

Response to Consultation on Cipfa Prudential Code for Capital Finance in Local Authorities and Cipfa Treasury Management Code of Practice

Purpose

For decision.

Summary

Cipfa are carrying out a periodic review of both the Prudential Code for local authority borrowing and the Treasury Management Code and consulting on possible changes. Although of a technical nature the codes are of great importance as they underpin the capital financing framework for councils. This paper outlines the role of the codes and the possible areas that may be revised. A response to the consultations from the LGA has been drafted for the board's consideration and discussion and is included at **Appendix A**.

Recommendation

That the Board agree the draft response to the consultation appended to this report.

Action

That officers make any changes requested by the Board and submit the response to Cipfa.

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Background

1. The Prudential Code for Capital Finance in Local Authorities (the “Prudential Code”) was introduced in 2004 and last revised in 2011. Local authorities are required to “have regard” to it when developing their capital investment plans. In practice the Prudential Code plays a central part in local authorities being able to determine the level of capital investment that they are able to undertake. The introduction of the code, and the legislation behind it, in 2004, was a major step in freeing local government from centrally imposed borrowing controls and the Government placing genuine trust and reliance in local government’s ability to manage its own affairs according to the sector’s own professional standards. The track record of local government since the Prudential Code was first introduced has shown both that local government has proved worthy of that trust and that the code has an important place in enabling successful locally determined capital investment by local authorities compared to central controls.
2. The Prudential Code was last updated in 2011 and is now due for a periodic review. Since the last review local government has had a sustained period of reduced funding, significantly changing the financial landscape; in addition the devolution agenda and introduction of mayoral combined authorities have introduced further factors to consider. Recent reporting by the NAO ¹highlighted a shift in local authority capital spending towards schemes designed primarily to achieve revenue savings or generate revenue income to cover reduced revenue funding. This is an important factor in the review of the code and will be discussed below.
3. The Treasury Management Code of Practice was introduced in 2001/02. Again, local authorities are required to “have regard” to the code in setting up and approving their treasury management arrangements. In practice the code is widely used, and it is likely that any local authority not following it would be required to justify (e.g. to its external auditors) why it had not used it.
4. The review of the Treasury Management Code is aimed much more at the organisations that use it (primarily local councils, but it is applicable to any public services organisation), and the questions are geared to improving the code for users. At this stage this is largely an information gathering exercise by Cipfa, and there are no specific ideas to comment on nor has a collective view emerged across the sector. As such, there is little for the LGA to say in policy terms in response to the specific questions.
5. Both reviews are being conducted in an open matter – highlighting areas where the landscape has changed and asking if the codes need to change in response. There are, therefore, few proposals for specific changes at this stage (except one relating to mayoral combined authorities, for example) to comment on, but responses to this consultation will shape further proposals that Cipfa will then put forward.

¹ <https://www.nao.org.uk/report/financial-sustainability-of-local-authorities-capital-expenditure-and-resourcing/>

6. Overall both the codes do a good job and the approach underpinning the suggested response is to suggest that the reviews should be of a light touch.

Key areas highlighted for review – Prudential Code

7. The Cipfa [consultation on](#) the Prudential Code for Capital Finance in Local Authorities was published by Cipfa in February and the consultation closes on 21 April 2017. The consultation opens with questions reviewing the current operation of the Prudential Code and whether it and its objectives are still relevant. The four objectives of the code are to provide a framework for local authority capital finance that will ensure for individual local authorities that:

- 7.1 capital expenditure plans are affordable;
- 7.2 all external borrowing and other long-term liabilities are within prudent and sustainable levels;
- 7.3 treasury management decisions are taken in accordance with good professional practice;

and that in taking decisions in relation to (i) to (iii) above the local authority is:

- 7.4 accountable, by providing a clear and transparent framework.
8. These all still appear to be relevant to the way that local authorities carry out their business and it is proposed that the response endorses these with no need for further amendment.
 9. The next series of questions cover new mayoral combined authorities and whether they should be covered by the code. The new mayoral combined authorities are to be given borrowing powers from April 2017 (currently any significant borrowing would have to be covered by their constituent councils). It is therefore appropriate that the new authorities should have a capital financing framework that is as robust as that for its constituent councils.
 10. The next group of questions relate to councils taking on different ways of financing activities – in particular having interests in bodies such as subsidiaries and joint ventures, and in particular, whether and how the increased commercial activities of councils (and perceived increased risks) should impact on the Prudential Code.
 11. This area is an important one for councils. In its response to the NAO report on Local Authority Capital mentioned above, the Public Accounts Committee raised concerns about councils' activities aimed at generating revenue income from capital investment in properties and businesses, such as developing houses and commercial units for rent or sale and that it was concerned about risks arising from this. (ref – PAC report 16 November and government response²). The consultation recognises the increased commercial activities of local authorities and asks whether and how the code needs to be strengthened in reaction to this.
 12. Members may wish to consider how to respond to this point in some detail. If the code were not strengthened, it is possible, in the light of the PAC report and Government

² <https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2015/financial-sustainability-local-authorities-16-17/>

acceptance of its recommendation, that the Government would feel the need to intervene. Members may feel that the response to the consultation is the opportunity to reinforce the principle that managing local government risk is a matter for local government.

13. These commercial activities are of increasing importance to councils. It is clearly right that councils should recognise and take account of any increased risks. Equally, if the code were to become too restrictive, councils may lose opportunities and income, leading to further reductions in revenue affecting local service provision. A possible response could be to emphasise that in broad terms the code already allows for assessment of risks associated with commercial activities, but making this more explicit in the code would help ensure councils take full account of them.
14. Then final questions of the consultation consider technical points about the indicators used in the Prudential Code. The suggested response includes some general points about these

Key areas highlighted for review – Treasury Management code

15. The “Treasury Management in Public Services: Code of Practice and Cross-Sectoral Guidance Notes, is also being consulted upon. The code was originally published in 2001 and was last updated in 2011. The aim of the code is to “create clear treasury management objectives and to structure and maintain sound treasury management policies and practices”. The [consultation document](#) was published by the Cipfa in February and the consultation closes on 21 April 2017.
16. The Treasury Management Code identifies the following three principles of Treasury Management that local government bodies should follow:

Key principle 1:

- 16.1 Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

Key principle 2:

- 16.2 Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

Key principle 3:

- 16.3 They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

17. As noted above the review of the Treasury Management Code is aimed much more at the organisations that use it (primarily local councils, but it is applicable to any public services organisation), and the questions are geared to improving the code for users. The questions cover issues such as whether organisations use the code or not – and if not, why not, whether the principles above are relevant to individual organisations and any possible amendments. As such therefore, the LGA will probably have little to say in policy terms in response to the specific questions at this stage. If ideas for improvements emerge as a result of this consultation, we will comment on them on behalf of the sector.
18. The suggested response from the LGA is therefore to reiterate the value of the code in providing a framework which provides assurance to the public when used by local authorities and other public services bodies.

Implications for Wales

19. This consultation from the Cipfa is aimed at all UK local authorities and applies to them all equally – whether England, Wales, Scotland or Northern Ireland. The impact on Welsh local authorities is therefore the same as the impact on English local authorities.

Financial Implications

20. This is part of the LGA's core programme of work and as such has been budgeted for.

Recommendations

21. That members of the Resources Board comment on and approve the contents of the draft consultation response included at **Appendix A** to this paper.