From the Private Finance Initiative to the new Prudential Borrowing Framework: A Critical Accounting Perspective

Authors:
D Asenova  Glasgow Caledonian University
J Hood  Glasgow Caledonian University
I Fraser  University of Stirling
S J Bailey  Glasgow Caledonian University

Date of draft: 25 May 2007    Word count 7716

Abstract

The governance and accountability arrangements for local government capital expenditures under the new Prudential Borrowing Framework (PBF) appear to adopt a much narrower set of evaluative and precautionary criteria than those of Public Private Partnerships and the Private Finance Initiative. The PBF seems to have been developed in complete ignorance of the critical accounting perspective and the valuable insights it proffers for overseeing public spending. This paper makes clear the need for a return to a more holistic and multidisciplinary approach to governance and accountability for capital expenditures based upon involvement of all relevant stakeholder groups, including the non-professional community.

Introduction

Over the last decade or so, UK central and territorial governments have increasingly used Public-Private Partnerships (PPPs) and the Private Finance Initiative (PFI) to finance public sector capital projects and associated services, being frequently referred to as “the only game in town” (TTF, 1997; HM Treasury, 1999, HM Treasury, 2000). However, the Local Government Act 2003 (and its equivalent in Scotland) introduced the new Prudential Borrowing Framework (PBF), granting local authorities a potentially significant degree of freedom and flexibility for their capital expenditures. Local authorities can now decide for themselves whether and at what levels they borrow money for financing any purpose relevant to their functions provided that they meet requirements for prudent management of their financial affairs.

At a conceptual level, the PBF marks a profound shift of capital finance decision-making responsibility from central to local government. The significance of this step should be considered against two key considerations: firstly, the still existing backlog of investment in many public services and secondly, the traditional financial arrangements where most of the revenues of local authorities come from central government.
By its design, the PBF involves complex accountability relations, making local authorities responsible for assessing the affordability, prudence and sustainability of their capital programmes and undertaking borrowing on that basis.

This paper analyses the PBF and the associated Prudential Code of professional practice, seeking to determine if it can potentially compromise other aspects of service delivery. The PBF and Code place firmly at the heart of the capital finance decisions accounting rules and measurements which are designed, enforced and monitored by accounting bodies and accounting professionals.

As will be demonstrated below, this seems to downgrade consideration of the broader assessment and accountability criteria in relation to PPP/PFI and so has the potential to change significantly their associated accountability and governance regime built up progressively since 1992. A critical accounting analytical framework is adopted to assess the potential for change of that regime. First, however, it is necessary to embed the PBF within the broader context of policy and earlier reforms of the public sector.

**The NPM and PPP/PFI Context for PBF**

In the UK as in many other OECD countries the way public services are organised, provided and financed has been reformed by a series of subtle (or more explicit) ideological, political and administrative reforms which come under the broad umbrella of the New Public Management (NPM) (Hood, 1995). These reforms have focused on setting standards of accountability, devolution and delegation of decisions from central to the local government level, flexible and responsive administration meeting diverse consumer aspirations and promotion of choices for ‘consumers’ of public services (OPSR, 2002).

Hood (1995) highlighted the reliance of these NPM reforms on private sector styles of management practice, more stress on discipline and prudence in resource use; explicit formal measurable standards and measures of performance and success; and greater emphasis on output controls. According to Hood (1995: 94) there are two basic doctrines behind all these initiatives which refer to:

… lessening or removing of differences between the public and the private sector and shifting emphasis from process accounting towards greater elements of accountability in terms of results. Accounting was to be a key element in this new conception of accountability, since it reflected high trust in the market and private business methods (no longer to be equated with organised crime) and low trust in public servants and professionals (now seen as budget-maximising bureaucrats rather than Jesuitical ascetics), whose activities therefore needed to be more closely costed and evaluated by accounting techniques.
From a contemporary perspective, these two presumptions can be described as the ideological and institutional rationale of the NPM whereby the former determines the latter.

Hood et al. (2000) observed that regulation of government became far more complex and specialised in the UK from the 1970’s. Gradually, administrative devolution occurred with organisational separation between central and local government. Although this authority delegation was initially an indication of greater decision autonomy for local authorities, an expanding regulatory pattern emerged nurturing the doctrine of ‘enforced self-regulation’.

Accountability in the public sector is now conceived as an extensive production of regulating standards of practice, specialised experts becoming responsible for operating instrumental accountability (Lowndes and Wilson, 2003; Carnegie and West, 2005). Holding local authorities accountable is being achieved with the invention of scrutinising technologies of instrumental accountability. Further, a mediating regulatory official body was made responsible for scrutinising the behaviour of local authorities. Effectively, the notion of self-regulation adopted a paradoxical meaning of increased disciplinary control rather than enrichment of local autonomy.

Enhancing instrumental accountability requires the establishment of positions of expertise whose role is more to ensure and take responsibility for operationalisation of the instrumental accountability techniques than to support the process of locally developed organisational decisions. This tends to promote measurable linear solutions to very complex local problems. A ‘new generation of accountocrats’ emerged (Hood, 1995), increasingly aligned with commercial ethos (Doig and Wilson, 1998).

There has been an ongoing and expanding scrutiny of almost all aspects of organisational life: an ‘audit explosion’ (Power, 1995). Making things auditable requires negotiation of a legitimate and institutionally acceptable knowledge base and the creation of environments which are receptive to this knowledge (Power, 1996). However, Power (2004) warns of an emergent culture of defensiveness that creates its own risks in preparing for or responding to the unknown future.

The risk management agenda becomes political argument in defence of the new class of experts and aids the individualisation/professionalisation process which requires risk experts and professionals to focus more on their own personal legal and reputational risks than on their formal mission. This argument is interesting in the context of the PBF because, as will be demonstrated below, the Prudential Code does not engage in a dialogue about the potential risk weighting to be placed on local authorities’ capital decisions. This is especially worrisome when the delegation of financial and management responsibility has been found to increase the risks of fraud and corruption in public services (Doig and Wilson, 1998). The Code does not clearly articulate how public risks (whether financial, social or environmental) are to be managed, while making expert systems for evaluating risks as sophisticated and transparent as possible.
The NPM rationale framed the aspirations and activities of the accounting professionals and the accounting firms, encouraging a gradual shift from financial monitoring towards proactive influence over socially important policy decisions, justification of those decisions, as well as the creation of new accounting regulations and standards. According to Arnold and Sikka (2001:475) the ultimate rationale of the Western governments for placing such considerable reliance upon accounting techniques for regulating both commercial and non-commercial organisations is the fostering of “trust” and “objectivity”.

Recent empirical research has suggested that the lobbying expenditures of the accounting firms in relation to various accounting issues are determined by their incentives which, in turn, are associated with potential income-increasing choices (Johnston and Jones, 2006: 225).

While both PPP/PFI and the PBF adhere to the spirit of the NPM reform there are a number of features associated with the PBF such as the increased autonomy, the pursuit of self-sufficiency and the emphasis on business-like “prudential” set of purely financial criteria which indicate that PBF is a step further or a “second generation” NPM initiative.

PPP/PFI has been analysed in depth from a wide range of academic perspectives, e.g. public finance, public policy and societal risk, with much of this analysis being highly critical. As a policy approach which relies heavily on private sector commercial interest, support and cooperation, PPP/PFI represents a radical u-turn from traditional Labour values, reflecting NPM ideas regarding the role of the private sector in the public services (Greener, 2005).

The PBF is now running simultaneously with PPP/PFI as a method of funding public services, but remains quite separate from it. In certain circumstances however, it offers an alternative to PPP/PFI, allowing councils themselves to provide physical infrastructure and associated services without needing to involve the private sector to any significant degree, for example the renewal of the Glasgow City Council primary school estate.

The near complete exclusion of the private sector is a distinct possibility because the PPP/PFI has been seen to be characterised by some highly undesirable features. These include the substantial running costs of PPP/PFI projects, complex contractual arrangements and extended contractual periods, all of which contribute to a heightened risk profile. In addition to the risk categories already identified above, these projects are exposed to financial risk which can arise from the inability of the project company to raise capital or can be related to other financial factors such as changes of interest rates (HM Treasury, 1997a). In a typical PPP/PFI contract, each of the risk categories is broken down into a number of individual risks which provides a very detailed risk map. For example, design and construction risk can also relate to site risk and industrial relations risk, as well as problems related to design and construction features (Hodge, 2004).
The underlying theory relating to risk in PPP/PFI is that the risk remains with the party best able to manage it, for example most of the risks associated with design, construction, operation as well as project finance are supposedly transferred to the private sector, whilst the regulation/legislative risk are either partially shared or retained by the public sector. Concern has been expressed, however, over the premium charged by the private sector for bearing risk and with the notion of the public sector always being the ‘risk bearer of last resort’.

Government guidelines place crucial importance on the proper identification and evaluation of the risks affecting particular projects, and these are reflected in the public sector financial model known as Public Sector Comparator (PSC), with “all significant risks expected be assessed following a rigorous quantitative framework” (HM Treasury, 1997b:16). Despite the availability of detailed guidance, risk allocation in early PFIs was often characterised by the public sector client seeking to transfer all risks to the private sector partners, which had substantial cost implications. As the policy has developed, it has become clearer that there are certain categories of risk over which the private sector has no control, and which therefore are better shared or handled by the public sector. Notwithstanding the serious concerns over the equity of risk allocation and transfer in PPP/PFI, such projects do, at least, have a risk framework which has evolved since the inception of the policy. This risk framework seems to be absent from the PBF and Prudential Code, as will be demonstrated below.

The existence of such risk-related frameworks within PPP/PFI has not, however, removed the \textit{de facto} intricacies and difficulties associated with the practical implementation of the risk management process. As noted earlier, criticisms of the treatment of risk and the level of actual risk transfer in PPP/PFI contracts has been levelled from a number of different perspectives. According to Lonsdale (2005) some contracts fail to account for key characteristics and relations associated with the main parties which potentially can have decisive impacts for the treatment of risk. Such key characteristics include an asymmetry of balance of power between the partners, superior commercial capabilities of the private sector and the political nature of public sector decision making. Such characteristic features and subsequent imbalances can explain the level of risk transfer in some projects which favours the interests of private sector shareholders over those of the citizens and leads to excessive profits for the private sector. Interestingly, however, Hood et al (2006) question the degree to which shareholders in private sector companies can establish the true levels of risk and reward associated with involvement in PPP/PFI contracts.

Whilst some technical issues and methodologies have also been a source of concern, true evaluation of the financial performance of most PFI projects will probably only be possible some years after it has entered the operational phase, perhaps even only after the full length of the contract (CPA 1998; NAO 1999). Hodge (2004) has noted that the utilisation of PPP/PFI as a purchasing device can potentially jeopardise public interest and policy issues, with the risks in the commercial domain given much attention and investigation, whereas the risks in the governance domain are often neglected.
While the PPP/PFI capital finance option has been rigorously pursued by the government, the criticism of it suggests that the risk allocation and transfer model has not been an unambiguous success and is probably not universally applicable. However, the existence of comprehensive risk model is a basic prerequisite for a more or less systematic approach to project risk and risk management.

Introduction of the PBF and its widespread adoption by local authorities does not obviate the need for such a comprehensive risk model. The general question is whether the PBF has the potential to remedy some of the well documented problems associated with PPP/PFI whilst avoiding creating a new set of problems by design or default.

The PBF and Prudential Code

Proposals for adoption of the PBF were set down in Renewing Local Democracy: The Next Steps (Scottish Executive, 2002) and, for England and Wales, in the White Paper “Strong Local Leadership: Quality Public Services (DLTR, 2001). In Scotland, capital (i.e. borrowing) consents were previously issued whereas in England and Wales a credit ceiling was defined and local authorities were issued with credit approvals. Generally, borrowing consents were granted under specific headings (e.g. housing, education etc.) which reflected the priorities of central government and although overspend was allowed within certain limits of up to a maximum 10%, any such sums were deductible from the following year’s consent.

The PBF introduces a radical reform of these arrangements as it relates to the total of borrowing by each local authority creating a ‘single pot’ for all capital expenditures, with the exception only of council housing. It requires local authorities to provide rolling three-year plans for planned capital expenditure as well as reasonable estimates for ‘capital expenditure unfinanced’, defined as that capital expenditure which is not financed by capital receipts, grants or revenue contributions. Each local authority must itself set a limit on the amount of borrowing it can undertake based on a professional code of practice. This Prudential Code was developed by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Observance of the Code means local authorities set their own limits on the total amount of debt they can take on. Thus the previous centralised and highly detailed administrative control system is replaced with one based on local autonomy tempered by professional financial advice offered within the Code’s rubric. This is intended to ensure adherence to certain purely financial rules, i.e. that all external borrowing is within prudent and sustainable limits, that capital expenditure plans are affordable and that treasury management decisions correspond with professional good practice. Whilst not necessarily resulting in any additional funds, the Code marks a significant shift from prescriptive statute-based control and from the centrally determined strategic priority areas such as education or the road network.
The only significant limitations that remain in place are the prohibition on the mortgaging of local authority property as well as on ‘securitisation’ of future revenue streams (e.g. rents) in return for immediate one-off payments. Nevertheless, in order to complement the PBF, general fund capital receipts from sale of assets can now be used to finance additional general fund capital expenditures whereas previously they could not.

The relevant Secretary of State in England, the Scottish Executive and the Welsh Assembly continue to have reserve powers over local authority borrowing and councils deemed to be misusing their new freedom may find themselves having central controls re-imposed on them. Moreover, whilst it grants greater autonomy by freeing councils from the former centrally-prescribed borrowing limits, the Framework does not necessarily mean that councils will have additional capital funds. In reality, however, it seems more likely that the emphasis on local authorities’ self-regulation and reliance on professional codes of practice (CPWP, 2000) can result in even higher degree of self-reliance and financial autonomy.

The professional code of practice developed for the PBF is encapsulated in the Prudential Code. The Code requires each authority’s Chief Finance Officer to establish procedures for reporting to the capital finance decision-making body of the local authority. Mirroring the Framework’s rationale for performance monitoring every three years, the Code sets down short- and medium-term Prudential Indicators of affordability and prudence (see the box below). These Indicators are intended to clarify the consequences of proposed investment policies, demonstrating transparency and accountability to community stakeholders.

<table>
<thead>
<tr>
<th>Prudential Indicators for affordability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimates of the ratio of financing costs to net revenue stream (%)</td>
</tr>
<tr>
<td>Actual ratio of financing costs to net revenue stream (%)</td>
</tr>
<tr>
<td>Estimates of the incremental impact of capital investment decisions on council tax</td>
</tr>
<tr>
<td>Estimates of the incremental impact of capital investment decisions on housing rents</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Prudential Indicators for prudence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net borrowing and the capital financing requirement</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Prudential indicators for Capital Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimate of total capital expenditure (3 years)</td>
</tr>
<tr>
<td>Actual capital expenditure for previous year</td>
</tr>
<tr>
<td>Estimates of capital financing requirement (3 years)</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>Actual capital financing requirement for previous year</td>
</tr>
<tr>
<td><strong>Prudential Indicators for external debt</strong></td>
</tr>
<tr>
<td>Authorised limit for external debt (3 years)</td>
</tr>
<tr>
<td>Operational boundary for external debt (3 years)</td>
</tr>
<tr>
<td>Actual external debts as at 31st March of previous year</td>
</tr>
<tr>
<td><strong>Prudential Indicators for Treasury Management</strong></td>
</tr>
<tr>
<td>Adoption of CIPFA Code of Practice for Treasury Management in the Public Services</td>
</tr>
<tr>
<td>Upper limit on fixed interest rate exposures (3 years)</td>
</tr>
<tr>
<td>Upper limit on variable interest rate exposures (3 years)</td>
</tr>
<tr>
<td>Upper and lower limits for the maturity structure of borrowing</td>
</tr>
<tr>
<td>Prudential limits for principal sums invested for longer than 364 days</td>
</tr>
</tbody>
</table>

Source: CIPFA (2003)

While the Indicators for affordability in the above box seem little different from the criteria that could have been expected to be used by the Public Works Loan Board (PWLB) - the main source of capital finance prior to the PFI regime - they are now placed into a different context.

Albeit consistent with 3-year budgeting used for public expenditure planning, the 3-year planning horizons for the indicators for capital expenditure, for external debt and for Treasury Management contrast sharply with the 30 to 60 year contracts under PPP/PFI and the conventional PWLB 25 year debt repayment period.

From a conventional accounting perspective, the lack of guidance on acceptable parameters for each Indicator is questionable as authorities have the freedom to interpret these as tightly or loosely as they please. Imprudent authorities may test the UK territorial governments’ resolve to make use of reserve powers to impose borrowing limits and to cap increases in Council Tax. For example, what ratio of financing costs to net revenue streams is too high? When is the incremental impact on council tax or rents excessive? Either these are set by central government or by council treasurers or they are open to very loose interpretation.
The PBF is of course concerned with the financing of capital expenditure rather than broader political, economic, social and other aspects of the capital expenditure decision per se. The CIPFA ‘Preliminary Guidance’ (CIPFA, 2003) on the Code, however, states (par.8) that:

‘depreciation is the appropriate basis for charging for and financing the cost of the consumption of fixed assets. This approach would be consistent with basing the capital control system on generally accepted accounting standards. It would also be a means to demonstrate that local authority capital investment strategies are sustainable. Since the transition to full depreciation’ will be difficult and complex, it cannot be introduced at the beginning of the new prudential system’.

The CIPFA guidance also states that ‘the Code explicitly recognises that in making its decisions to make capital investment the authority must have explicit regard to (inter alia) option appraisal’ (CIPFA, 2003, par. 24). The published Indicators, however, do not include any measures that might usefully be used for option appraisal or for the evaluation of the risks and returns affecting particular projects. One reason for this is that the Indicators are primarily input based. The risk of poor option appraisal was highlighted specifically in the responses made to a recent survey of the perceptions of the Code held by local authority Chief Finance Officers (Bailey et al, 2007). This is consistent with views of respondents to that survey to the effect that public sector capital financing decisions should take into account revenue forecasts - output measures - based on ‘reasonable’ levels of income while achieving best value.

The Indicators of affordability - primarily, the ratio of financing costs to net revenue stream - do not appear to specify consideration of the relative timing of the incidence of outputs or inputs and are therefore not only limited but, on their own, might be deemed to be imprudent.

The approach of the Code to the financing of local authority capital expenditure - prescriptive yet at the same time strictly limited in scope - contrasts clearly with the detailed guidance laid down by HM Treasury (1997b) in connection with PFI transactions which, for example, specifies that for particular projects there should be an evaluation of the Net Present Value (NPV) of potential profit variations for both operator and client. The absence of such measures in the Prudential Code appears to be legitimated by the CIPFA guidance which suggests that the obligation on authorities to have regard to option appraisal (and other matters) implies that ‘the implementation of the Code is not a narrow financial requirement that can be managed by the chief financial officer alone’ (CIPFA , 2003, par. 25) since ‘good practice cannot be measured solely by numerical indicators’ (CIPFA, 2003, par.43).

This resonates with our primary criticism of the Code – that its technist and prescriptive approach compromises the broader aspects of public sector delivery. We develop this criticism in the following section of the paper, comparing the Code and PPP/PFI within a critical accounting perspective.

The Critical Accounting Perspective
Contemporary public service financial accountability requirements reflect the complex, diverse and locally embedded nature of the reforms, challenging the conventional practices of accounting representation of the public sector organisational activities (Quirk, 1997; Carnegie and West, 2005). Accounting function aspects such as the raising of finance, the decisions to spend (on revenue and capital expenditure), the basis of recording transactions and the assessment of financial performance of public services have to cope with ideological pressures and with the increasing need to consider the wider social context of accounting practices as well as the sector’s institutional arrangements (Pallot, 1992; Guthrie et al, 1999; Lapsley, 1999). Compared to the narrow mainstream accounting research this approach has different fundamentals and embraces different values such as wider gender, class, wealth distribution, ethical, theological, societal, and environmental issues (Broadbent and Laughlin, 1993; Tinker, 1985; Chew and Greer, 1997; Laughlin, 1999; Moerman, 2006) and is often referred to as critical accounting. According to Laughlin (1999; 73) it can be defined as:

A critical understanding of the role of accounting processes and practices and the accounting profession in the functioning of society and organisations with an intention to use that understanding to engage (where appropriate) in changing these processes, practices and the profession.

This view which emphasises the new policy-creation role of the accounting profession is further supported by Shaoul (1997: 382) who described the critical accounting research as:

… being characterised by an analysis of accounting processes to determine the meaning behind the practices and numbers (the same practices and numbers that have been so problem-free for the positivists).

In line with these and other similar definitions, our thinking in this paper has been informed by two broad sets of concepts. Firstly, the critical accounting concept in its wider sense as a departure from the traditional numbers-based technicist approach towards more holistic societal policy-assessment paradigm, and secondly, but related to this, we allocate our analysis within a multi-disciplinary context which takes into account the interests of various societal stakeholders, the associated uncertainties and the long-term implications of current decisions in relation to the provision of public services, often interpreted as associated risks.

It has been well documented that the complexity of matching public sector ethos, standards and operational principles with the private sector profit-driven values and techniques poses unique set of challenges to which the private sector does not always respond adequately (Greener, 2005; Pollock, 1995; Pollock, 2004; Gaffey et al, 1999; Pollock et al, 2002; UNISON, 1999; Asenova et al., 2007). The PPP/PFI accounting standards created and enforced by the accounting professionals have been used as a means for establishing common language between different actors.
Some critical studies approach the broader accounting problem in PPP/PFI from somewhat technical starting point but nonetheless illuminate important political relations concerning the interest of different actors including the capitalist state and powerful professional groups. Broadbent and Laughlin (2002) have investigated the balance of the political and technical trade-offs in the changing accounting requirements for PPP/PFI which caused disagreement between the UK government (the Treasury) and the corresponding accounting body (the Accounts Standards Board - ASB). Those authors emphasised the fact that the accounting treatment of particular project (on- or off- the public sector balance sheet) rather than other benefit-based criteria has been used as an indication for projects’ success or failure. They also noted that in relation to PPP/PFI accounting status the ASB is far from impartial (2002: 653):

The ASB, given its autonomy, is taking a very strong line in maintaining the objectivity of the “accounts” produced. The professional firms, which have to engage in capital accumulation, as well as legitimising the process, are less whole-hearted in their support of this strong line. If PFI is undermined then lucrative opportunities for earning fee income may well be lost.

Other accounting bodies such as CIPFA and ICAS have raised questions regarding the ASB’s regulatory authority, which can potentially jeopardise the objectivity of ASB and ultimately the objectivity of the state as a legitimising authority. Furthermore, Broadbent and Laughlin conclude that when it comes to the shaping of the accounting standards and the professional standing of the accounting professionals the state is neither objective nor impartial as its approach is determined by political considerations (2002: 655):

When the use of accounting standards promotes the existence of a capitalist society through “validating” the accounts of those organisations engaged in the capital accumulation, then it is likely that the state will uphold and promote the process. Where the state is suffering from contradictory demands and the rule of standards is undermining its ability to arbitrate between them, then the favourable position of the profession (granted to them by the state) may well be questioned.

In the context of the PBF, the accounting rules governing its practical implementation are encapsulated in the CIPFA Prudential Code. The previous section noted that the Code is biased exclusively towards the demonstration of financial rigor and the key financial requirements are confined within a very limited time scale. The fact that its narrow focus could present difficulties in the long-run for local authorities in terms of sustainability has been noted by another professional body - the Association of Chartered Certified Accountants (ACCA, 2003) which questioned different provisions including the long-term sustainability aspects of the Code, the reporting mechanisms for the prudential indicators, its potential for maintaining appropriate investment levels, the overall context of the Indicators and the distinction between indicators and targets (Hood et al., 2007).

“The Code is written in a language which suggests that upper limits should be set on local authority capital investment, but not lower limits. We believe that inter-generational
equity requires that suitable levels of investment are maintained, at least to maintain the fabric of local authority properties” (ACCA, 2003).

A second area of concern is that a particular approach to depreciation is not specified in the Code. The suggestion that depreciation would be a means of achieving ‘sustainability’ is not congruent with traditional accounting practice where depreciation is conceptualised as primarily an allocation of the historic cost of the asset. To achieve ‘sustainability’ of local authority capital investment, by means of depreciation would assume its provision by some version of replacement cost accounting.

Khadaroo (2005: 73) describes the adoption of private sector-type accounting standards as “isomorphism” whereby the public sector seeks legitimisation by the more or less mechanical transfer of private sector techniques. Carpenter and Feroz (2001: 556) refer to this as “organisational imprinting”.

Looking at a range of typical NPM initiatives such as Best Value, PPP/PFI, Resource Accounting and Resource Budgeting, Khadaroo (2005) argued that this transfer of techniques is driven by cultural and political processes rather than by the stated objectives (e.g. efficiency gains). Many public sector organisations, including the local authorities which have been traditionally considered as laggards rather then leaders in the adoption of commercial techniques have experienced coercive, mimetic and normative pressures (Khadaroo, 2005: 73) to comply. The paper concludes that while the accounting standard setting process is a complex process, in the case of PFI the standard setting was clearly prevailed upon by normative pressures from the accounting professional bodies and by their “given” political power.

There is an obvious comparison with the PBF guidance. If the CIPFA Code is considered the only standard which local authorities are expected to observe in the context of the PBF, the actual standard setting process followed a pattern where the local authorities’ finance directors were engaged by CIPFA in a consultation process which resulted in the Prudential Code. Some of the earlier versions of the Code which included various risks were abandoned and one exclusively financial ratios-based version of the Code was eventually enforced.

There is obviously some question as to whether a professional code of practice in relation to borrowing is appropriate as a means of regulating what are still essentially political and economic decisions. Nevertheless, it promotes local financial accountability and, except for housing, the ‘single pot’ allows for some tailoring of local capital financing to suit local needs and spending preferences. As such, it could be argued that the PBF strikes an appropriate balance in allowing for the removal of central controls provided local authorities behave in a prudent manner.

Nevertheless, it is arguable that CIPFA’s Prudential Code embraces a very narrow interpretation of the PBF. It is not sufficiently community oriented, failing to recognise the role of all stakeholders in the decision process for capital finance. The way that uncertainty is converted into only calculable financial form blinkers the crucial notion of
risk and responsibility in the long term. It does not address sufficiently the transparency of the decision taken in terms of financial, political, economic and social accountability, long-term affordability, prudent financial management and sustainability. Non-financial resources have also to be valued for accountability purposes. The almost exclusive financial focus of the Code and its Indicators fails to embrace the need for much broader discourse of accountability within public sector settings (Carnegie and West, 2005).

Public sector accountability is a much more complex, local and diverse issue than seems to be recognised in the Code. The enrichment and enhancement of accountability has to meet the needs for communities’ well-being and achieve best value in capital financing. Public managers have to become accountable to everyone (Quirk, 1997) but this is problematic given the risk-averse managerial culture (Romzek, 2000; Power, 2004).

To reiterate, the Prudential Code seems too instrumental, only containing quantitative indicators. How it will be used is, however, open to question. Whilst it could be used more innovatively than expected, experience elsewhere does not suggest it will be. Jackson and Lapsley (2003) surveyed the extent to which accounting practices implemented in the public sector have been adopted innovatively. They found that the practices adopted by the sector have been forced by regulation and that limited experimentation to change was undertaken. That indicates the need for greater awareness of the consequences of an unchallenged adoption of accounting standards that do not consider to a great extent the appreciation of intelligent risk management.

Ultimately, there are no simple solutions to be found in financial calculations within the Prudential Code. Practices and institutional arrangement for public accountability cannot be studied and explained without an analysis of their wider social context (Broadbent and Guthrie, 1992, Guthrie et al, 1999).

**Conclusions**

The question arises as to why the limited approach to the appraisal of local authority capital expenditure that is exemplified in the Prudential Code has been adopted in what is an extremely significant shift of capital finance decision-making responsibility from central to local government. Part of the answer may lie in the continuing need to demonstrate the success of each reiteration of the NPM ‘revolution’ and to “show that things are working well, that objectives are being achieved” (Power, 1997, p.93).

Whilst there is a need for quantifiable measures of performance in order to demonstrate ‘objectivity’, ultimately, public sector capital expenditure must be assessed in terms of its success in achieving the political objectives upon which it is predicated. In an ideal world this would involve measurement of both outputs and outcomes. Klein and Carter, (1988) distinguish between these and highlight effectiveness as the link between them). Both of these, however, are likely to present problems of measurement and, especially in the case of outcomes, of identification. Where both outcomes and outputs are problematic, there is a likelihood of a regression to relying upon input measures. Power
points out that “where outcomes, and hence effectiveness, are ambiguous or controversial……..cost imperatives and output measures tend to dominate the language of evaluation” (1997, p.117). The Prudential Code appears to be a clear case of this phenomenon.

In essence the Code assesses local authority capital expenditure by reference to ‘costs’. While the accounting profession, as well as other occupational interest groups, may be visualized as a matrix of tasks and jurisdictions characterised by continuous change (Abbott, 1988), cost-based evaluation has a particular resonance for the accounting domain. The ‘hard’ accountancy base of bodies such as CIPFA mean that its influence on evaluative constructs, such as the prudential code that it designs, gives them a legitimacy that other more informal and ‘messy’ evaluative approaches may lack.

A much broader consideration, however, as with so much contemporary public sector activity, may lie in the need to produce auditable measures of performance. The problem with this, however, is that these measures may have a problematic relationship to ‘what matters’ in terms of the underlying activity and its societal relevance. Thus in the case of the Prudential Code the approved indicators focus on inputs rather than societal outcomes thereby resonating with sentiments expressed by Power who states that ‘the operational reality of auditing has a problematic relation to the democratic ideals that drive it’ (1997, p127). The narrowness of the Code and its Indicators may simply reflect the fact that CIPFA is a body of professional accountants and, specifically, one which has a particular public sector jurisdiction. CIPFA’s role in the public sector is ‘rival’ with other occupational groups having an evaluative role, those with an interest in risk management for example.

It maybe somewhat ironic, however, that contemporary mainstream accounting discourse is beginning to place an increasing emphasis on accounting with a ‘softer’ focus and a more narrative character. This is the case even in for those forms of accounting that place a premium on objectivity and verifiability; most obviously in the case of external financial reporting. The International Accounting Standards Board (IASB) has published a discussion paper Management Commentary\(^1\) (IASB, 2005) resulting from a project set up with the objective of working towards ‘the eventual inclusion in IAS 1 Presentation of Financial Statements (IASB, 2003) of a requirement to prepare a narrative report, coupled with non-mandatory implementation guidance on what ought and ought not to be included in such a report’ (IASB, 2005, p.3). There are various views as to what should be included in such narrative reports but information on business risks and social and environmental impacts tend to feature prominently. It is widely recognized (e.g. Beattie, 1999) that external reporting in the private sector corporate sphere will gradually begin to assume this less rigidly numerical character. Given this contemporary background the

\(^1\) IASB (2005) defines management commentary as follows: ‘Management commentary is information that accompanies financial statements as part of an entity’s financial reporting. It explains the main trends and factors underlying the development, performance and position of the entity’s business during the period covered by the financial statements. It also explains the main trends and factors that are likely to affect the entity’s future development, performance and position (IASB, para.19)’.
indicators adopted by the Prudential code - rigidly numerical and limited in scope - seem all the more inappropriate.

The governance and accountability arrangements for local government capital expenditures under the PBF appear to adopt a much narrower set of evaluative and precautionary criteria than those pertaining to the PPP/PFI regime. This is surprising given that the latter were finessed with the benefit of experience and hindsight of, at times, harsh criticisms which contributed to the steep learning curve of the PPP/PFI regime.

Irrespective of whether PBF is seen as ideologically and pragmatically more acceptable than PPP/PFI, it seems to be highly imprudent not to incorporate the generic governance and accountability lessons of the latter regime into the former. The risk of poor value for money and improper use of public finance for capital expenditure programmes seems to be heightened considerably by this omission.

From a more academic perspective, the PBF seems to have been developed in complete ignorance of the critical accounting perspective and the valuable insights it proffers for public finance. That this state of affairs should apply to a regulatory mechanism and process developed by the leading public sector professional accountability body is all the more surprising. It suggests a very substantial detachment of the profession from its academic underpinnings in terms of being completely unaware of current and ongoing methodological, philosophical and ethical developments driving evolution of best practice within the accountancy discipline. Moreover, it suggests lack of a joined-up, holistic, approach to multidisciplinary professional practice, relevant professions apparently working completely separately from each other – each in their own isolated bunkers.

This conclusion emphasises the need for a return to a more holistic and multidisciplinary approach to governance and accountability structures for capital expenditures based upon involvement of all relevant stakeholder groups, including those in the wider non-professional community. Whilst no doubt welcomed by the staunch critics of PPP/PFI, the changeover to PBF does not dispense with the need for the holistic approach of the former to governance and accountability. The PBF needs to be imbued with this approach if value for money is to be safeguarded.

**Acknowledgment**

The authors acknowledge the value of the work of Dr M. Manochin on a previous project related to this research.
References


Broadbent, J. and Laughlin, R. (1993) Moving Forward an Accounting that will be Enabling: Accounting, Habermas and Issues of Gender, Proceedings of the Fourth interdisciplinary Perspectives on Accounting Conference, University of Manchester, Manchester, UK.


CIPFA (2003), *The Prudential Code for Capital Finance in Local Authorities* UK: CIPFA publications http://secure.cipfa.org.uk/cgi-bin/cipfa.storefront/44fd55d61398c2ee273f3efdf40706ef/Product/View/CF005


Hood, C., O. James, C. Scott (2000), ‘Regulation of government: has it increased, is it increasing, should is be diminished?’, *Public Administration*, Vol. 78, No2, pp. 283 – 304.


