APPENDIX B

PRUDENTIAL CODE OBJECTIVES

1 *The key objectives of the Prudential Code are:*

1.1

- To ensure that capital investment plans are affordable, prudent and sustainable.
- To ensure treasury management decisions accord with good professional practice and in a manner that supports affordability, prudence and sustainability.
- To be consistent with and support local strategic planning, local asset management planning and option appraisal.

1.2 To demonstrate the achievement of these objectives the Prudential Code sets out indicators that must be used and the factors that must be taken into account. The code does not suggest limits or ratios as these are for the authority to determine.

The regulations do not cover Investments other than to require authorities to have regard to the CIPFA Treasury Management Code.

1.3 The prudential indicators are designed to support and record local decision making. They are not intended to be comparative performance indicators and their use in this way could be misleading. In particular, authorities will have widely different debt positions at the start of the Prudential system and the exercise of local choice could increase these differences.

1.4 The Act refers to affordability only, whereas the Code refers to affordability and prudence. The two are related concepts. When making a decision to invest in capital assets an authority must not only determine whether it can afford the immediate cost. To ensure long-term affordability the decisions have also to be prudent and in the long term sustainable. Therefore in carrying out their duties in respect of affordability an authority is required to have regard to all the aspects of the Code that relate to affordability, sustainability and prudence. The code also requires an authority to have regard to wider management processes (option appraisal, asset management planning, strategic planning and achievability) in accordance with good professional practice.

1.5 The Code promotes transparency by using information in the published statements of accounts.

1.6 The authority should have a treasury management strategy within which borrowing and investments are managed in accordance with good professional practice.

2 *Governance*

2.1 The Code sets out the procedure for setting and revising prudential indicators. The body that decides the authority's budget ie Council will do this. The Chief Financial Officer is responsible for reporting and monitoring.

2.2 Indicators for previous years will be taken directly from information in the statement of accounts. If any relevant item is subject to audit qualification this must be highlighted when the indicators are set/revised.

2.3 Indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, and must be reviewed for the current year when the prudential indicators are set for the following year.

2.4 Prudential indicators for treasury management should be considered along with the treasury management strategy.

3 *Affordability*

3.1 The objective here is to ensure that total capital investment remains within sustainable limits and, in particular, to consider the impact on Council Tax.

3.2 In considering the affordability of its capital plans, the authority is required to consider all of the resources available, together with the totality of its capital plans, revenue income and expenditure forecasts for the forthcoming year and the following two years, plus known significant variations beyond this timeframe. This necessitates as a minimum three-year capital, revenue and Council Tax forecasts. We forecast on a five year timeframe.

3.3 Affordability considerations should include risk and uncertainty, and risk analysis and risk management strategies should be taken into account.
The affordability indicators include:

- capital expenditure
- the ratio of financing costs to net revenue stream.
- capital financing requirements (need to borrow)
- the incremental impact of capital investment decisions on the Council Tax
- the authorised limit for external debt
- the operational limit for external debt
- actual external debt

3.4 Both the authorised and operational limits for external debt need to be consistent with the plans for capital expenditure and accounting, and with the treasury management policy and practices. The operational limit should be based on a prudent but not worst case scenario, whilst the authorised limit can include headroom over and above the authorised limit, sufficient for example for unusual cash flow movements.

4 *Prudence and Sustainability*

4.1 As noted earlier, prudential indicators in respect of external debt must take account of affordability. Through this means the objectives of prudence and sustainability are addressed year on year.

4.2 To ensure that over the medium term net borrowing is only for capital purposes, an authority must ensure that, except in the short term, net external borrowing does not exceed the total capital financing requirements of the previous year's actual plus current and next 2 years estimates.

4.3 Prudence also includes that treasury management is carried out in accordance with good professional practice. The relevant indicators are:-

- Net external borrowing not to exceed the preceding years capital financing requirement plus current and next year's estimated capital financing requirement

- compliance with the CIPFA Code of Practice for Treasury Management

- upper limits on fixed interest rate and variable interest rate exposures

- upper and lower limits for the maturity structure of borrowings

- upper limit for principal sums invested for longer than 364 days