The Chartered Institute of
Public Finance & Accountancy

CIPFA

Minimum Revenue Provision

Response to the consultation on changes to statutory guidance and regulations

A Submission by:
The Chartered Institute of Public Finance and Accountancy

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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Introductory comments

CIPFA welcomes this opportunity to respond to the consultation on changes to statutory guidance and regulations: Minimum Revenue Provision. CIPFA also welcomes the additional clarity for local authorities on what the government considers to be a prudent provision provided by the proposed changes to regulations and guidance.

Prudent Minimum Revenue Provision (MRP) is a key component in ensuring that local authorities' capital expenditure is affordable and sustainable, and is a factor in financial sustainability in the sector.

It is important that decisions around MRP are subject to effective and robust scrutiny and the proposed changes to the guidance for the annual MRP statement should help elected members to better understand the impact of MRP decisions being made.

Response to the consultation questions

CIPFA's response to the questions posed in the consultation is included below. Text from the consultation paper is included, in grey italics, for ease of reference.

Proposed changes to the regulations

Changes to the regulation proposals.

29. As stated, there are no substantive changes to the policy intent of the Regulations that were consulted on in June-July 2022 (revised legislative changes). However, the consultation identified some necessary amendments. These changes have been amended in the new draft Regulations (revised Statutory Instrument ("the SI") included at Annex B):

a. Amended regulation 1(3A) to specifically exclude Mayoral development corporations from the duty to charge MRP. Section 23(1)(e) of the Local Government Act 2003 brings into scope of the MRP duty certain Mayoral development corporations that are functional bodies of the Greater London Authority. This is not consistently applied to other Mayoral development corporations. The amendment removes all Mayoral development corporations from the scope of the MRP duty.

b. Amended regulation 27(3), such that an authority can delay the MRP charge to revenue to the year after the asset becomes operational. This is not a change in policy. As per the existing guidance (options 3 and 4), where an authority uses a method of determining MRP over the life of an asset, the requirement to make MRP can be deferred to the financial year after the asset is operational. This is similar to how depreciation functions. It was not the intent of the Regulations to change this, so it has been amended.

c. Amended regulation 27(4) and 28(2), to align the language used in IFRS 9. Changed to "expected credit loss" to match the language used in the Accounting Code, in which credit loss has a specific definition.

d. Amended regulation 27(5), to extend the definition of a commercial loan. The Regulation changes, as revised in the second consultation, defines a "commercial loan" based on the expenditure the money is ultimately used for. Some respondents highlighted that the loans themselves can also be investments to generate financial return. The definition has been widened to recognise that a capital loan can be an investment primarily for profit in itself.

e. Amended regulation 28(3) to recognise that the expected/actual credit loss MRP charge may be less the amount recognised under IFRS 9. IFRS 9 requires an expected credit loss or actual credit loss to be recognised against the amount in the balance sheet. Due to the way that authorities can attribute CFR to assets, and then reduce that CFR by setting aside MRP, applying capital receipts or other available resources but not actually pay off the loan, it is possible for the CFR associated with the financing of any given capital loan to be less than the amount of the loan asset in the balance sheet. The wording of the regulation has been extended to recognise that authorities may use capital receipts and potentially other resources) as well as MRP), to have reduced the CFR with respect to any given capital loan. Therefore, the MRP charge made with respect to an expected credit loss or actual loss may be less than the amount recognised under proper practices.

f. Amended regulation 28(5), to make clear that any capital receipt used under that provision must be used to pay down debt. Repayments of capital loans to an authority are classed as capital receipts. Capital receipts may be used to pay down debt but can also be used to fund new capital expenditure. The Regulation changes, as revised in the second consultation, allow authorities to specifically reduce what would otherwise be the MRP charge by (up to) the value of the capital receipt received that is a loan repayment on the relevant loan. The amendment makes clear that authorities can only do this if they use the capital receipt to reduce debt. In practice, the capital receipt must be applied to the Capital Adjustment Account (thus reducing the CFR) and the cash ultimately used to repay borrowing.

g. Amended regulation 28(6) for clarity. Some respondents were confused by the language in 6(a)(III) where it stated "a local authority has charged minimum revenue provision…". The confusion arises because the purpose of this provision is to allow authorities to use the repayment of loans (capital receipts) in place of an MRP charge (provided the capital receipt is used to reduce debt). This would not be applicable if an authority had, under regulation 27(4), determined not to charge MRP on that loan in the first place. Therefore, the Regulation was worded to ensure that the option to use capital receipts in this way can only apply where there is otherwise a policy to charge MRP on capital loans. The wording has been adjusted to be clearer.

Q1: Do the revised Regulations meet government's objectives as set out in this consultation? Please provide details to support your answer.

Response: Yes, to the best of CIPFA's knowledge as finance experts rather than legal experts. Paragraph 27.(1) (a) is clear that MRP must be made in respect of all debt except where exceptions are stated in the regulations. The proposed regulation appears to effectively provide exemptions for non-commercial loans and assets that are not yet in use. The proposed paragraph 28.(4) makes it clear that capital receipts can not be used in place of the revenue charge.

Q2: In your view, do the most recent amendments to the Regulations as set out in this consultation document give rise to any unintended consequences or new risks? Please provide details to support your answer.

Response: Unintended consequences and risks identified in earlier stages of the consultation related to non-commercial loans and expected credit losses are mitigated by the proposed regulations in CIPFA's view.

There may be a risk that increased complexity in the regulations deters effective scrutiny.

Proposed changes to the guidance

Changes to the statutory guidance

30. This section details all substantive revisions made to the current Guidance to produce the revised Guidance and informal commentary, provided in Annex C, and invites responses on the amendments. It does not list all changes – the main focus is to set out clearly the amendments that support the revised regulations and other substantive changes. Where necessary, this document provides the rationale for why the changes have been made. Where respondents are asked to consider the Guidance, the informal commentary should be considered concurrently as this provides additional information to help interpret the Guidance.

Introduction to the Guidance

31. The revised Guidance includes more detailed information on the rationale for the MRP duty to give further clarity on its purpose and objectives and provide context for the implementation of the Guidance. This is not intended as a change to policy but to support the understanding of users of the Guidance, including a broader range of stakeholders.

Annual MRP Statement

32. The revised Guidance sets out more detail on what an authority's statement of its policy on making MRP ("MRP Statement") should contain. The requirement to produce an MRP Statement and for this to be approved by full Council remain unchanged from the current Guidance, but the revised Guidance now contains additional detail as to what would be expected to be within the MRP Statement to ensure transparency and accountability. This is not intended to be prescriptive, but provides users of the Guidance and other stakeholders an understanding of what an MRP Statement should provide as minimum information.

33. The revised Guidance also now makes clear that changing the MRP methodology should not be for the primary purpose of reducing the revenue charge. Authorities may change methodologies where they determine this will provide a more prudent charge, and it may be the case that the MRP charge is reduced as a consequence, but seeking to reduce MRP as the primary objective of changing methodologies is unlikely to result in a more prudent charge.

Q3: Do you agree with the additional guidance on what should be included in the MRP Statement? Please provide details to support your answer.

Response: The additional guidance on what should be included in the MRP statement should provide useful information for members and any other external scrutiny that a prudent charge is being made.

It is critical that the methodology for calculating MRP is outlined, since the decision-making body should have sight of this.

Meaning of Prudent Provision

34. The revised Guidance provides further detail and rationale that CFR is the appropriate measure of indebtedness that should be used to determine the MRP charge. This is not a change from the current Guidance, but it is more explicit and provides the definition of CFR as set out in the Prudential Code to benefit users of the document who may not have access to the Prudential Code.

35. Paragraph 37 of the revised Guidance explains that regulation 27(a) requires the MRP charge to be determined with respect to the total CFR of an authority. The change to regulations is intended to prevent authorities purposefully omitting portions of their CFR that relate to the financing by debt of investment assets (as described in this document as one of the issues government is seeking to address). There are statutory exceptions that allow authorities to not include within the MRP determination CFR relating to assets purchased in year, assets not yet in use or where the capital expenditure relates to capital loans. The approach to CFR associated with a Housing Revenue Account (where applicable) in determining the MRP charge is addressed later in the Guidance and is not addressed here.

Q4: Is the guidance sufficiently clear that MRP must be determined with respect to total CFR, less only those elements of CFR permitted by statute? Please provide details to support your answer.

Response: Yes. Paragraph 37 is clear that authorities must calculate MRP based on the entirety of its CFR, excepting capital loans that are not commercial loans and expenditure on assets that are not yet in use.

Q5: Is it clear that authorities must not exclude any portion of CFR from the determination of the MRP charge on the basis that the CFR is associated with an investment asset? Please provide details to support your answer.

Response: Yes. The wording in paragraph 37 is clear that amounts of CFR cannot be excluded because it relates to assets (including investment assets) that are expected to retain their value or increase in value.

Meaning of a charge to the revenue account

36. Paragraph 43 of the revised Guidance now contains a statement that an authority cannot determine a prudent MRP charge and then not charge that amount to revenue. Although this may seem obvious, the purpose is to clarify that capital receipts cannot be used in place of a revenue charge. MRP must be a charge to revenue. This is not a change in policy, but has been added to the revised Guidance to provide users a more complete understanding of the MRP duty.

37. Paragraph 45 sets out additional detail on where an MRP charge may be £nil. The intent is to provide a comprehensive list of the only circumstances where an MRP charge could be £nil while still being compliant with the statutory provisions and revised Guidance.

Q6: Is the list of circumstances where the MRP charge may be determined to be £nil sufficiently clear and complete? Please provide details to support your answer.

Response: Yes. The list of circumstances is clear. CIPFA is not aware of any other circumstances where a nil charge would be expected.

Local authorities in government financial support

38. Paragraph 46 is new to the revised Guidance. Since the current version of the Guidance was drafted, there have been a small but significant number of local authorities that have experienced severe financial failure, requiring government intervention and/or ongoing financial support. These are differentiated from authorities requiring one-off government support by the scale and challenge of their financial issues, and necessity for government support over a longer timescale. It is important that the Guidance recognises the existence of such circumstances. The intent is that this is only applicable in very exceptional circumstances where the scale of financial failure is such that the government has been

required to take actions to intervene and where there is a need for ongoing government support. The Guidance does not specify how this may impact the determination of the MRP charge nor does it propose any limitations, as individual circumstances will vary greatly and approaches will need to be tailored accordingly. It sets out that where government support is factored into the determination of MRP, the government must agree. The government does not consider this to be a change in policy as it is intended to be consistent with existing duties and guidance, however, the addition to the Guidance provides additional clarity for local authorities, auditors and other relevant stakeholders

Conditions for using the options

39. Paragraphs 59 and 60 of the revised Guidance make it clearer that it is expected Options 1 and 2 are used for supported capital expenditure. The Guidance allows that local authorities are free to determine other methods of calculating MRP, but should set out in their MRP Statement why using another methodology other than that provided in the Guidance provides a more prudent charge. Options 1 and 2 have historically only been available for supported borrowing – the calculation results in the MRP charge being highest in the early years of capital expenditure, aligning the charges with the specific revenue grant support provided to the authority and, as is likely in most cases, the period over which the benefits of the asset manifest. If an authority uses another method with respect to supported capital expenditure, it should explain why it is more prudent.

Housing revenue account

40. Concerns were expressed in the previous consultations that the changes to the 2003 Regulations would mean MRP would be required to be charged for HRA capital expenditure where it had not been before. This is addressed by paragraph 65 of the revised Guidance, which includes additional detail as to why it may be appropriate to not make any further MRP charge to revenue with respect to the CFR associated with the HRA. Since 2008, when the 2003 Regulations were amended, there is no statutory provision for not making MRP with respect to the HRA. However, as there is already a charge to revenue with respect to HRA capital expenditure through the charging of depreciation and requirement to hold a Major Repairs Reserve, an authority may determine that no further revenue charge is required as prudent provision has already been made. This is not a change in policy.

Q9: Is the revised Guidance clear on how HRA CFR should be treated with respect to determining an MRP charge? Please provide details to support your answer.

Response: Yes. Paragraph 65 is clear that depreciation taken to the major repairs reserve can be considered to be a prudent charge to revenue for the HRA element of an authority's CFR.

Q8: Does the revised Guidance address concerns that changes to the Regulations might require additional MRP for the HRA CFR? Please provide details to support your answer.

Response: Yes, as per response to the previous question.

Use of capital receipts

41. The revised Guidance includes new material to provide an explanation of the new provisions with respect capital receipts in paragraphs 67 and 68.

42. Responses to previous consultation surfaced some confusion as to how the provisions under the 2003 Regulations, regulation 23 interacted with the emphasis that capital receipts cannot be used to directly reduce the MRP charge. Regulation 23 allows that capital receipts

may be used to "repay the principal of any amount borrowed". The government does not consider that the revised provisions are in any way contradictory to this. Regulation 23 allows that capital receipts can be used to reduce CFR by either being set aside for that purpose or used to repay borrowing. The requirement for MRP is with respect to CFR but must be a revenue charge. This means that:

• An authority can use capital receipts to reduce the overall CFR. When MRP is then calculated with respect to CFR, then it will be reduced to some extent because the debt is reduced. If CFR is reduced to zero through the use of capital receipts, then MRP may also be zero.

• An authority cannot determine the MRP and then use a capital receipt as a direct replacement to this charge. It is the government's view that this has never been a permissible practice, and it is the intent of the revised provisions to put this beyond doubt. The statute is, and has always been, clear that MRP must be a charge to revenue.

43. This is reflected in the revised regulations 28(4) (Annex B), which states that "a local authority must not reduce its determination of what would otherwise be a prudent amount by the value of any capital receipts used or to be used by the authority in accordance with regulation 23 in the financial year to which the determination relates.". This does not, and it is not the government's intention that it should, prevent a local authority from using capital receipts to reduce the level of debt with respect to a capital loan (or any other capital expenditure financed by debt) and thereby reduce the level of debt on which MRP is calculated.

Q9: Is the revised Guidance clear on how capital receipts may be used to reduce the CFR, and therefore the MRP charge?

Response: Yes. Paragraphs 67 and 68 are clear that capital receipts cannot be applied to offset MRP in that year.

Q10: Is the revised Guidance clear that capital receipts cannot be used to replace, in whole or part, the charge that is required to be made to revenue?

Response: Yes.

Provisions with respect to loans

44. The guidance includes an explanation of the new regulations with respect to capital loans in paragraphs 69 to 74.

Q11. Is the revised Guidance clear that:

(a) MRP need not be made with respect to capital loans provided they are not commercial capital loans?

(b) MRP must be made with respect to commercial capital loans?

Response: Yes. This is clearly set out in paragraphs 69 to 74.

Q12. Taking into account both the draft amendments to the Regulations and the revised Guidance, is it clear what constitutes a commercial loan?

Response: No. The definition in the regulations refers to "financial return" which is in accordance with the Prudential Code definition of investments for commercial purposes. However, paragraph 69 of the MRP Guidance uses "primarily for profit" to define commercial

loans. CIPFA's view is that this should be made consistent with the definition using in the regulations.

Q13. Does the revised Guidance sufficiently explain how repayments of a capital loan, which are capital receipts, may be used to directly offset the relevant MRP charge (as a statutory exception to the general rule that capital receipts cannot be used to offset MRP)?

Response: Yes. Paragraphs 70 and 71 are clear how loan repayments can be used to offset the relevant MRP charge.

45. Paragraphs 72 and 73 set out how to interpret the new requirements in regulations to make an MRP charge equal to expected credit loss or actual credit loss. From the previous consultations.

46. Paragraph 73 specifically explains the new regulation 28(3) that the amount of MRP charged with respect to an expected credit loss or actual loss may be less than the loss recognised in the statement of accounts because the amount of CFR attributable to the loan is less than the value of the loan asset recorded in the balance sheet.

Q14. Does the revised Guidance sufficiently explain:

(a) the requirement to include in the MRP charge an amount for any expected credit loss or actual loss with respect to a capital loan?

(b) the circumstances where the MRP charge may be lower than the recognised loss?

Response: These are clear in CIPFA's view. However, guidance could be clearer that the expected credit loss recognised in a financial year should be included in the MRP charge for that year, and not spread over future years. This is clear in the regulations but not explicitly stated in the guidance. The guidance could be strengthened by making this intention clear.

47. Some respondents to the previous consultations asked if any expected credit loss taken as MRP could be reversed if the expected credit loss was reversed under IFRS 9. Paragraph 73 of the revised Guidance is clear that the MRP charge cannot be reversed, that is there cannot be a corresponding negative MRP charge, however, this may be treated as a prior year overpayment and future MRP payments reduced, as would be the case if a voluntary overpayment had been made.

Retrospective application

48. Some respondents questioned whether the new regulations should only apply to decisions taken after the changes to Regulations come into force. This is not the government's intent. Authorities should not be using practices to reduce MRP below a prudent amount and the intent of these changes is to prevent this. Where authorities were already following the MRP duty appropriately, there should be no changes necessary. Revisions have been made with respect to capital loans to ensure that the impact to delivery for priorities such as housing are not adversely affected. The amended Regulations and revised Guidance will apply from April 2024 to both existing and new borrowing and credit arrangements. Paragraph 23 of the Guidance states this.

49. It is, however, not the government's intent that prior period adjustments be required as a consequence of these changes. That is, where changes are required to practices as a consequence of the amendments to regulations and Guidance, they should be applied prospectively over the residual asset lives.

Q15: Please provide any further comments you have on the revised Guidance or amendments to the Regulations.

The guidance states in paragraph 60: “It is not expected that these options are appropriate for supported capital expenditure.” Many authorities will see this as a change in policy having believed that the previous guidance did not prevent them using options 3 and 4 and moved to this method of calculation in good faith. However CIPFA’s position has always been that these options should not be used for Supported Capital expenditure. Authorities that have used this method should explain why they believe it is prudent to use these options in their MRP statements.

Statutory overrides prevent expected credit losses hitting the General Fund (GF) but MRP changes mean they will impact the GF and could cause large variations. CIPFA would recommend that the government considers whether it is comfortable with this or wishes to consider allowing credit losses to be covered by MRP over the remaining life of the loan, rather than all in the year that the credit loss is initially recognised.

CIPFA is aware of commentary from stakeholders in the sector that complexity in regulations makes scrutiny harder. Explanatory notes should reflect this.

CIPFA also wishes to note some minor amendments to the wording in the proposed guidance that the government may wish to make:

- Paragraph 64: sentence in the second line appears to be missing a “to”: i.e. “…the prudent charge **to** revenue can be regarded…”
- Paragraph 65: full stop missing at end of paragraph
- Paragraph 75: the sentence in the 2nd bullet “*The authority should calculate MRP in accordance with Option 3*.” should be moved to a new line as it applies to both of the bullets above
- Paragraph 12 of the informal commentary: consider removing “new” from the second sentence *“…additional freedoms conferred under the **new** arrangements.”* as these arrangements have been in place since 2008.
- Paragraph 62 of the informal commentary: there appears to be a typo. *“This **is** no way prevents…”* should be “This **in** no way prevents…”.

Other matters arising

50. The issue was raised in prior consultation as to whether authorities that receive capital grant can apply this in place of MRP. This is applicable where combined authorities receive general capital grant (sometimes referred to as ‘gain share’). Where a combined authority wishes to borrow to invest, this capital income can be used to reduce debt over time. However, the duty to make MRP is specifically a revenue charge and capital grant cannot be transferred to revenue.

51. It is not the government’s intent that the revised regulation changes would affect any current practices in this respect. Under the current duty, the requirement to make MRP is a charge to revenue. The revised changes to regulations prohibit the use of capital receipts to be used as a direct, one-for-one replacement of MRP. It will be for individual authorities to ensure that they are making a prudent charge.

Implementation timetable

52. The government plans to introduce the changes to the Regulations and the revised Guidance to apply from the financial year beginning 1st April 2024 onward.

Financial impact of the revised changes

53. It is important to understand any financial or other consequences of the changes to the Regulations and the Guidance. This section asks respondents to consider the impact on their local authority or local authorities they represent.

Q16. Consider the changes to the Regulations and the Guidance. Will these result in a change to your MRP charges in future years?

Response: N/A to CIPFA

Q17. Where possible, please provide an estimate as to the increase or decrease in your authority's MRP charge. Assume the revised changes come into effect from April 2024. Please provide an absolute value and percentage.

Response: N/A to CIPFA

Q18. Will the changes result in an adverse impact on your authority's financial sustainability or ability to deliver services? Please provide details.

Response: N/A to CIPFA