

The Prudential Code: brief outline of key issues

Basic principle

The basic principle of the new system is that local authorities will be free to invest so long as their capital spending plans are affordable, prudent and sustainable. The Code sets out the indicators that local authorities must use, and the factors they must take into account, to demonstrate that they have fulfilled this objective.

Impact of the new system

The problem with the present system is that schemes that would save money over time and provide better services, but which require up-front investment, often do not proceed because of government controls over capital spending. Under the new system, an authority will be able to undertake such a project since it will be the authority's own judgement that will determine the scale of its capital investment.

The present system in England and Wales by which the government controls local authority borrowing by a system of credit approvals will be abolished. In Scotland, the new system is being introduced by the Local Government in Scotland Act 2003.

Corporate governance

It will be for each local authority to set the prudential indicators specified in the Code, and to make its own decision as to limits of its capital expenditure.

Affordability

When deciding to invest in a capital asset, the authority must do more than simply determine whether it can afford the immediate cost. In order to ensure long-term affordability, decisions have also to be prudent and, in the long term, sustainable.

The investment will also have broader implications for running costs and income. The Code therefore requires that the authority does not only consider its anticipated capital resources but also its overall revenue forecast for the following and subsequent two years, and subsequent years where there are known significant variations beyond this.

Prudence

If the authority is unable to deliver its capital programme, or to afford the cost of running and maintaining the new facilities, the chosen level of capital investment will not be sustainable in the long-term. Prudence and affordability are related concepts.