 2012 a council incurs expenditure which is:
 - (a) financed by borrowing or credit arrangements; and
 - (b) treated as capital expenditure by virtue of either a direction under section 19(3) of the 2011 Act or regulation 12 of the 2011 Regulations

the council should make MRP in accordance with Option 1.

- 8.2 For the purpose of the formula in paragraph 6.1.1 (a) above, in the initial year of making MRP the variable "C" should be given the maximum values as set out in the following table:

<u>Expenditure type</u>	<u>Maximum value of "C" in initial year</u>
Expenditure capitalised by virtue of a direction under s19(3)	"C" equals 20 years
Regulation 12(1)(a) Expenditure on computer programs	"C" equals the value it would have for computer hardware

Regulation 12(1)(b) Loans and grants towards capital expenditure by third parties	"C" equals the estimated life of the assets in relation to which the third party expenditure is incurred
Regulation 12(1)(c) Repayment of grants and loans for capital expenditure	"C" equals 25 years, or the period of the loan, if longer
Regulation 12(1)(d) Acquisition of share or loan capital	"C" equals 20 years
Regulation 12(1)(e) Expenditure on works to assets not owned by the council	"C" equals the estimated life of the assets

*Any queries about this document should be addressed to:
John.Small@doeni.gov.uk*

Department of the Environment

September 2011

The Freedom of Information Act 2000 – confidentiality of consultations

1. The Department may publish a summary of responses following completion of the consultation process. Your response, and all other responses to the consultation, may be disclosed on request. The Department can only refuse to disclose information in exceptional circumstances. Before you submit your response, please read the paragraphs below on the confidentiality of consultations and they will give you guidance on the legal position about any information given by you in response to this consultation.

2. The Freedom of Information Act gives the public a right of access to any information held by a public authority, namely, the Department in this case. This right of access to information includes information provided in response to a consultation. The Department cannot automatically consider as confidential information supplied to it in response to a consultation. However, it does have the responsibility to decide whether any information provided by you in response to this consultation, including information about your identity, should be made public or be treated as confidential.

3. This means that information provided by you in response to the consultation is unlikely to be treated as confidential, except in very particular circumstances. The Lord

Chancellor's Code of Practice on the Freedom of Information Act provides that:

- the Department should only accept information from third parties in confidence if it is necessary to obtain that information in connection with the exercise of any of the Department's functions and it would not otherwise be provided;
 - the Department should not agree to hold information received from third parties "in confidence" which is not confidential in nature; and
 - acceptance by the Department of confidentiality provisions must be for good reasons, capable of being justified to the Information Commissioner.
4. For further information about confidentiality of responses please contact the Information Commissioner's Office (or see website at: <http://www.informationcommissioner.gov.uk>).

List of Consultees

All Northern Ireland District Councils

Arc 21

Association of Local Government Finance Officers

Association of Public Service Excellence

Belfast Solicitors Association

Chief Local Government Auditor

Civil Law Reform Division

Clerk of the Petty Sessions

Community Relations Council

Confederation of British Industry

Equality Commission for NI

Federation of Small Businesses

Food Standards Agency Northern Ireland

HM Council of County Court Judges

Human Rights Commission

Inland Revenue

Law Centre (NI)

Local Government Staff Commission

MEPs

Ministry of Defence

MLAs

MPs

NI Assembly/ Committee for the Environment

NI Association of Citizens Advice Bureaux

NI Chamber of Commerce and Industry

NI Chamber of Trade

NI Council for Voluntary Action

NI Political Parties

NI Residents Magistrates' Association

NIC/ICTU

North Western Region Waste Management Group

Northern Ireland Court Service

Northern Ireland Judicial Appointments Commission

Northern Ireland Law Commission

Northern Ireland Local Government Association

Northern Ireland Ombudsman

Participation and the Practice of Rights Project

QUB – Institute of Professional Legal Studies

QUB – School of Law

Secretary- Catholic Bishops of Northern Ireland

Section 75 Groups

Society of Local Authority Chief Executives

Southern Waste Management Partnership

The Executive Council of the Inn of Court of Northern Ireland

The General Consumer Council for Northern Ireland

The Law Society of NI

UU- School of Law

