Grant Thornton

Minimum revenue provision

Prudent financing of local authority capital expenditure

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The prudential framework

In delivering local public services, local authorities determine their own capital programme for investment in non-current assets, deciding whether to borrow and invest, in accordance with The Prudential Framework, which is based on principles of prudence, affordability and sustainability.

The Prudential Framework sets out the boundaries of what is permitted and comprises:

- underlying legislation (Local Government Act 2003 and Local Authority (Capital Finance and Accounting) Regulations 2003, as amended in 2024) which local authorities must adhere to
- four statutory codes that local authorities **must have regard to**.

Since the Prudential Framework was introduced in 2004, the economic and regulatory environment has changed and risk in the local government sector has evolved.

Borrowing to finance commercial investments, authorities taking on disproportionate levels of debt, entering novel transactions without securing or following appropriate expert advice, and issues with local authority companies are examples of practice that have attracted Government attention.

The then Ministry of Housing, Communities and Local government, and more recently the Department for Levelling Up, Housing and Communities, reviewed the Capital Framework to ensure it is fit for purpose to constrain financial risk and drive sound decision making. The Chartered Institute of Public Finance and Accountancy (CIPFA) updated the Prudential and Treasury Management Codes and accompanying guidance in December 2021. PWLB reformed its arrangements to prevent debt for yield investments, ie, investment assets bought primarily for financial return, from November 2020, with guidance updated in November 2023. Following extensive consultation, the Department for Levelling Up, Housing and Communities clarified and updated the regulations and guidance relating to minimum revenue provision in April 2024, and changes took full effect from 1 April 2025.

Alongside these updates to the prudential framework, the implementation of IFRS 16 Leases from April 2024 also impacts local authorities.

In this publication, we focus on the duty to make minimum revenue provision (MRP), an important element of the Prudential Framework.

What is minimum revenue provision?

Capital expenditure may be financed from government grants, contributions, capital receipts or revenue resources. Where resources are insufficient to fully finance the capital expenditure incurred, the balance is unfinanced capital expenditure. This is commonly referred to, including in the MRP guidance, as capital expenditure financed by debt. This does not necessarily mean that local authorities have financed this from external borrowing.

Where local authorities finance capital expenditure by debt (even where internal cash resources are used, rather than taking on additional external debt), local authorities must set aside an amount of money each year to cover the underlying need to borrow for a capital purpose.

The broad aim of MRP is to require local authorities to put aside revenue over time to cover their capital financing requirement (CFR) as it applies to general fund assets. This replaces the requirement of accounting standards for an annual charge for depreciation to be charged against revenue resources. In the financial statements, the charging of MRP is one of the adjustments between the accounting and funding basis that is reflected in the movement in reserves statement.

Regulations 27 and 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 requires English local authorities to determine a prudent level of MRP.

In accordance with Section 21(1B) of the Local Government 2003 Act, local authorities are required to have regard to statutory guidance. The 5th edition of guidance for local authorities on determining a prudent level of MRP took full effect for accounting periods from 1 April 2025.

How should MRP be calculated?

Authorities are required to comply with the statutory guidance, unless there is a justifiable reason to depart from it. The guidance outlines four possible options as methods of calculating a prudent amount of MRP. It also includes specific recommendations on calculating MRP in respect of credit arrangements including leases, PFI arrangements and transferred debt. Local authorities may determine that no MRP applies to assets within the housing revenue account (HRA), where depreciation is charged to the HRA and they hold a major repairs reserve.

Local authorities have a significant degree of discretion in determining MRP. If departing from statutory guidance, however, they must demonstrate that this is a reasonable thing to do, that it results in a prudent basis for provision and that the authority meets its overriding statutory duty.

Key features of the MRP calculation

The capital financing requirement is a complete measure of capital expenditure not yet funded by capital resources (grant or capital receipts) or revenue resources (revenue contributions or MRP). Local authorities must calculate the CFR accurately and consistently in accordance with the Prudential Code and directly from the balance sheet. The guidance is clear that this CFR should be the basis of the MRP calculation.

Where depreciation is charged to the housing revenue account and then transferred to the major repairs reserve, a local authority may determine that no further revenue provision is required for capital expenditure on housing assets. Otherwise, no amounts should be excluded from the CFR used to determine MRP, unless exempted by statute. Notably, the CFR used for the basis of the MRP must include unfinanced capital expenditure relating to assets which local government bodies believe will retain or increase in value (such as investment property), right of use assets brought onto the balance sheet with the implementation of IFRS 16, and expenditure treated as capital under statute.

The period over which MRP is charged should align to the period over which the local authority expects the benefits from the original capital expenditure – akin to the useful life of the asset. The statutory guidance recommends that useful lives should not exceed 50 years, unless a longer period is supported by an opinion from an appropriately qualified professional adviser (eg, a valuer) or where a lease or PFI contract has a term exceeding 50 years. The guidance also sets out the maximum periods to be used for items that are capital under statute, such as loans, investment in share capital, and expenditure on assets owned by other parties. For leased assets, an MRP charge equal to the element of the payment that goes to write down the balance sheet liability in that year is regarded as prudent.

What has changed?

The amendments to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and the 5th edition of the guidance on minimum revenue provision now provide detailed interpretation and more clearly outline government expectations of how the requirements should work in practice. This tackled two main issues in which some authorities had previously reduced their MRP charges. Notably, the current guidance reinforces that a local authority:

- cannot exclude any amount of CFR from its calculation, unless by an exception set out in statute
- cannot use capital receipts to directly replace, in whole or part, the prudent charge to revenue - with the exception that MRP may be reduced by deducting capital receipts arising from in-year loan repayments providing these are used to repay the principal of any amount borrowed to finance the loan.

There are additional flexibilities for circumstances where a local authority awards a loan to a third party and that loan is treated as capital expenditure. From April 2025:

- capital loans that are financed by debt may be excluded from the requirement to make MRP (by way of local policy choice), provided the loan is not a commercial loan and that there has been no expected or actual credit loss
- where MRP charge is required for a lease or capital loan (eg, for a commercial loan), the MRP charge can be reduced by the amount of repayment received where that capital receipt is then applied to repay the principal of any amount borrowed to finance that loan.

For any capital loan given on or after 7 May 2024, if an expected credit loss or an impairment is recognised in line with proper accounting practice for that loan, the MRP charge must be at least equal to that amount in that financial year.

Regulation 27 (5) defines a commercial loan as a loan from the authority to another entity for a purpose which, if the authority were to undertake itself, would be primarily for financial return; or, where the loan is, itself, capital expenditure undertaken primarily for financial return.

Local authorities in government financial support

In recent years, the number of local authorities in receipt of 'exceptional financial support' (EFS) has increased significantly. Where EFS is provided by the government, this typically takes the form of a 'Capitalisation Direction', under s16(2)(b) of the Local Government Act 2003. The statutory guidance on MRP requires that where expenditure is capitalised under s16(2)(b), MRP is charged over a maximum period of 20 years. The statutory guidance acknowledges that, in very exceptional cases, it may be appropriate to reflect the nature of financial support in the determination of a prudent provision. Where this is the case, authorities must seek agreement from the government on how any assumptions with respect to the support are reflected in the determination of MRP.

Who is responsible for determining MRP?

A local authority's chief finance officer and the members of a local authority have key responsibilities in relation to the calculation and charging of MRP, exercising judgement on what constitutes a prudent MRP.

Regulations specify that the function of formulating a plan or strategy for the control of the local authority's minimum revenue provision is not the sole responsibility of an authority's executive.

The annual statement of policy on making MRP is required to be approved by full council (or the closest equivalent) before the start of each financial year. The statutory guidance is now more explicit in setting out the minimum content of that policy statement to specifically cover:

- the policy, assumptions and methodology to be used
- any departure from the guidance and to explain how that results in a more prudent charge
- rationale for, and financial impact of, any changes compared to the prior year
- how the authority has considered the requirements set out in statute and related guidance to ensure it is meeting its duty to make prudent provision
- details of how capital receipts will be used to reduce indebtedness and the impact on the MRP charge
- a description of the CFR on which MRP is determined and an explanation of where MRP is not being made with respect to any amount of CFR and the statutory basis for this
- the detail of any planned voluntary overpayment of MRP.

Section 25 of the Local Government Act 2003 requires that, in discharging the budget requirement responsibilities of the Local Government Finance Act 1992, the chief finance officer of a local authority must report to it on both the robustness of the estimates made for the purposes of the calculations, and the adequacy of the proposed financial reserves. A local authority must have regard to this report when making decisions about its budget.

The approval of MRP is covered by the authority's annual MRP statement, but also as part of the approval of the revenue budget along with option appraisal and decisions regarding the affordability of individual capital projects – all before the resultant charge is included as a charge to a local authority's General Fund within its annual statement of accounts.

The Accounts and Audit Regulations 2015 set out responsibilities for the signing and approval of a local authority's annual statement of accounts. Firstly, by the responsible financial officer, to confirm they are satisfied that it presents a true and fair view of both the financial position of the authority at the end of the financial year to which it relates, and that authority's income and expenditure for that financial year. Then, following the period for the exercise of public rights, members are also required to approve the statement of accounts.

Why is MRP of interest to auditors?

The external auditor's objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes their opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

It is a local authority's responsibility to determine and make a prudent MRP. It is not the role of the external auditor to determine for an authority what is prudent.

In any one year, MRP is often not a material figure in the financial statements. MRP is, however, an area of auditor interest for the following reasons:

MRP is a direct charge to the general fund

The minimum revenue provision (MRP) is a charge to an authority's general fund, a real cost that must be met from the annual budget. Auditors will be alert to the possibility of deliberate measures to reduce an MRP charge.

All authorities are having to continue to make savings through transformation, restructures, changes in service or increases in fees. But another, less visible approach is the potential for saving around MRP.

Some authorities have sought to reduce their minimum revenue provision, for example to ease budgetary pressures or to increase general fund reserves.

The statutory guidance highlights that local authorities may vary their methodology for calculating MRP, provided that there is justifiable reason to do so, but that should not be driven primarily by an objective to reduce the revenue charge.

Complex calculations

Errors which, while in any one financial year may not be material, over time can become cumulatively material.

The calculations that determine MRP are built up over time and may be complex. They typically rely upon spreadsheet records and calculations that are at risk of error.

They also involve judgement, not least in an authority determining the period over which their capital expenditure is expected to provide benefits.

Long-term implications

Not having a prudent MRP, or deferring charges into the future or even failing to account for MRP in the correct way, can store up problems for future taxpayers. A local authority may end up taking on more debt than would otherwise be affordable.

When statutory guidance is not followed: some illustrations

A

Authority A determined that no MRP was necessary on the unfinanced capital spend on its investment property portfolio based on an expectation that asset values would rise. With a change in the economic environment impacting the demand for that type of property, the fair value of the investment properties fell. The authority was unable to recover the full value of its original investment and didn't have the expected funds to repay the external debt.

B

The MRP charge for Authority B wasn't calculated in accordance with the authority's stated policy. Coupled with errors in the underlying calculations, this resulted in a significant undercharge. Addressing this put further pressure on budgets and the general fund balance.

C

Authority C used capital receipts to offset MRP and reduce the amount of MRP charged to the general fund. This is not a permitted use of capital receipts. Reversing this, contributed to a budget deficit and the authority needed to seek exceptional financial support via a capitalisation direction.

D

Authority D spread its MRP charge over a period far longer than it expected to get the benefit of the use of the underlying assets. Those assets are no longer in use but the MRP charge continued to impact on annual budgets.

Challenge questions

We set out in the Appendix some challenge questions for you to consider as you review your authority's arrangements for MRP and assess how the updated statutory guidance and regulations affect these. As you review your local authority's arrangements for MRP, and assess how the updated statutory guidance and regulations affect these.

Appendix

Challenge questions

Has the full council, or the closest equivalent, approved an MRP statement for the financial year, setting out policy and methodology that's in line with current statutory guidance?

Members need sufficient information and a clear, transparent explanation of the policy to demonstrate how the authority complies with its statutory duty.

Can you demonstrate that the underlying calculations match the methodology approved by members and are in line with current statutory guidance?

The statutory guidance specifies four options for making prudent provision, to ensure that the CFR is written down over a period that is reasonably commensurate with how long the capital expenditure provides benefits. Other options aren't precluded but must result in a prudent MRP charge.

Is the capital financing requirement calculated in accordance with the Prudential Code?

The CFR reflects the capital expenditure that has not been funded from capital receipts, capital grants or other contributions, or not yet from revenue. Local authorities must calculate CFR accurately and consistently in accordance with the Prudential Code, and directly from the balance sheet. The guidance is clear that this CFR should be the basis of the MRP calculation.

Do your working papers show what unfinanced capital expenditure is in the scope of each option and how MRP is being calculated?

The updated statutory guidance is clear that MRP must be determined with respect to the CFR and that local authorities cannot exclude any amount of CFR from the calculation unless by an exception set out in statute. The duty to make MRP applies to investment properties in the same way as it does to property, plant and equipment, ie, where their acquisition, after application of capital or revenue resources, results in an increase in the CFR.

Are you including all relevant assets?

MRP is chargeable in the first year after a relevant asset is available for use.

Just because something is expected to hold its value doesn't negate the requirement to charge MRP.

MRP is not limited to assets funded by external debt. A local authority may, properly, use internal cash resources rather than entering new external borrowing at the time capital expenditure is defrayed. However, this does not obviate the need to charge a prudent MRP.

Have you applied MRP appropriately to items that are capital under statute?

For example, if an authority provided a loan for capital purposes to a third party, this is only exempt from MRP in certain circumstances. Are you clear on the distinction between commercial and non-commercial loans, and on how they are treated in your calculations?

Can you demonstrate that you're setting an appropriate period over which to charge MRP?

Are the periods used in line with the statutory guidance? If you're applying a blanket or portfolio approach – where MRP is being spread over periods that are not in line with the life over which the authority expects to benefit from the use of a particular asset – can you demonstrate that to be a prudent provision?

Are you including MRP for assets financed by credit arrangements, including leases and PFI arrangements?

The general principle is that MRP will match the payments of the principal over the lease term. If your authority departs from this statutory guidance, can you demonstrate good reason for doing so? Are you able to show that the profile more reasonably reflects the benefits to the authority from the use of the related assets?

Is the amount charged to the general fund in the accounts, consistent with the prudent charge determined? Or is anything being offset against MRP to reduce the annual charge?

A prior year voluntary overpayment, identified and disclosed as such, can be applied to reduce a current charge. Changing the method used to calculate MRP can never give rise to an overpayment in respect of previous years, however.

Capital receipts can be used to repay debt, leading to a reduction in the CFR. There is, though, no provision for capital receipts to be used to offset MRP, which is a revenue charge for the year except for in-year loan repayments applied to repay the principal of any borrowing used to finance the loan.

Where an authority is reducing its annual MRP due to over-provision in previous years, can you demonstrate that the over provision is calculated appropriately and that applying it to offset future years' MRP is appropriate and in line with the extant statutory guidance?

Appendix

Capital finance: guidance on minimum revenue provision

The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

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