Annex A

Annexe A – Options for prudent provision – Extract from WG Guidance (First Issued 2008)

Option 1: Regulatory Method

MRP is equal to the amount determined in accordance with the former 2003 regulations, as if they had not been revoked by the 2008 Regulations.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.

Option 2: CFR Method

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

Option 3: Asset Life Method

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:

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

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 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 (eg by the application of capital receipts) should be made as necessary.

Commencement of provision. Subject to paragraph 13 below, MRP should normally commence in the financial year *following* the one in which the expenditure was incurred.

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

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.

MRP commencement. 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.

Option 4: Depreciation Method

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.

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

(a) 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.

(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 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

Options 1 and 2 may only be used in relation to:

(a) capital expenditure incurred before 1 April 2008; and

(b) capital expenditure incurred on or after that date which the authority is satisfied forms part of its Supported Capital Expenditure.

For expenditure incurred on or after 1 April 2008 which does not form part of the authority's Supported Capital Expenditure, prudent approaches include Options 3 and 4 (which may also be used at the authority's discretion in relation to all capital expenditure, whether or not supported and whenever incurred).