



SCOTTISH EXECUTIVE



Public Service Reform Directorate  
Local Government Finance Division

Victoria Quay  
Edinburgh EH6 6QQ

**Finance Circular No 5/2007**

Directors of Finance of Scottish Local Authorities

cc. COSLA, CIPFA, LASAAC, Audit Scotland

Telephone: 0131-244 7950  
Fax: 0131-244 7020  
sara.lightbody@scotland.gsi.gov.uk  
<http://www.scotland.gov.uk>

Our ref: B1401618

3 July 2007

Dear Director of Finance

**RE: CONSENT TO BORROW FOR GRANTS TO COMMUNITY GROUPS TO FINANCE CAPITAL EXPENDITURE**

1. Further to representations made by Comhairle nan Eilean Siar, and following consideration of the position by a Working Group (which included representation from COSLA, CIPFA and Audit Scotland), Ministers have agreed to allow a limited relaxation in the rules surrounding the treatment of grants to community groups for capital projects.
2. Under the new arrangements, the Scottish Ministers will now be prepared to consider applications from local authorities to extend the purposes for which they can borrow under Para 1 (2) of Schedule 3 of the Local Government (Scotland) Act 1975. The background to this decision, and the specific circumstances under which consent may be considered, are included in the attachment to this letter.
3. This circular is being sent to all Directors of Finance and will also be made available through the Local Government Finance section of the Scottish Executive website at:  
<http://www.scotland.gov.uk/Topics/Government/local-government/17999/Fincirc5of2007>
4. The application process has been piloted with Comhairle nan Eilean Siar. However, the position will be kept under review and any comments will be taken into consideration as part of any future evaluation.
5. Any applications under this provision, or enquiries relating to the circular, should be directed to me in the first instance.

Yours faithfully



Sara Lightbody

**Sara Lightbody**  
Deputy Team Leader  
Local Government Finance Division



# **GUIDANCE ON CONDITIONS UNDER WHICH SCOTTISH MINISTERS MAY CONSENT TO EXTEND THE PURPOSES FOR WHICH LOCAL AUTHORITIES CAN BORROW UNDER THE LOCAL GOVERNMENT (SCOTLAND) ACT 1975**

## **BACKGROUND AND COMMENTARY**

1. Until April 2004, the system for controlling capital expenditure was through legislation known as 'section 94' capital consents. This resulted in a definition of capital expenditure that was wider than the formal definition under proper accounting practice as defined in the CIPFA/LASAAC Code of Practice on Local Authority Accounting: A Statement of Recommended Practice (known as the SORP).

2. Section 94 consents were replaced by the Prudential Borrowing Regime from 1 April 2004. A working group set up to help implement the prudential framework in Scotland, with representatives from the Executive, COSLA, CIPFA and Audit Scotland, concluded that capital expenditure should be as defined in the SORP. This effectively excluded grants to third parties from being capitalised, as these do not result in an asset in the ownership of the local authority. As such, these grants can only be funded through revenue resources.

3. Representations from Comhairle nan Eilean Siar, that this decision was causing them funding issues, led to a review of the position by a similar working group in light of experience since the introduction of the prudential regime. This Group concluded that there is merit in allowing increased flexibility in how certain grants are funded. This conclusion related to grants to community groups on capital projects for the provision of public services, where such expenditure if incurred by the authority itself were classed as capital under the SORP.

4. The Minister, therefore, agreed to allow a limited relaxation in the rules surrounding the treatment of grants to third parties for capital projects.

5. It was initially suggested that this be managed through a change to proper accounting practice as defined under section 12 of the Local Government in Scotland Act 2003 (the 2003 Act). However, certain groups raised concerns over the associated impact on accounting practices. Use of the 2003 Act would require relevant expenditure to be capitalised and then the accounting adjusted, using a series of complicated accounting entries, to effectively return it to revenue.

6. An alternative provision was identified under Para 1 (2) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act). On balance, this alternative approach was considered to be preferable at this time. This approach allows a similar outcome in permitting authorities to borrow for eligible expenditure, in this case certain grants to community groups for capital projects.

7. The 1975 Act provides that:

'With the consent of the Secretary of State, a local authority may borrow, on such terms and conditions as to repayment as the Secretary of State may in so consenting allow, such sums as are required to meet expenses other than expenses to which sub-paragraph (1) above relates, which the authority have power to incur in the exercise of any of their functions (excluding functions relating to a public utility undertaking); but the Secretary of State shall give such consent only if satisfied that the expenses are of such a nature that they should be met by such borrowing.'

8. Scottish Ministers may, therefore, use this power to provide consent to extend the purposes for which local authorities may borrow.

9. Based on the recommendations of the Working Group, Scottish Ministers have advised that they are willing to look favourably on applications from local authorities, using this provision, under certain specific conditions.

## CONDITIONS FOR CONSENT

10. Before consent is given, two tests must be met:
  - 1) the authority must have a statutory power to incur the expenses in exercise of their functions; and
  - 2) Scottish Ministers must be satisfied that the expenses are of such a nature that they should be met by borrowing.
11. In meeting test 1 above, consent will only be considered where:
  - a) the authority can identify a statutory power to incur the expenditure for which it wishes to borrow; and
  - b) borrowing for the expenditure is not prohibited under any other enactment.
12. It should be noted that we are unable to issue a consent to borrow for grants made under the Power to Advance Well-being this power (section 20 of the 2003 Act), as the use of borrowing is specifically precluded within the legislation (at section 22 (7) of the 2003 Act). This same restriction would have applied if we had made a change of policy and allowed community grants to fund capital projects to be capitalised. Councils will need to ascertain (through their own legal advice) that the provisions under which they are issuing grants are appropriate, and that the use of borrowing to fund the expenditure is not precluded.
13. In meeting test 2, consent will only be considered for expenditure:
  - a) on grants made to a properly constituted community group (not local authority controlled companies, trusts or partnerships, housing associations or other public sector bodies); and
  - b) which would, if incurred by the authority, result in a fixed asset in the authority's balance sheet.
14. A properly constituted community group is considered to be a local body set up for the public good in the specific local authority's area, that operates on a 'not for profit' basis, and has a constitution, or set of rules. This may or may not be incorporated, but does not extend to local authority controlled companies, trusts or partnerships, housing associations or to other public sector bodies.
15. It is presumed that the projects supported with the grants would be for works that are of economic, social or environmental benefit to their local area where:
  - a) the authority would not meet the full costs of such projects, but provide sufficient capital investment to leverage additional funding from other sources; and
  - b) the authority shall not be liable for the ongoing or future maintenance of any facility or infrastructure provided with the aid of the grant assistance.
16. Lastly, the use of borrowing to fund this expenditure should be as a last resort. Councils will be asked to confirm that there are no revenue contributions to their current capital programmes as revenue resources should be used to fund third party grants in the first instance.
17. If a project meets all the above conditions, it is likely that Scottish Ministers would be satisfied that the expenses are of such a nature that they should be met by borrowing.
18. Where applications do not meet the criteria at point 16, additional justification would be required as to why borrowing for the projects should be allowed.

19. Any consent to borrow would require that repayment of the associated loans fund advance should not exceed 10 years from the date of the advance.

20. If a consent to borrow is provided, this constitutes a statutory borrowing power. As such, authorities may wish to note the applicability of Para 25 of Schedule 3 of the 1975 Act.

### **PROCEDURE FOR APPLYING FOR CONSENT**

21. If a council wishes to apply for consent to borrow for their grants programme, they must apply in writing. Example wording that should be used in the letter requesting consent is outlined below:

"On behalf of XXX Council, I am writing to request that Scottish Ministers provide consent for the council to borrow under Para 1 (2) of Schedule 3 of the Local Government (Scotland) Act 1975 for the purposes outlined in the attached Annex.

The total budget for the schemes for which consent is requested is estimated at £X over the financial year XXX.

In making this request, I confirm that borrowing would only be used for expenditure on grants to properly constituted community groups i) where the local authority had a statutory power to incur the expenditure; ii) that the use of borrowing is not precluded under this power; iii) where the expenditure would, if incurred by the authority, result in a fixed asset in the authority's balance sheet; and iv) where the expenditure could not be funded through revenue resources (and there are no revenue contributions to existing capital programmes).

I further confirm that the council will keep appropriate records of any borrowing incurred under this consent for audit purposes."

22. Information on the schemes for which consent is being requested should be included in an attachment to the letter using the template form as at Annex A. Individual template forms should be completed for each grant scheme for which the council wishes to borrow.

23. Electronic versions of the template form will be placed on our website in due course. However, in the meantime, if you wish to apply, please contact Sara Lightbody in the Local Government Finance Division (e-mail: [sara.lightbody@scotland.gsi.gov.uk](mailto:sara.lightbody@scotland.gsi.gov.uk), tel. 0131 244 7950).

**Local Government Finance Division**  
**July 2007**

**APPLICATION FOR CONSENT TO BORROW UNDER PARA 1 (2) OF SCHEDULE 3 OF THE LOCAL GOVERNMENT (SCOTLAND) ACT 1975**

**Local Authority:**

**Scheme for Which Consent Requested:**

**Column For Official Use  
Only  
Ref. No.**

Name of Grant Scheme	Comments	
<b>1. Who are grants to be provided to?</b>		
<b>2. What proportion of the project costs are funded by the grant?</b>		
<b>3. What commitments are expected from grant recipients (e.g. maintenance of infrastructure)?</b>		
<b>4. What statutory power does the authority have to incur this expenditure?</b>		
<b>5. What expenditure are the grants provided for?</b>		
<b>6. For what purpose are the grants provided?</b>		
<b>7. Estimated expenditure involved in this financial year (£) (Please state year)</b>		
<b>8. Will this scheme continue? If so, for how long and what is the projected expenditure in forward years?</b>		
<b>9. Any other supporting information</b>		

**Checked by:**