GUIDANCE ON MINIMUM REVENUE PROVISION

Guidance issued by Welsh Ministers under section
21(1A) of the Local Government Act 2003
[Revised 2018]

DEFINITIONS

1. In this guidance:

2003 Act means the Local Government Act 2003.

2007 Act means the Local Government and Public Involvement in Health Act 2007.

2003 Regulations means the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 2003/3239, as amended].

CFR means the Capital Financing Requirement, as defined in the Prudential Code.

Credit arrangement has the meaning given in section 7 of the 2003 Act.

Housing assets means any land, houses or other property to which subsection (1) of section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account) applies. (Section 74 was amended by section 222 of, and paragraph 24(2) of Schedule 18 to, the Housing Act 1996).

Lease means a lease transaction as defined under proper accounting practices.

Local authority has the meaning given in section 23 of the 2003 Act. (This guidance does not apply to community councils and charter trustees).

MRP means Minimum Revenue Provision.

Non-housing CFR has the meaning given in regulation 22 of the 2003 Regulations before this was amended by the 2008 regulations.

Prudential Code means the code of practice referred to in regulation 2 of the 2003 Regulations.

Supported Capital Expenditure means the total amount of capital expenditure which a local authority has been notified is to be taken into account in the calculation of the revenue grant due to the authority in respect of its use of borrowing and credit. It excludes any expenditure which is supported by capital grant.

APPLICATION

Effective date

2. This Guidance applies for accounting periods starting on or after 1 April 2019. It supersedes all previous versions of this Guidance.

Transitional arrangements

3. There is no requirement for local authorities to recalculate MRP charged for 2018-19 or any prior year following the issue of this updated guidance. Where, prior to 31 March 2019, a local authority changed the methodology that it uses to calculate a prudent provision and thus calculated an over-provision, it can continue to incorporate that overprovision into the future calculations of prudent provision, if the Authority considers it appropriate to do so.

4. As set out in paragraph 19 of the statutory guidance, if a local authority changes the methodology it uses to calculate MRP, then this change can never give rise to an overpayment.

Local authorities

5. This guidance applies to all local authorities in Wales and their relevant bodies. It does not apply to town and community councils or charter trustees.

INTRODUCTION

6. Under regulation 21 of the 2003 Regulations, local authorities are required to charge to their revenue account for each financial year MRP to account for the cost of their debt in that financial year. Prior to its amendment by the 2008 Regulations, regulation 22 set out details of the method authorities were required to follow in calculating MRP. This has been replaced with a requirement that local authorities calculate an amount of MRP which they consider to be prudent.

7. In calculating prudent provision, local authorities must have regard to this guidance. Where this guidance is not followed and authorities adopt an alternative method of calculating a prudent provision, the authorities must

explain the non-compliance and how this calculates a more appropriate provision

ANNUAL MRP STATEMENT

8. It is recommended that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full council. The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year.

9. 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 at that time.

MEANING OF "PRUDENT PROVISION"

10. Regulation 22 of the 2003 Regulations requires a local authority to calculate for the current financial year an amount of MRP which it considers to be prudent. Welsh Ministers recommend that, for the purposes of regulation 22, the prudent amount of provision should normally be determined in accordance with paragraphs 11 and 12 below.

11. An underpinning principle of the local authority financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or debt. The broad aim of prudent provision is to ensure that the cost of debt is charged to a revenue account over a period that is commensurate with that over which the capital expenditure provides benefits.

12. In the case of borrowing supported by the Welsh Government Revenue Support Grant, the meaning of prudent provision is to put funds aside over a period commensurate with the period implicit in the determination of that grant. "Commensurate" is not intended to require exactly the same period as in the determination of the grant.

13. Welsh Ministers consider that the methods of making prudent provision include the options set out in paragraphs 21 to 26, subject to the conditions in paragraphs 27 to 35. This does not rule out or otherwise preclude a local authority from using alternative approaches differing from those exemplified should it decide that it is more appropriate.

OVERPAYMENTS OF MRP

14. Local authorities may choose to pay more MRP than they consider prudent in any given year. If they do so they should separately disclose the in-year and cumulative amount of MRP overpaid in the Statement presented to full council.

MEANING OF CHARGE TO A REVENUE ACCOUNT

15. A charge to a revenue account for MRP cannot be a negative charge.

16. A charge to a revenue account can only be £nil if:
    - A local authority's CFR was nil or negative on the last day of the preceding financial year; or
    - A local authority chooses to offset a previous year's overpayment (as set out in paragraph 14) against the current year's prudent provision. If a local authority chooses to offset a previous year's overpayment, they should disclose this fact and any remaining cumulative overpayment of MRP in the Statement presented to full council.

CHANGING METHODS FOR CALCULATING MRP

17. A local authority may change the method(s) that it uses for calculating part or all of its MRP at any time.

18. Where a local authority changes the method(s) that it uses to calculate MRP, it should explain in its Statement why the change will better allow it to make prudent provision.

19. The calculation of MRP under the new method(s) should be based on the residual CFR at the point the change in method is made (i.e. it should not be applied retrospectively). Changing the method used to calculate MRP can never give rise to an overpayment in respect of previous years, and should not result in a local authority making a reduced charge or a charge of £nil for the accounting period in which the change is made, or in any subsequent period on the grounds that it needs to recover overpayments of MRP relating to previous years.

TRANSFERRED DEBT

20. Where debt is transferred between authorities, the authorities concerned should agree on arrangements for the continued making of MRP and adjust their CFRs accordingly. Normally, the authority relinquishing the debt should cease to make MRP in respect of it and the authority taking it over should begin to make MRP as if incurring new debt funded capital expenditure.

OPTIONS FOR PRUDENT PROVISION

Option 1: Regulatory Method

21. MRP is equal to the amount determined in accordance with the former 2003 regulations, as if they had not been revoked by the 2008 Regulations. For the purposes of that calculation, the Adjustment A should normally continue to have the value attributed to it by the authority in the financial year 2004-05. However, it would be reasonable for local authorities to correct any perceived errors in adjustment A, if the correction would be in their favour.

22. The former Regulations 28 and 29 of the 2003 Regulations are included at Annex A.

Option 2: CFR Method

23. MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year.

Option 3: Asset Life Method

24. 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, authorities 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:

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

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 authority 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 (e.g. by the application of capital receipts) should be made as necessary.

Option 4: Depreciation Method

25. 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 chargeable to the Income and Expenditure Account.

26. For this purpose standard depreciation accounting procedures should be followed, except in the following respects:

    - MRP should continue to be made annually until the cumulative amount of such provision is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter MRP shall be zero.
    - On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. 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.
    - Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

CONDITIONS FOR USING THE OPTIONS

27. Options 1 and 2 may only be used in relation to:
    (a) capital expenditure incurred before 1 April 2008; or
    (b) capital expenditure which forms part of its supported capital expenditure.

28. For expenditure incurred on or after 1 April 2008 which does not form part of the authorities supported capital expenditure, prudent approaches include Options 3 and 4.

29. For all capitalised expenditure incurred on or after 1 April 2008, the Welsh Government recommends that authorities should use Option 3, adapted in accordance with paragraphs 39 and 40 below.

30. Where a local authority uses options 3 or 4 or any other alternative methodology that has the useful life of assets as a component to the

calculation, asset lives should not normally exceed a maximum useful life of 50 years. Local authorities may exceed this maximum in two scenarios;

- Where a local authority has an opinion from an appropriately qualified professional advisor that an asset will deliver service functionality for more than 50 years it can use the life suggested by the professional advisor; and
- For a lease or PFI asset, where the length of the lease/PFI contract exceeds 50 years. In this case the length of the lease/PFI contract should be used.

Estimated useful life of assets

31. The estimated life of the asset should be determined in the year that MRP commences and not subsequently be revised.

Investment Properties

32. The duty to make MRP extends to investment properties where their acquisition has been partially or fully funded by an increase in borrowing or credit arrangements. As depreciation is not charged on investment properties, Option 4: the Depreciation method is not a suitable approach for calculating the MRP to be charged in respect of investment properties.

Freehold land

33. 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 (subject to conditions of paragraph 25).

Commencement of provision.

34. Subject to paragraph 35 below, MRP should normally commence in the financial year *following* the one in which the expenditure was incurred.

MRP commencement.

35. When borrowing to provide an asset, the authority 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. Investment properties should be regarded as becoming operational when they begin to generate revenues.

Leases and PFI

36. In the case of finance leases (or, when applicable, leases where a rightto-use asset is on balance sheet) and on balance-sheet PFI contracts, the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability.

37. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off-balance sheet, the MRP requirement would be regarded as having been met by the inclusion in the charge, for the year in which the restatement occurs, of an amount equal to the write-down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.

Housing Assets

38. The duty to make MRP to cover borrowing or credit arrangements used to finance capital expenditure on housing assets remains unchanged from the current determinations.

Capitalised Expenditure

39. Where on or after 1 April 2008 an authority incurs expenditure which is:

(a) funded by borrowing or credit arrangements; and
(b) treated as capital expenditure by virtue of either a direction under section 16(2)(b) of the 2003 Act or regulation 20(1) of the 2003 Regulations,

The authority should make MRP in accordance with Option 3.

40. For the purpose of the formula in paragraph 24 above, in the initial year of making MRP the variable, "C" should be given the maximum values as set out in the following table:

Expenditure type	**Maximum value of "C" in initial year**
Expenditure capitalised by virtue of a **direction** under s16(2)(b)	"C" equals the period specified in the direction. This will generally not exceed a maximum of 20 years.
Regulation 20(1)(a) Expenditure on computer programs	"C" equals the value it would have for computer hardware or the length of the software license.
Regulation 20(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 20(1)(d) Acquisition of share or loan capital	"C" equals 20 years
Regulation 20(1)(e) Repayment of grants and loans for capital expenditure	"C" equals 25 years or the period of the loan if longer
Regulation 20(1)(f) Expenditure on works to assets not owned by the authority	"C" equals the estimated life of the assets

Regulation 20(1)(h) Expenditure incurred on the acquisition, production or construction of assets not owned by the authority	“C” equals the estimated life of the assets