

BLACKBURN WITH DARWEN BOROUGH COUNCIL - CAPITALISATION POLICY

Unless expenditure qualifies as capital it will normally fall outside the scope of the Prudential Framework and will be charged to revenue in the period that the expenditure is incurred. If expenditure meets the definition of capital, there may be opportunities to finance the outlay from capital receipts or by spreading the cost over future years' revenues.

There are three routes by which expenditure can qualify as capital under the Prudential Framework:

- The expenditure results in the acquisition, construction or enhancement of non-current assets (tangible and intangible) in accordance with "proper practices";
- The expenditure meets one of the definitions specified in regulations made under the 2003 Local Government Act; or
- The Secretary of State makes a direction that the expenditure can be treated as capital expenditure.

Capitalisation under proper practices

Proper practices are defined to include *the Code of Practice on Local Authority Accounting in the United Kingdom* ("the Code"). The Code is published annually and its provisions relating to capitalisation are based on IAS 16 *Property, Plant and Equipment*.

Expenditure on acquisitions and construction work is analysed to decide whether it satisfies the accounting rules for recognising a non-current asset in the Council's Balance Sheet. The amount capitalised generally comprises the purchase price plus any expense directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Examples include:

- acquisition of land and site preparation;
- acquisition, construction, preparation or replacement of roads, buildings and other structures;
- acquisition, installation or replacement of movable or immovable plant, machinery, apparatus and vehicles; and
- acquisition of non-current assets that do not have physical substance but are identifiable and are controlled by the Council as a result of past events i.e. the Council will receive future economic benefits or service potential as a result of enforceable rights, such as a legal title or licence (intangible assets).

Capitalisation can include subsequent expenditure on existing assets, where the value of the asset is enhanced by:

- lengthening substantially the life of the asset;
- increasing substantially the open market value of the asset; or
- increasing substantially the extent to which the asset can be used for a function of the Council.

Assets may also be recognised (at fair value) under leases, PFI contracts and similar agreements.

The Council has some limited discretion on what is deemed capital expenditure, for example assets costing below £10,000 (the “de-minimis” amount) are not capitalised and are charged to revenue in the year the expenditure is incurred.

Regulations made under the Local Government Act 2003

Special arrangements exist in local government for the extension of the accounting definition of capital expenditure. Regulation 25 of the 2003 regulations (as amended) allows certain expenditure to be classified as capital for funding purposes when it does not result in the expenditure being carried on the Balance Sheet as a non-current asset. The purpose of this provision is to enable payments to be funded from capital resources rather than charged to the General fund and impact on that year’s council tax.

Capital expenditure within the 2003 regulations includes:

- The giving of a loan, grant or other financial assistance to any person, whether for use by that person or by a third party, towards expenditure which would, if incurred by the Council, be capital expenditure (except for advances made to officers as part of their terms or conditions of employment or in connection with their appointment);
- The repayment of any grant or other financial assistance given to the Council for the purposes of expenditure which is capital expenditure;
- The acquisition of share capital in any body corporate (except for investments in Money Market Funds or an investment in a real estate investment trust);
- Expenditure incurred on works to any land or building in which the Council does not have an interest, which would be capital expenditure if the Council had an interest in that land or building; and
- Expenditure incurred on the acquisition, production or construction of assets for use by or disposal to a person other than the Council which would be capital expenditure if those assets were acquired, produced or constructed for use by the council.

Revenue expenditure funded from capital under statute (REFCUS)

This term relates to payments that would otherwise be revenue expenditure but are treated as capital expenditure for the reasons above and are financed from capital resources.

The underlying revenue nature of the expenditure means that it is debited or charged to the Comprehensive Income and Expenditure account when it is incurred. The statutory provision to treat the expenditure as capital allows the debit against the General Fund to be reversed and posted to the Capital Adjustment Account, so that there is no impact on the Council’s “bottom line”.

The adjustment that is made between the accounting basis and the funding basis is reflected in the Movement in Reserves Statement within the Council’s statutory accounts.

Capitalisation directions

The Secretary of State for Housing, Communities and Local Government has powers to direct that expenditure that would not otherwise be capital, should be treated as such. As the treatment of revenue expenditure as capital is contrary to the normal accounting requirement that long-term borrowing or capital receipts should only be used for capital investment, the Secretary of State advises authorities that they must meet strict criteria before a direction will be given. These criteria are set out each year in a guidance note.

At the time of writing this Policy, the Government had just closed a period of consultation which sought views on granting wider flexibilities around the use of capital finance and borrowing. In particular, this Call for Views posed various options as follows:-

Option 1: Extend capitalisation flexibilities to include a wider set of eligible costs to allow authorities to capitalise general cost pressures and meet these with capital receipts.

Option 2: Extend the flexible use of capital receipts to allow authorities to borrow for the revenue costs of invest-to-save projects. This would be a simple extension of the current direction to allow authorities to borrow to finance the revenue costs of eligible projects, as well as use capital receipts.

Option 3: Allow additional flexibilities for the use of the proceeds of selling investment assets.

It is not known at this stage what the outcome of the Call for Views is and whether the Government will implement any of these options. However, subject to the outcome, it may be necessary to provide an update to this Capitalisation Policy.