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**LOANS AND  
BORROWING POWERS**

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and Depreciation**

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# LOANS AND BORROWING POWERS OF LOCAL AUTHORITIES

BY

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"LOCAL AUTHORITY FINANCE, ACCOUNTS AND AUDITING"



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## PREFACE

OF the many phases of a municipal financial officer's duties probably none is more important than that relating to loans and borrowing powers, neither is there any matter in respect of which more money could be lost if managed indiscriminately or without proper knowledge or appreciation of the importance of these transactions.

For the benefit of young readers preparing for examinations, and others, the book has been illustrated throughout wherever practicable, and an added feature is the presence of one hundred questions and problems the answering of which will enable students to test their knowledge of the subject in all its phases.

It has been the author's endeavour to present in a manner easy of assimilation, a review of the subject of Loans and Borrowing Powers of Local Authorities.

J. H. P.





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# LOANS AND BORROWING POWERS

## PART I Administration and Finance

### CHAPTER I

#### CAPITAL EXPENDITURE

**Capital Expenditure** is that incurred for the purpose of creating, acquiring, equipping, or extending fixed or permanent assets by means of which an undertaking or service is to be carried on. It is expenditure the benefit of which will extend over a period of years.

#### REASONS FOR BORROWING

The latter part of this definition illustrates the difference between capital expenditure and revenue expenditure. This great distinction applies equally to local authorities and commercial businesses. Just as revenue expenditure must be charged to the current revenue account because it is expenditure necessarily incurred and used up in working the undertaking or service during the current period and does not benefit a future period, so must capital expenditure also be charged to revenue account over the period that will use up, or be benefited by, such expenditure.

The method adopted in charging capital expenditure to revenue account is to debit current revenue account with an amount estimated to be not less than the value of the assets absorbed or used up, and to credit such figure either to a Depreciation Fund or Renewals



Fund or, less preferably, to the asset account. This has the effect of writing off the cost of the assets over the periods that will benefit.

As this period affects many years in the greater number of cases the necessity for borrowing the amount required to acquire, etc., the assets is immediately apparent; hence the reason why commercial firms introduce "capital" into their businesses and why local authorities do the equivalent, i.e. borrow money.

Just before leaving these early observations it is perhaps as well to state that a commercial concern always considers its capital expenditure as *permanent* and consequently never makes any attempt to redeem the debt (share capital) which enabled the assets to be obtained, while *a local authority is not allowed to effect permanent debt* but must make provision for redemption and must actually redeem such loans within a sanctioned period not exceeding the probable life or period of utility of the assets.

Though there may appear to be a marked difference between the two classes of ownership this disparity is less real than apparent because while a commercial firm makes a depreciation provision in order that it may replace its assets when necessary and thus always retain its capital intact, a local authority makes provision to discharge the debt within a similar period so that when the assets cease to be of value the loans will be redeemed. Theoretically the local authority must discontinue the undertaking or start again by getting a new sanction, obtaining new loans, and acquiring new assets.

### WHAT MAY BE BORROWED

Sanction can be obtained to borrow for the purpose of "permanent works" only. Of course, the word

*permanent* does not in this case carry a strictly literal definition. It is intended to mean works that will last at least several years, and corresponds to the term "fixed" or "permanent" assets of a commercial concern.

There may not be included in the expenditure which the Government will sanction to be borrowed the salaries or wages of permanent servants of the local authority (except such portion as it deems reasonable in the case of capital expenditure for housing).

If the services of permanent officials or workmen are employed on works of a capital nature there is no objection to such being charged to capital account but except in the case stated *no such expenditure may be made out of borrowed money*. It may be defrayed out of revenue or rate account and treated in the books as "capital expenditure defrayed out of revenue or rate account." Thus there is no objection to its being debited to assets account and shown as an asset in the balance sheet. The restriction as to the inclusion of salaries and wages of permanent employees is applicable only where the borrowing is under a sanction granted by the Ministry of Health under provisions of a general Act, and does not extend to borrowings under local Acts unless such Acts specially exclude such expenditure. Even in the former case district auditors do not in practice disallow the wages of workmen (not salaries of officials), but generally call attention to the matter in their report.

Some difficulty may present itself in defining the word "permanent" for the purpose of complying with the Government's order, and one may be apt to place too strict an interpretation on the term. It is reasonable to assume that the meaning of "permanent workman" is one who would *necessarily* be employed

all the year round, even if there were no capital works in progress. This is different from the case of the man who *actually*, although not *essentially* works throughout the year. It may logically be contended that men in this latter category are temporary because they may be dispensed with at any time on being given a day's or a week's notice.

It may be interesting to note the difference between the views of two sanctioning departments of the Government on this subject: the Ministry of Health and the newer creation the Electricity Commission, respectively, when consenting to the raising of loans,

#### MINISTRY OF HEALTH

No payments should be made out of the loan to workmen in the Council's permanent employment, or to any salaried officer of the Council, except in the case of payments (if any) due to yourself for legal work in connection with the object of the loan and not within the scope of your ordinary duties under the terms of your appointment as Town Clerk.

In such a case the bills, as taxed, may properly be paid out of the loan.

#### ELECTRICITY COMMISSION

No part of the salary or wages of the Council's permanent staff or employees ordinarily charged to Revenue Account should be defrayed out of moneys borrowed under this sanction, but additional payments to such staff or employees in respect of works connected with the object of the loan may be so defrayed. When, however, substitutes are temporarily employed to take the place of permanent staff or employees while engaged on such work, a sum equal to the payments to such substitutes may be defrayed out of moneys borrowed under this sanction.

### DISTINCTION BETWEEN CAPITAL EXPENDITURE AND LOAN EXPENDITURE

**Capital Expenditure** has already been defined and includes *all* expenditure in creating, acquiring, equipping, or extending an undertaking or service the benefit of which will be spread over a future period, whether it be borrowed or charged to current revenue or rate account.

**Loan Expenditure** is that portion of capital expenditure that may be defrayed out of borrowed moneys.

There is no general legal obligation to seek borrowing powers for the purpose of acquiring permanent assets. It is apparently quite in order for a local authority to obtain all its capital requirements by a direct levy on the ratepayers in the same way as it obtains its current rate fund moneys. But such a procedure may not be practicable nor equitable if indulged in to any extent. This leads to a consideration of the objects of borrowing.

### OBJECTS OF BORROWING

The objects of defraying capital expenditure out of loans are—

- (a) The cost of permanent works is spread equitably over the period that will have the benefit of the expenditure, and thus it is ensured that each year's ratepayers will be responsible for that year's quota and that no particular period will be overburdened and made to pay for something of which it cannot have full benefit ;
- (b) Extensive and costly schemes can be carried out which would be impossible if the whole cost had to be defrayed out of current revenue or rates.

## CHAPTER II

### OBTAINING BORROWING POWERS

BORROWING powers, subject to proper sanction of the Government department, are conferred on local authorities by a number of *general* statutes, by local Acts and by provisional orders. The following are the principal general Acts, the maximum period for which sanction may be given under each being stated—

#### GENERAL STATUTES

	Period (Years)
The Public Health Act, 1875, Sections 233 and 234 . . . . .	60
The Municipal Corporations Act, 1882, Sections 106, 112, 113 and 120 . . . . .	30
The Local Government Act, 1888, Sections 62 and 69 . . . . .	30
The Local Government Act, 1894, Section 12 (incorporating the provisions of the Public Health Act, 1875) . . . . .	60
The Tramways Act, 1870, Section 20 . . . . .	30
The Electric Lighting Acts, 1882-1909 . . . . .	60
The Housing Acts, 1890-1919 . . . . .	80
The Housing, etc., Act, 1923 (for Subsidy grants) . . . . .	20
The Education Act, 1921 . . . . .	60
The Small Holdings Act, 1908 } for Land . . . . .	80
} for other purposes . . . . .	50

A number of other Acts, e.g. the Baths and Wash-houses Acts, the Public Libraries Acts, the Small Dwellings Acts, etc., authorize the borrowing of money (subject to proper Government sanction), but instead of specifying periods, conditions, etc., they incorporate the borrowing powers provisions of a general Act, as a rule the Public Health Act, 1875.

#### PROMOTION OF A LOCAL ACT

Where there is no general statute that authorizes borrowing for the purposes, or on such conditions or in such a manner as the local authority desires, the method resorted to is that of promoting a local Act.

### PROVISIONAL ORDERS

A provisional order is an order made by a Government department, such as the Ministry of Health, and is later confirmed by Parliament. A local inquiry is held into the circumstances concerning which a local authority has made application for borrowing powers. The Ministry prepares a scheme, which is embodied in an Order, and this appears along with others in a Parliament Orders Confirmation Bill which eventually (when confirmed by Parliament) becomes an Act.

A provisional order is resorted to to obtain power to do something which has not been made fully permissible by Act of Parliament but of which Parliament has already approved the principle.

### SANCTIONING DEPARTMENTS

The State and other authorities empowered to authorize borrowing under the general law are as follows—

AUTHORITY	PURPOSE OF LOAN
(1) Ministry of Health	General
(2) Electricity Commissioners and Ministry of Health	Loans under Electric Lighting Acts
(3) Board of Trade	Tramways and Light Railways
(4) Treasury and Parliament	Loans of London County Council
(5) London County Council	Loans of Metropolitan Borough Councils under
	(a) Housing of the Working Classes Acts ;
	(b) Metropolis Management Act, 1855, for most purposes
(6) County Councils and Minis- try of Health	Loans of Parish Councils

## CHAPTER III

### PRELIMINARIES TO BORROWING

#### CONDITIONS PRECEDENT TO RAISING LOANS

THE conditions precedent to raising loans are many and important, and to save time and space may be summarized as follows—

- (1) The proposed expenditure must have the consideration and approval of the local authority. This will consist of the sanction of the Council following the report of the Finance Committee, which committee will have considered and reported on the proposals of the executive committee responsible for the undertaking or service which it is proposed to carry out.
- (2) The proposed expenditure must be of such a nature that in the opinion of the sanctioning department of the Government it may be spread over a term of years.
- (3) Such expenditure must have statutory authority either by general Act or by local Act as stated in Chapter II.
- (4) If the authority is a local Act no further sanction (except in extraordinary cases) beyond the resolution of the Council is necessary before the raising of loans is proceeded with.
- (5) Where the authority is a general statute, sanction of the appropriate Government department must be obtained. The Council cannot by its own resolution raise capital moneys. Its powers

are limited. It can only decide to apply for sanction to borrow, and in making application must furnish certain information or statistics.

### STATISTICS

The application must be accompanied by figures showing (*inter alia*)—

- (a) The population of the district ;
- (b) The rateable and assessable value of the district ;
- (c) The existing debt, both as regards the special purpose and as regards the total for all purposes ;
- (d) The amount of the proposed loan ;
- (e) The purpose for which required ;
- (f) The suggested period within which the money would be redeemed ; and (where the purpose involves the carrying out of works)
- (g) Copies of plans, sections, and detailed estimates

### INQUIRIES

Before granting the sanction the Government requires to be satisfied of the necessity or advisability of the scheme and will usually hold a local inquiry to ascertain the wishes of the ratepayers. In the case of applications under the Public Health Act, 1875, a public inquiry is generally held by an inspector. A local inquiry *must* be held where the indebtedness, including the proposed loan, will exceed one year's assessable value. Where the application is under the Municipal Corporations Act, 1882, a notice of the intended application must be affixed outside the Town Hall for one month prior to the application.

A specimen statistical statement such as would be submitted to an inspector holding an inquiry is shown on pages 10 and 11.



## BOROUGH OF .....

Area (in Acres).....

Population (1) (last census).....

(2) Registrar General's Estimate (latest).....

(3) Medical Officer of Health's Estimate (latest).....

Rateable Value (present).....

Assessable Value (present).....

*Penny Rate.* Sanitary Purposes. Amount realized by a rate of one penny in the pound on the above assessable value for Sanitary Purposes.....

<i>Statement of Rates levied—</i>	Year 19..	Year 19..	Year 19.
Borough Rate . . . . .			
General District Rate . . . . .			
Other Rates (if any) . . . . .			
Differential rates (if any) . . . . .			

## BOROUGH OF

STATEMENT AS TO LOAN DEBT AND UNUSED BORROWING POWERS,  
31st March, 1924.

DEPARTMENT	Outstanding Loans contracted under the Sanitary Acts or the Public Health Act, 1875, at 31st March, 1924.	Unused Borrowing Powers under sanctions granted under the Sanitary Acts or the Public Health Act, 1875, at 31st March, 1924.
	£    s    d.	£    s    d.
Baths and Wash-houses . . . . .		
Cleansing (or Scavenging) . . . . .		
Improvements . . . . .		
Libraries . . . . .		
Parks and Recreation Grounds . . . . .		
Burial Board . . . . .		
Highways and Sewers . . . . .		
Paving . . . . .		
Sewerage and Sewage Disposal . . . . .		
Public Sanitary Conveniences (under 1875 Act) . . . . .		
Housing (under 1875 Act) . . . . .		
Public Halls (under 1875 Act) . . . . .		
Hospitals . . . . .		
Police Stations . . . . .		
Fire Stations . . . . .		
	£	£

Outstanding Loans contracted for Sanitary purposes under Local Acts— at 31st March, 1924.	Unused Borrowing Powers for Sanitary purposes under Local Acts— at 31st March, 1924.
£            s.            d.	£            s.            d.
Balances of Outstanding Loans for all purposes (including above amounts)— at 31st March, 1924.	Unused Borrowing Powers for all purposes— at 31st March, 1924.
£            s.            d.	£            s.            d.

MARGIN OF BORROWING POWERS UNDER THE  
PUBLIC HEALTH ACT, 1875.

	£    s.    d.
The Assessable Value (1924) for Sanitary Purposes amounts to £ . . . . .	
The Assessable Value for two years would therefore amount to . . . . .	
<i>Deduct</i> the outstanding loans to which the limitation of Section 234 of the Public Health Act, 1875, applies (31st March, 1924) <sup>1</sup> . . . . .	
Margin of Borrowing Powers under the Public Health Act, 1875.	£

<sup>1</sup> This matter is dealt with in detail in next chapter.

## CHAPTER IV

### RESTRICTIONS ON BORROWING

THE object in requiring the statistics referred to in the previous chapter is to enable the inspector or the State department to ascertain whether or not certain limitations which attach to the borrowing powers of all local authorities must affect the decision.

#### EXTENT OF BORROWING POWERS

The extent of local authorities' borrowing powers under the general law is limited as follows—

**County Councils.** One-tenth the assessable value of the County unless extended by provisional order (Local Government Act, 1888, Section 69).

**Borough Councils.**

(a) *For Sanitary purposes.* Twice the assessable value of the borough on the date of the application (Public Health Act, 1875, Section 234).

(b) *For Municipal purposes.* No limit under the Municipal Corporations Act, 1882, but expenditure under the Small Dwellings Acts, 1899–1923, is limited.

**Urban District Councils.** Twice the assessable value of the district on the date of the application (Public Health Act, 1875, Section 234).

**Rural District Councils.** Twice the assessable value of the district on the date of the application (Public Health Act, 1875, Section 234).

**Parish Councils.** Half the assessable value of the parish (Local Government Act, 1894, Section 12), and certain indirect limitations to revenue expenditure which necessarily affect the extent of borrowing.

**Metropolitan Borough Councils.** No limit except

under the following Acts for which purposes Sections 233 and 234 of the Public Health Act, 1875 apply—

- (a) Museums and Gymnasiums Act, 1891 ;
- (b) Public Libraries Act, 1892.

**Boards of Guardians.** One quarter of the total rateable value of the parishes in the Union, unless extended by provisional order. (Poor Law Act, 1889, Section 2.)

**Overseers of the Poor.** No limitation.

### MEANING OF "ASSESSABLE VALUE "

The Ministry of Health's definition of the term "assessable value for two years," is "twice the assessable value of the district for one year," i.e. rateable value (less three-fourths the rateable value of certain properties, e.g. lands, etc.) multiplied by two. The compounding properties are for this purpose taken at their full rateable value.

### EXCEPTIONS TO LIMITATIONS

In noting the restrictions set out above, it should be observed that such limitations apply only to the purposes authorized by the Acts specified, and by later Acts to similar purposes. The restrictions do not apply to other purposes such as trading undertakings.

Debt under the following Acts even though for purposes similar to those with restrictions, may be excluded from the total debt for the purpose of ascertaining the margin of borrowing powers—

- Allotments Act, 1922 ;
- Blind Persons Act, 1920 ;
- Education Act, 1921 ;
- Electric Lighting Act, 1909 ;
- Electricity Supply Act, 1922 ;

Housing Acts ;

Local Authorities (Financial Provisions) Act, 1921 ;

Mental Deficiency Act, 1913 ;

Public Health Act, 1875, on credit of sewerage land and property ;

Small Dwellings Acquisition Acts, 1899-1923 ;

Local Authorities (Financial Provisions) Act, 1921, in respect of money borrowed before 1st April, 1924, if certified by the Ministry of Health to have been borrowed for the purpose of work undertaken to provide work for unemployed persons ; and money borrowed to provide temporarily for current expenses.

Debt under the Small Holdings and Allotments Act, 1908, may be excluded in the case of County Councils only.

### EFFECT OF SINKING FUNDS ON BORROWING POWERS

As soon as a portion of debt is redeemed the total debt outstanding is necessarily reduced and the margin of available powers is simultaneously increased. Sinking funds in hand for the discharge of debt may not, however, be treated as equivalent to a reduction in debt except in the case of County Councils.

The London County Council, by arrangement sanctioned by the Treasury, in addition to possessing the privilege of deducting the amount of sinking funds in hand from its outstanding debt for the purpose of fixing its statutory limit of borrowing powers, is allowed also to deduct the value of its surplus lands. A valuation of such assets is made annually and submitted to the Treasury for approval.

## CHAPTER V

### METHODS OF RAISING LOANS

As soon as the necessary sanction is obtained, the chief financial officer may proceed to raise the money, though he will, of course, have due regard to the date when payments thereout will be made, as it is no use borrowing simply to swell the bank balance and pay a higher rate of interest to the lenders than is being received from the bank. At the same time the opposite standpoint must be watched, and in this connection it often happens that payments are made in anticipation of loans.

As the loans are raised they may be allocated to a specific sanction against which borrowed, or be credited to a consolidated loans fund and apportioned to the various sanctions as required. The former method is adopted more particularly by the smaller authorities which try to borrow their requirements under each sanction in one sum and for the whole period of the sanction. The latter system is taken advantage of by many of the larger corporations in consequence of the many benefits arising therefrom. Consolidated loans funds are dealt with in detail in Chapter XV.

### METHODS OF BORROWING

Capital is obtained by the raising of money by the chief financial officer by one or more of the following methods—

- (1) The issue of mortgages.
- (2) Loans on deposit (usually small sums).
- (3) Annuities.
- (4) The issue of stock.

- (5) Debentures, debenture stock or annuity certificates, under the Local Loans Acts, 1875 and 1885.
- (6) Bills of exchange.
- (7) Bank overdraft.
- (8) Utilization of sinking funds.
- (9) Issue of Housing bonds.
- (10) Loans from the Public Works Loan Commissioners.
- (11) A proportion of the proceeds of the sale of National Savings Certificates.

The periods fixed by the statutes mentioned in Chapter II are the maximum periods for which the Government may authorize a local authority to borrow for permanent works. In some cases the sanction is given for a shorter period.

### 1. MORTGAGES

A mortgage is a transfer of property or income as security for money lent. It must be sealed with the common seal of the Council, must state the consideration, the place and date of repayment and be properly stamped. Mortgages are generally raised in response to advertisements, though when the amounts are small and few, the borrowing may be effected from a banker, insurance company or other body, or the Public Works Loan Commissioners, in one sum and thus the work connected with registration, etc., is much reduced. A disadvantage of mortgages is that they generally have as security the particular fund or rate in connection with which the expenditure is to be incurred. To avoid this and so to adopt a form of common mortgage, it is necessary to obtain a local Act authorizing mortgages to be secured on all rates and revenues.

This method of borrowing finds a good and a continuous market and is especially suitable in the case of local authorities whose loan requirements are never ending.

Mortgages may be issued for

- (a) Short periods ;
- (b) A minimum period and then subject to repayment on stipulated notice ; or
- (c) The whole period of the sanction, redeemable
  - (i) in total at the end of the period ;
  - (ii) by equal yearly or other periodical instalments ; or
  - (iii) by regular, though not equal, instalments of principal, which together with the interest on the principal sum outstanding at the commencement of the period makes up an equal total sum which is continuous throughout the period of the loan. This is called the annuity method.

## 2. LOANS ON DEPOSIT

These are generally small sums for a specified term, or repayable at short notice. Sometimes a deposit receipt only is given. This contains a statement to the effect that a mortgage deed will be issued in respect of the deposit on application by the depositor and payment by him of the necessary stamp duty. If this note is included an " agreement " stamp appears to be necessary. When repaid the deposit receipt or mortgage deed must be surrendered and cancelled. It then acts as a voucher for the payment.

## 3. ANNUITIES

Borrowing by annuities is really a borrowing by mortgage in the many cases where deeds are issued



The term "annuity" applies more particularly to the method of redemption than to borrowing and covers terminable annuities. It also includes borrowing by perpetual annuities not now granted, though some are in existence and are in effect irredeemable loans. Life annuities similar to those of the Post Office are to some extent a gamble, being a gift of a certain amount in exchange for an annuity for life on the termination of which the capital and all liability is deemed to be liquidated.

#### 4. STOCK

Any urban authority having power to borrow money, may with the consent of the Ministry of Health exercise such power by the creation of redeemable stock. This may be done under powers obtained in one of three ways—

- (a) From the Ministry of Health under the provisions of the Local Loans Act, 1875.
- (b) From the Ministry of Health under the provisions of the Local Government Act, 1888 (County Councils), or the Public Health Acts (Amendment) Act, 1890 (Urban Authorities).
- (c) By promotion of a local Act.

The principal method is that under the Public Health Acts (Amendment) Act, 1890, Section 52, which reads—

Where any authority whether municipal corporation, local board, or improvement commissioners, which is an urban authority, have for the time being either in their capacity as urban authority or in any other capacity, any power to borrow money they may, with the consent of the Local Government Board, exercise such power by the creation of stock to be created, issued, transferred, dealt with and redeemed in such manner and in accordance with such regulations as the Local Government Board from time to time prescribe.

Sections 69 and 70 of the Local Government Act, 1888, give somewhat similar facilities in respect of county councils.

Metropolitan borough councils have no power to issue stock.

Pursuant to these enactments the Local Government Board has made, and the Crown has confirmed, certain orders which have the effect of statutes. They are cited as—

(1) The Stock Regulations 1891, 1897, 1901 and 1921, and

(2) The County Stock Regulations 1891, 1897, 1901 and 1921.

These orders relate to urban authorities and county councils respectively. Both sets are almost identical, but the latter differ from the former as follows—

(1) No consent order is required ;

(2) Forty years is prescribed instead of sixty ;

(3) The definition of rate, that it includes water rents, gas rents, and charges for supply of water or gas or hire of meters or fittings connected with the same, found in the Stock Regulations, is absent from the County Stock Regulations.

The preliminary to borrowing by an urban authority, but not by a county council, is the " Consent Order." (This is quite in addition to the ordinary sanction to borrow). The contents of the Consent Order are—

(1) Recitals as to (a) the Stock Regulations, 1891-1921 ; (b) issue of the *first Consent Order* in respect of the class of stock now proposed to be issued, and that the stock could be redeemed after..... years (usually 20) and must be redeemed entirely after..... years (not exceeding 60) from the first issue of the class of stock in question ; (c) the name by which the stock is to be known ; (d) the issue of subsequent orders up to the last one ; (e) the application of the local authority for the present Consent Order.

(2) Orders of the Ministry—(a) consenting to the exercise of its statutory borrowing powers by creation and issue of stock, including expenses of issue properly chargeable to capital, and that it shall bear the same name and be on the same terms and conditions as the previous issue referred to under (1) ; and (b) prescribing the determination of the contributions from revenue account for redemption of the stock and the rate of interest on the contributions.

(3) Schedule giving date, purpose, amount, and period of each sanction to be included in the issue.

(4) Seal of the Ministry of Health with date and signatures of the Minister and Secretary.

The following points should be carefully considered as they are of vital importance—

(1) The local authority, after obtaining the Consent Order, may by resolution exercise the power of creating and issuing stock on such conditions as they consider desirable. It may be issued at a discount (though not less than 95 per cent except where the Consent Order specifically empowers), at par, or at a premium.

(2) A local authority may create *more than one class of stock* but all issues of one class must be subject to the same terms and conditions, except as regards price of issue.

(3) Expenses of issue and discount may be capitalized and borrowed. Suppose a local authority wishes to exercise a sanction of £100,000 by the issue of stock at 96 per cent, the estimated expenses of issue being £3,000. The amount necessary (and permissible) to be raised would be—

$$\frac{100 \times 103,000}{96} = \text{£}107,292 \text{ Stock.}$$

(4) The stock must not exist for more than 60 years, but it may exist for the full period (if the Consent Order allows) irrespective of the periods of the sanctions. The stock should be considered entirely separate from the sanction, and although *provision must be made to pay off the stock within the time limited by the sanction there is no necessity to redeem it within that time.*

(5) Although the stock and interest thereon are charged indifferently on all revenues and funds of the local authority, the contributions to the Sinking (or Redemption) Funds and Dividends Funds must be allocated to and properly drawn from the appropriate revenues.

(6) Separate accounts must be kept in respect of each borrowing power exercised by the issue of stock.

(7) Sinking (or Redemption) Funds must be established in respect of each borrowing power, but the practical effect is that of one consolidated fund for each class of stock.

(8) Though expenses of issue and discount may be capitalized and borrowed for the whole period of the stock, the redemption fund provision must be based on the accumulation of a fund sufficient to redeem the stock representing such expenses of issue and discount by the time the stock is first redeemable at par at the option of the local authority (Stock Regulations, 1921).

(9) Only redeemable stock may be created.

(10) Stock is redeemable at *par* at the *option* of the authority after the expiration of a certain period named in the Consent Order.

(11) Provision is made for conversion of other securities into stock.

(12) A dividends fund must be established.

(13) A registrar must be appointed and regulations made as to transfers, dividends, stock certificates with coupons to bearers, returns, trusts, etc.

(14) Stock is personal property.

(15) Attached to the regulations are two schedules containing (a) forms relating to creation, issue, transfer, etc. of stock, and (b) form of abstract of stock redemption fund account.

(16) If part of the proceeds of an issue is temporarily invested until needed a ledger account for the investment is required and the Allocation Account is correspondingly less. The interest on such investment is utilized in paying dividends. Any profit on realization of the investment should be carried to Redemption Fund, and if appreciable in amount the future annual contributions may be reduced.

**Provision for Redemption Fund Contribution in respect of Discount and Expenses of Issue.** In view of the revision of the treatment of the annual contribution in respect of discount and expenses of issue enacted in the Stock Regulations, 1921, the opinion of Mr. Carson Roberts, in his book on Local Authorities' Accounts, is interesting and worthy of adoption.

He argues that discount does not become a liability until the last year of the life of the stock, and that at that time the allocation may differ materially from the original distribution and that there is a possibility that by the purchase of stock at a discount for cancellation during the existence of the stock more discount may have been received than the liability to be met. He suggests that instead of allocating the discount and expenses over the various funds a single account should be set up as part of the loans fund and a sinking fund accumulated which will be sufficient to redeem the discount at the end of the life of the stock in case it has not been redeemed earlier by discount obtained by purchase. The yearly contribution to this sinking fund should be apportioned amongst the various funds, according to the proportions in which they are at the time employing the stock proceeds, until such time as no further contributions are needed

by reason of the profits on stock purchased being enough to pay off the discount and expenses liability.

**Operations in Connection with an Issue of Stock.** The operations relating to the creation and issue of stock under a local Act are usually set out in the Act. Procedure under the general statutes may be summarized as follows—

(1) The local authority adopts Part 5 of the Public Health Acts (Amendment) Act, 1890.

(2) It must be in possession of statutory borrowing powers.

(3) The Consent Order is obtained (except in the case of county councils creating stock under provisions of the Local Government Act, 1888) to exercise borrowing powers by the issue of stock. The sanctions available are set out in the schedule to the Consent Order.

(4) The Consent Order will state, *inter alia*, the price of issue; the period within which the stock *may* be redeemed at the option of the local authority; the period within which it *must* be redeemed by the local authority; the borrowing powers covered; the annual provision for redemption of the stock; the dividends to be paid on the stock.

(5) If desired, loans may be consolidated and compensation paid to holders of existing securities for premature redemption. The period for redemption may be equated. Compensation payable may be capitalized.

(6) When the opportune time arrives the Council will pass a resolution creating £.....redeemable stock (stating the rate of dividend it is to bear, the conditions of issue, and of transfers) in respect of the following borrowing powers.....(here follows a list of the sanctions included in the Consent Order).

(7) Transfers may be by deed; by inscription in the books (the entry in the book not the certificate here constitutes the title); or by delivery, in the case of stock certificates payable to bearers.

(8) Arrangements may be made with the Inland Revenue Commissioners for composition of stamp duty on transfers, otherwise transfers may be made only by deed duly stamped.

(9) The mode of issue is decided upon, i.e. through bank, brokers, or through the local authority's own financial officer.

(10) Advertisements are inserted in the principal newspapers and a prospectus is issued giving particulars as to the assets and debt of the local authority, its trade and prospects and full details of the terms and conditions of the stock. The principal contents are—

- (a) Authority for issue—Consent Order, etc.;
- (b) Price of issue—if a fixed price is adopted;
- (c) Name of the issuing party, i.e. bank, financial house, borough treasurer, etc.;
- (d) Amount payable on application, allotment, etc.; dates

- when further instalments are to be paid ; discount on instalments paid in advance ;
- (e) Periods after which the authority *may* and *must* extinguish the stock ;
  - (f) Purposes for which the money will be applied ;
  - (g) Securities given ;
  - (h) Particulars of loan debt ;
  - (i) Particulars of rateable value, population, produce of Id. rate, etc. ;
  - (j) Rate of dividend on stock and amount payable for first broken period ;
  - (k) Method of transfer ;
  - (l) Application will be made for quotation on the Stock Exchange.
- (11) Tenders or applications are received and the senders of those accepted are furnished with letters of allotment.
- (12) Certificates are issued.
- (13) Registrar is appointed.
- (14) The account is made up for the Inland Revenue Commissioners and the stamp duty on the loan capital is paid.
- (15) A knowledge of the Money Market is highly desirable, and a perusal of a volume on the subject is strongly recommended. There are many good books, e.g. Bagehot's " Lombard Street " ; Sykes' " Banking and Currency " ; Duguid's " Stock Exchange " ; Jevons' " Money " ; Duguid's " How to Read the Money Article " ; Withers' " The Meaning of Money " and " Money Changing " ; " Money, Stock and Share Markets," by Emil Davies ; Spalding's " The London Money Market " ; Easton's " Money, Exchange, and Banking."

The accounting procedure relative to the issue of stock is given in detail in Chapter XXVI, but the following journal entries may not be out of place here. Taking the above figures as an example—

Cash (Consolidated Loans Fund)	Dr.	£103,000	£
Discount	"	4,292	
To Stockholders			107,292
Expenses of Issue	Dr.	3,000	
To Cash (Consol. Loans Fund)			3,000
Allocation of stock to various funds, viz :			
Borough Fund, District Fund, Gas, Works, etc.	Dr.	107,292	
To Cash (Consol. Loans Fund)			100,000
To Discount			4,292
To Expenses of Issue			3,000

Discount and Expenses of Issue will be allocated proportionately over the sanctions.

The operations relating to Registration, Transfer and Cancellation of Stock are dealt with in Chapter XVII.

**Modes of Issue of Stock.** There are three modes by which stock may be issued.

(1) *Fixed Price Method.* This method is the one generally adopted. It attracts the general public. They know exactly how they stand in reference to a proposed investment. Few persons other than financial experts have much idea of the kind of tender that is likely to be accepted where the issue of stock is on a tender basis.

(2) *Tender.* Stock is publicly tendered for; the price is settled by competition. (See remarks to Fixed Price Method above.)

(3) *Continuous Issue.* Applications may be made at any time for an amount of stock at a fixed price, varied from time to time according to the state of the money market.

#### ADVANTAGES OF THE MODES OF ISSUE COMPARED

(1) *The Advantages of the Fixed Price Method are—*

(a) Money is drawn from many of the smaller investors who have not the financial experience required for making tenders for stock. Consequently more money is attracted;

(b) The stock is more popular;

(c) When much of the money comes from local ratepayers they take a keener interest in local affairs;

(d) Better results are obtained than under the Tender System;

(e) In the event of a whole issue not being applied for by the public, the list of applications may remain open without difficulty, and the remaining stock allotted at the fixed price, as applications are received.

Though possibly the local authority may not get

quite so good a price in respect of its first issue, in consequence of the figure being fixed rather low to avoid risk of failure, the public is likely to give a better price for subsequent issues, especially if the first one soon reaches a premium price.

(2) *Advantages of the Tender Method—*

(a) The stock is offered to the public and the price is settled by competition ;

(b) A minimum price only has to be fixed, though this requires much care and judgment ;

(c) No difficulty in allotment is experienced as the stock is issued to the highest bidders ;

(d) It is less expensive as there is less cost in advertising and allotment.

(3) *Advantages of the Continuous Issue Method—*

(a) Applications may be made at any time for an amount of stock at a fixed price ;

(b) There is a continuous influx of money ;

(c) There is no disadvantage and loss (as in the other methods) in respect of more money being received than is immediately required ;

(d) The price of issue may be varied from time to time according to the state of the money market and the local authority's loan requirements ;

(e) The inward flow of money may be regulated by altering the price of issue.

**Persons Effecting an Issue of Stock.** Some local authorities arrange with a bank or financial house to issue the stock. Others issue it themselves through the chief financial officer assisted by a local broker. Where the issue is through a bank, etc., there is the additional cost of the bank's charge, but this must be weighed against the greater risk of an unsuccessful issue without such assistance, and possibly a lower price of issue.



There is undoubtedly a certain prestige attaching to stocks issued through the Bank of England and, indeed, the other great commercial banking houses. This is reflected in the price of the stock.

**Management of an Issue of Stock.** Sometimes it is arranged with a bank to issue the stock and to manage it afterwards. In other cases the bank issues and the local authority manages it; where the local authority effects the issue of stock it almost invariably manages it as well.

The advantages accruing when the local authority manages the stock are as follows—

(1) Saving in expense. The cost of management by the borough treasurer is less than the charge payable to a bank;

(2) Comparatively easy and economical when the stock is allotted and the certificates issued and registered;

(3) The loans fund and redemption fund accounts must be kept locally;

(4) The prescribed accounts, the preparation of returns, etc., and the application of redemption funds are carried out locally;

(5) The application of redemption funds is more economical when carried out locally;

(6) The chief financial officer is in touch with the stock holders.

**Management Expenses of Stock.** These include—

(1) Registrar's salary;

(2) Printing and stamping of dividend warrants;

(3) Composition for stamp duty on transfers (if compounded for);

(4) Income tax on interest from sinking fund, etc., investments;

(5) Establishment of compensation fund under Forged Transfers Acts (if desired).

These expenses are apportioned annually during the life of the stock to the revenues concerned, in proportion to the amount of stock outstanding on each purpose.

These items are purely revenue charges and outside the costs of issuing the stock, which expenses, subject to a maximum usually fixed by the Ministry of Health, may be capitalized and borrowed. (*See next paragraph.*)

**Expenses of Issue.** Expenses or costs of issuing stock consist of the following items—

- (1) Discount on issue ;
- (2) Discount on payment of instalments in advance ;
- (3) Charges for floating the stock where done by a bank or financial house ;
- (4) Printing, stationery, advertising, etc. ;
- (5) Stamp duty on the nominal loan capital ;
- (6) Proportion of first dividend paid, where a full period is paid instead of the exact amount due on the basis of the actual periods from the dates of the instalments ;
- (7) Brokerage to banks, brokers, solicitors, agents, etc., for placing stock ;
- (8) Underwriting commission paid to persons who undertake to take up all stock not subscribed for by the public. It is in the nature of an insurance of the success of the issue and ranges from 1 to 1½ per cent.

**Premiums on Stock.** These should be credited to a "Premium on Stock" account, and are generally applied in reduction of expenses of issue or paid into sinking fund enabling a reduced annual contribution to be effected.

**Inscribed Stock.** Inscribed Stock is that in respect

of which the entry in the books (and not the stock certificate) forms the title to the holding and where transfers are effected by entry in the books which are kept where the stock is managed, i.e. at a bank or at the office of the local authority.

*The Advantages of Inscribed Stock* are: Security, and expedition in transfer (where personal attendance of the stockholder at the office is easy).

*The Disadvantages of Inscribed Stock* are: The necessity for the personal attendance of the stockholder at the office, the reluctance to give power of attorney, and the expense of obtaining such power.

**Differences between Stock and Mortgages.** The principal differences are shown as follows—

STOCK.	MORTGAGES.
(1) Market value fluctuates	No fluctuation in value
(2) Transfer easy, by sale in open market	Transfer difficult; no free market
(3) Divisible into fractional parts	Not divisible
(4) Evidence of title to holding—stock certificate or inscription in the books	Evidence of title—mortgage deed
(5) Date of redemption fixed, or optional, after a certain period, at the <i>discretion</i> of the local authority	Date of redemption may be a fixed one or subject to notice on <i>either</i> side
(6) Charged indifferently on all revenues of the local authority	Sometimes charged on a particular fund or rate

**Irredeemable Stock.** The creation of irredeemable stock is not now sanctioned. Nevertheless, there is some in existence which was issued many years ago under the provisions of private Acts, some of which require the accumulation of a sinking fund sufficient to redeem the stock within a definite period, though no compulsion to do so exists. In these cases the benefits (if any) of irredeemable stock accrue as well as those of redeemable stock though the consent of the lender may be required, and in any case he has the option of refusing to sell in the open market.

There are certain dangers inseparable from the issue of irredeemable stock, and the sinking fund difficulties are considerable.

What made irredeemable stocks attractive at one time was probably the higher price of issue then obtainable than for a redeemable stock.

**Redeemable Stock.** There are several kinds of redeemable stock in existence, varying according to the manner or circumstances in which redemption may or must take place.

Some such stocks are definitely and compulsorily redeemable on a fixed date without any option on either side. Others have a similar compulsory redemption clause requiring the discharge to be not later than such date but give an option to the authority to redeem on notice at an earlier date. This is the general method now sanctioned, and that most favoured. Some few other stocks are redeemable only at the option of the local authority on notice after a given date, with no *power* ever to *demand* redemption on the part of the stockholder.

**Considerations as to Price of Issue of Stock.** A local authority will be concerned chiefly in raising money as cheaply as possible.

The price at which stock may be issued is generally that at which the yield in interest to an investor, allowing for redemption, will approximate to that obtainable elsewhere at the same time by similar stocks of like security. The law of supply and demand operates in regard to the price of stocks, as also do the terms of redemption, and the particular preferences of the investing public at the time of issue.

After a stock has been issued the local authority's interest in the market price of the stock is two-fold. If further issues are contemplated, for the success and

economical aspect of them a high market price of the authority's existing stock is wished for, as the current quotations from time to time represent in a general way the demand price of its credit. On the other hand a fall in the market price of its stock enables a local authority to take advantage of using its redemption fund in the purchase of some of it at a discount for cancellation, and so to make a profit.

The conditions of redemption have an influence on the market value of a stock. In the case of an irredeemable stock the only limit to the rise in price is that imposed by the prevailing rate of interest. Where a stock is not compulsorily redeemable at a definite date, but the local authority has an option to redeem on notice after a certain date, the option will before the date on which it becomes exercisable have a retarding effect on the market price over par. After the date of the option it cannot rise much above par as no investor would buy at a premium of an appreciable figure with the risk of having it redeemed at par compulsorily within a very short time afterwards. The option does not, of course, prevent a fall below par.

In the case of a stock compulsorily redeemable at a fixed date without option, the redemption price acts as a magnet, retarding both rise and fall and increasing in its effect as the date of redemption approaches.

Where a stock is compulsorily redeemable at a fixed date, with an option to the local authority to redeem earlier, if the price has risen above par it will tend to fall to par as the optional redemption date approaches. The rise or fall in price when below par will not be much affected by the option.

An investor is apt to place his money by preference in a stock definitely redeemable on a certain date

where the price at the time of his investment is below par as there is absolute certainty of redemption at par on the date specified. The preference arises not so much in the desire to have a redeemable stock, but to the security which such stocks, when bought below par, afford against ultimate loss of capital and possibly the greater yield of the stock when the difference between the present (discount) price and the redemption (par) price is taken into account.

This last point may be illustrated thus: A 3 per cent stock redeemable in, say 1950, may now be quoted at 64. The rate of interest is approximately £4 13s. 6d. per cent. In 1950, however, £100 must be paid to redeem the stock. This means that between 1924 and 1950 there will be a capital increment of £36 in 26 years making the annual yield to the investor of to-day an average of £6 1s. 2d. per cent.

#### 5. DEBENTURES, DEBENTURE STOCK AND ANNUITY CERTIFICATES UNDER THE LOCAL LOANS ACTS

The Local Loans Acts, 1875 and 1885, enable local authorities to raise loans by three methods—

(a) **Debentures**, which in their nature are almost identical with ordinary mortgages, and have the same effect as a deed, charging the assets or rates for the authority with the payment of principal and interest ;

(b) **Debenture Stock**, which, subject to the restrictions stated below, is almost identical with the creation of stock under the stock regulations ; and

(c) **Annuity Certificates**, also of the mortgage class, the redemption of which takes the form of a fixed annual payment consisting of both principal and interest

These statutes are made very little use of, chiefly owing to the peculiarities and restrictions of the Acts, and because the authorities affected have power to raise loans in other and more economical ways. The Acts do not confer any borrowing power, but provide the methods of applying power already possessed under other Acts.

The disadvantages under these methods of borrowing are—

- (a) Loans rank according to priority of issue.
- (b) Debenture Stock cannot be issued for a larger nominal amount than the borrowing power.
- (c) Debenture Stock may be issued only by authorities having power under other Acts.
- (d) No power is given to re-borrow for discharge of loans.
- (e) The sinking fund provisions are defective.

## 6. BILLS OF EXCHANGE

These are resorted to as a means of raising money in special circumstances. As a general rule the method is adopted when money is needed immediately, and in large amounts, and when the conditions of the money market are not favourable to the issue of stock or when loans on mortgage could not be obtained quickly enough without offering an abnormally high rate of interest. Power to borrow by bills is obtained by local Act only. The procedure for issuing is usually by advertisement asking for tenders for bills of certain fixed nominal amounts generally not less than £1,000. The tenderers are asked to state the price per cent they are willing to give for bills repayable in full at the end of the period, generally six months. Bills are allotted to the highest bidders. The interest payable by the corporation is represented by the

difference between the actual amount received and the nominal amount repayable.

This method of borrowing is available only to very large authorities. The currency of these bills is from three to twelve months. The object is to have raised, by the time the bills mature, sufficient money by means of stock or mortgages to meet them. If this has not been accomplished it is customary to renew the bills or to issue new ones. They are liable to stamp duty at the same *ad valorem* rate as commercial bills of exchange.

#### FORM OF BILL OF EXCHANGE.

.....Corporation Bill.

Pursuant to Local Act of.....

Due. ....

£1,000

This .. .. . Corporation Bill entitles .. .. .  
or order to the payment of one thousand pounds at .. .. .  
Bank, out of the funds of the Corporation of .. .. .  
on the .. .. . day, .. .. . 19.....

Sealed by order of the Council of the County Borough of .. .. .

Seal of Council

.....  
*Town Clerk.*

## 7. BANK OVERDRAFT

If the overdraft is secured by a mortgage, this form of borrowing is like an ordinary loan on mortgage. Where no mortgage deed is executed, borrowing by this means is only of a temporary nature pending the first opportunity for borrowing by mortgage or stock the proceeds of which will be paid into the authority's account on which the overdraft has been incurred, automatically paying off the overdraft borrowing.

If sanction to borrow has been received, a temporary bank overdraft pending an issue of stock or mortgages is legal.



An overdraft on revenue account is now legal if incurred to provide working capital sanctioned to be borrowed by the Ministry of Health under provisions of the Local Authorities (Financial Provisions) Act, 1921. (See also Chapter XXI.)

One objection to borrowing by means of overdraft arises because there is no legal obligation to provide for redemption until the "permanent" loan is actually raised. In view of this it is perhaps advisable to set aside provision for redemption from the date of expenditure instead of from the date of the real loan.

Interest paid on overdraft is generally considered to be an illegal payment. But if the aggregate banking account of the local authority is in credit no overdraft charges should be paid and the equivalent to interest thereon is "paid" by the authority by receiving less interest on its bank balances. This obviates any uneasiness as to the legality of interest on overdrafts and enables money to be borrowed at the exceedingly low rate of interest which the bank allows on credit balances.

## 8. THE UTILIZATION OF SINKING FUNDS FOR NEW CAPITAL PURPOSES

Power to use redemption funds in lieu of borrowing is conferred on local authorities who have issued stock under provisions of the Stock Regulations, by the Regulations of 1901. Incidentally, this procedure obviates the expense and attendant risks of investing the redemption funds in outside securities.

The privilege is present only where the authority has a statutory borrowing power authorizing the new capital purpose, and where such borrowing power may be exercised by the creation and issue of stock,

i.e. a Consent Order of the Ministry of Health is necessary except in the case of a county council.

There is no general statutory power to apply as new capital sinking funds other than those in respect of stock under the Stock Regulations, though many local authorities have obtained power to do so under local Acts.

Briefly stated, the effect is to issue new stock or loans at a comparatively low rate of interest, at par or other value, as fixed by the Ministry of Health, without any expenses of issue and minus the labour attending such an issue. One method of accounting is to deduct from the debt on which the sinking fund is being accumulated, portions of the stock at par, equal to the amount of the fund so applied, and a similar amount is carried to a new capital purpose. In effect the transactions are—

(a) As regards the account from which the stock and the sinking fund are transferred, the effect is the same as if the stock were redeemed and cancelled.

(b) As regards the new borrowing, the effect is as though new stock had been issued without any expenses of issue.

Other methods sometimes adopted are—

(1) To transfer the required sum from the sinking fund, and an amount of stock which that sum would purchase at the current market price, from the old account to the new account.

(2) To treat the sum transferred as a loan from the sinking fund to the new capital account just as though the money were invested.

**Important Points.** Points to be borne in mind when the use of sinking funds as new capital is contemplated are as follows—

(a) Could more interest be obtained on the fund

if invested in outside securities than would have to be paid for new loans? Care must be taken not to overlook the fact that the dividends would be received *less* tax and that this deduction is not always available as a set-off.

(b) Where the fund is required for redemption purposes on a definite date, amounts applied out of the fund must be replaced by that time. Thus borrowings from the fund must not be for a longer period than such date will allow.

(c) The lenders' rights must not be prejudiced. For example, where the mortgage is earmarked to a particular borrowing power; and where the sinking fund is in respect of one particular fund it should not be used for borrowings of a different fund.

(d) The power to utilize sinking funds as new capital should not be used when the time for redemption of the original debt is near, as a forced borrowing on unfavourable terms may then be necessary.

**Objections to the Utilization of Sinking Funds for New Capital Purposes.** The Select Committee on the application of Sinking Funds in Exercise of Borrowing Powers reported in 1909 that the principle of using sinking funds, etc., in this way is financially unobjectionable if properly safeguarded, and that a great advantage and economy thereby result.

The chief objections raised against the principle in evidence before the committee were—

(1) It amounts to a breach of faith; it is understood, and sometimes stated in the prospectus, that the funds will be used in redeeming stock;

(2) This breach of faith, if generally known, would impair the corporation's credit;

(3) If several corporations, having used their sinking funds as new capital, had to borrow money to redeem

their debts about the same time (which might be an inopportune one), it would be a serious matter for the money market and the corporations' credit ;

(4) Owing to the ease with which capital money is available, and to the fact that the ratepayers are not warned that new capital expenditure is about to be incurred, reckless expenditure is encouraged ;

(5) Continual application of the sinking fund in redemption of stock might move up the price of stock and so appreciate the corporation's credit and enable more economical borrowings to be effected.

Incidentally, the sinking fund moneys would not go as far, and loss would be sustained counterbalancing the value of enhanced credit. This point did not appear in the Report.

The committee did not attach very much importance to any of the objections and came to the conclusion that the *general principle* involved in the application of sinking fund moneys in the exercise of borrowing powers is financially unobjectionable.

## 9. HOUSING BONDS

This form of borrowing may be adopted by all local authorities having powers relating to housing purposes. The consent of the Ministry of Health to the issue of housing bonds is necessary. They are usually issued in denominations of £5, £10, £50 and £100 and in multiples of £100, for a period of not less than five years, at par. They are *exempt from stamp duty on issue*, but not on transfer. Transfer must be by deed and may cover the whole or a part.

The security accorded to investors in Housing Bonds while embracing all rates, properties, and revenues of the local authority, including properties erected under

housing schemes, also comprises Government subsidies in respect of housing.

The interest is payable without deduction of tax in the case of bonds not exceeding in the aggregate £100. The recipient must, however, account for the interest in his income tax return.

The statutory authority under which the local authority may apply for permission to issue housing bonds, and which regulates the conditions, terms, etc., of them is the Housing (Additional Powers) Act, 1919, Section 7; the Housing (Local Bonds) Regulations, 1920; and General Housing Memorandum, No. 21.

#### 10. LOANS FROM THE PUBLIC WORKS LOAN COMMISSIONERS

Borrowings from the Public Works Loan Commissioners are in the nature of mortgage loans (dealt with on page 16). Many of the smaller authorities who consider ordinary short term (and other) mortgage loans from the public troublesome, difficult to obtain, or expensive to administer, or because the ordinary investor does not wish to have his money returned in the form of an annuity, often have recourse to the above-named body which was established under the Public Works Loans Acts, 1875, for the purpose of making advances of this nature out of money obtained on national credit.

The amount available for such advances by the Commissioners consists of proceeds of Local Loans 3 per cent Stock, and other funds, together with one-half of the proceeds of the sale of national savings certificates.

Advances are made at rates of interest fixed by the Treasury from time to time so that no loss will be caused to the State, i.e. interest is slightly in excess

of national borrowings, in order to cover the administrative expenses of the department.

In addition to the payment by the local authority of stamp duty at the rate of 2s. 6d. per cent on loans obtained from the Public Works Loan Commissioners certain fees are charged by the Commissioners as follows—

For the 1st	£1,000	a fee of	20s.	per cent
„ „ 2nd	£1,000	„	15s.	„
„ „ 3rd & 4th	£1,000	„	10s.	„
„ „ 5th to 10th	£1,000	„	5s.	„
„ each subsequent	£1,000 up to £100,000	„	2s. 6d.	„
Loans exceeding	£100,000	to be charged as	£100,000.	

Where a loan is advanced by instalments secured by one deed, an additional fee is charged for each advance after the first, of £1 if the advance does not exceed £100, and £2 if the amount of the advance exceeds £100.

A fractional part of £100 is to be regarded as £100 for the purpose of calculating the fees payable.

In addition to the above fees and stamp duty, counsel's fees and other disbursements incurred by the Commissioners in respect of the applications are payable by the borrowers.

In respect of loans not on rates, the fees payable are fixed by the Commissioners, regard being had to each particular case.

There is a slight saving on the part of the local authority by reason of the fact that the Commissioners prepare the mortgage deed, whereas in the case of borrowings from other sources the local authority usually does it.

The Commissioners do not lend to local authorities having a rateable value exceeding £200,000 except in certain cases, such as housing, education and land

settlement purposes, when such limitation may be waived if local supplies fail. As a general rule the larger authorities have no need to apply to the Commissioners by reason of their being able to borrow from the public direct and more economically.

Loans from the Commissioners must be kept in a separate account under the title "Public Works Loan Commissioners," and orders for payment thereout must show clearly that they are being made out of that account and that they are for the purposes for which the loans were made. On this latter point the Ministry of Health require to be satisfied, and consequently require returns giving such particulars and verified by statutory declaration. If the Ministry are of opinion that the money is being wrongly appropriated they may order the sum to be applied as originally intended, or towards redemption of the loan or otherwise as they direct. Unapplied balances may, with the consent of the Commissioners and the sanctioning department, be applied to any purpose to which moneys borrowed on the security of the same rate are properly applicable.

The advantages and disadvantages of loans of this type are dealt with in the next chapter.

## II. PROPORTION OF THE PROCEEDS OF THE SALE OF NATIONAL SAVINGS CERTIFICATES

The Finance Act, 1920 (Section 59), provided that as from the 1st October, 1920, half the gross proceeds of the sale of savings certificates in an authority's area would be available for loans to local authorities for housing purposes irrespective of rateable value.

From the 1st October, 1921, the purposes for which the money could be advanced were extended to

include *any purpose for which the Public Works Loan Commissioners have power to lend money*. The amount for which a local authority may apply is a figure not exceeding one-half of the gross proceeds of certificates sold in that authority's area, and is available irrespective of the rateable value of the authority.



## CHAPTER VI

### ADVANTAGES AND DISADVANTAGES OF THE VARIOUS METHODS OF BORROWING

THE advantages and disadvantages to the local authority of the various methods of borrowing may be summarized as follows—

#### MORTGAGES

##### Advantages.

- (a) Simplicity of procedure and records ;
- (b) Economical in expenses of issue as compared with stock ;
- (c) Freedom from market fluctuations ;
- (d) Redeemable at par (always) ;
- (e) Supply is generally good and continuous ;
- (f) May be redeemed (where terms permit) and replaced at lower rate of interest when market is favourable ;
- (g) Much money is obtained locally, thus giving incentive to good citizenship ;
- (h) The only method available in many cases of small authorities.

##### Disadvantages.

- (a) Amounts of individual loans small ;
- (b) Possible difficulty in raising large sums in a short time ;
- (c) Heavy cost of administration, especially if loans are small and period short, by reason of many accounting records, full stamp duty on every short period loan.
- (d) Heavy stamp duty on transfers (*see* page 131).

**LOANS ON DEPOSIT (USUALLY SMALL SUMS)****Advantages.**

- (a) Available to wider public than larger loans ;
- (b) Possibility of lower rate of interest on small sums ;
- (c) Much money obtainable locally from small investors and incentive to good citizenship ;
- (d) Redemption and replacement at lower interest when market is favourable ;
- (e) Saving of stamp duty and other expenses where no mortgage deed is issued ;
- (f) Available as temporary loans pending issue of more permanent debt, such as stock.

**Disadvantages.**

- (a) Many loans required to raise large sums ;
- (b) Heavy cost of administration, including stamp duty if deeds are demanded ;
- (c) Possibility of compulsory redemption and replacement at higher rate of interest ;
- (d) Possibility of heavy compulsory repayments with inability to replace quickly enough, leading to bank overdraft and consequent charges ;
- (e) Comparative cost of short term mortgages (or loans on deposit) with longer period loans is much higher, as the cost of preparing the mortgage deed (where required), the stamp duty on it, and negotiations for new loans to replace repayments is the same irrespective of the period of the loan.

**ANNUITIES****Advantages.**

- (a) Simplicity of accounting records, and of calculations ;
- (b) Light cost of administration ;

(c) No complicated sinking funds or redemption funds ;

(d) Earlier reduction of debt by reason of part redemption every year ;

(e) Economy in labour ;

(f) No investments to seek ;

(g) No bother in keeping an eye on the money market ;

(h) No loss by depreciation of capital value of investments of redemption funds ;

(i) Where redeemable on the "fixed instalment of principal" method, the total cost to the local authority is least of all methods ;

(j) Greater equity in the distribution of the annual charge where on the "fixed instalment of principal" method as it involves a heavier charge in the earlier years when the greatest benefit is received from new assets and repairs are few. The heavier repairs fall when the annual charge for redemption and interest is lower ;

(k) Where redeemable on the "equal annual instalment of principal and interest combined" method the total annual debt charge is uniform throughout the period ;

(l) Fewer transfers ;

(m) Less opportunity for fraud ;

(n) Large amounts obtainable in one amount from Public Works Loan Commissioners, and other bodies.

(o) Where borrowed from the Commissioners, that body prepares the mortgage deed.

#### **Disadvantages.**

(a) Difficulty of finding lenders who are prepared to receive back their capital in instalments ;

(b) Where borrowed for a long period, inability to

pay off and replace on more favourable terms even if the market is suitable ;

(c) Higher rate of interest generally payable under this method ;

(d) Restriction to one method of redeeming the debt.

(e) Where borrowed from the Public Works Loan Commissioners additional fees and costs are payable (*see page 39*).

(f) Heavy stamp duty on transfers (*see page 131*).

## STOCK

### Advantages.

(a) A large amount of money can be raised at one time, and quickly ;

(b) The rate of interest is comparatively low and uniform over the whole period of the loan ;

(c) Uniform period for redemption of the whole issue (redemption funds must be created within the period of the sanction) ;

(d) Redemption funds may be used for new capital purposes under provisions of the Stock Regulations ;

(e) Redemption funds may be used in purchase of stock for cancellation in the open market and unknown to the seller as to the object of purchase ;

(f) Easily disposed of by sale on the stock market ;

(g) Transferable in fractional parts ;

(h) It is a trustee security in the case of county councils and county borough councils ;

(i) Optional powers to redeem at par after a short period (15-20 years), but no compulsion until the full period of the stock has expired (30-60 years).

(j) Scheme for consolidation and equation of loans may be arranged. Floating debt may be funded (Public Health (Amendment) Act, 1890) ;

- (k) Continual borrowing and re-borrowing avoided and consequent saving in cost of borrowing ;
- (l) Stability of local finance ;
- (m) No risk of sudden calling in as might happen with mortgages ;
- (n) Book-keeping entries fewer than with mortgages ;
- (o) The clear capital gain in respect of discount when purchased below par in open market for cancellation ;
- (p) The security given is the whole rates, revenues and properties of the local authority ;
- (q) Interest and redemption charges constant throughout life of stock.

#### Disadvantages.

- (a) Only available to the larger authorities ; the minimum of the Ministry of Health for a Consent Order is £50,000 ;
- (b) Extra trouble in obtaining power by reason of Consent Order and sanction, both being required, except in case of county councils ;
- (c) Accounting records considerable and the cost increased ;
- (d) Extra trouble, skill, and cost in registration, transfers, etc. ;
- (e) Cost of flotation and underwriting heavy ;
- (f) Cost of composition for stamp duty, etc. ;
- (g) Possible loss of the tax deducted from interest on investments of the redemption fund by reason of such interest not being available as set off in income tax assessment ;
- (h) Possible loss by inability to redeem when a favourable market presents itself.
- (i) Heavy stamp duty on transfers, if not compounded for (*see* page 131).

(j) Redemption (by purchase) only possible, at current market price.

### DEBENTURES, ETC., UNDER THE LOCAL LOANS ACTS, 1875—1885

#### Advantages.

(a) Debentures and annuity certificates may be issued to bearer or to a person named, the local rate being charged with the amount ;

(b) Transferable by delivery if to bearer, otherwise by writing ;

(c) Coupons for interest are generally attached to the instrument, thus minimising the work of preparing interest warrants.

#### Disadvantages.

(a) Loans rank according to priority of issue making future issues unpopular ;

(b) Debenture stock cannot be issued for a larger nominal amount than the amount of the sanction, thus discount and expenses of issue cannot be capitalized and borrowed ;

(c) Debenture stock may only be issued by authorities having power under other Acts ;

(d) No power is given to re-borrow for the discharge of loans ;

(e) The sinking fund provisions are defective.

### BILLS OF EXCHANGE

#### Advantages.

(a) Large amount of money obtained at one time and very quickly ;

(b) Very beneficial and economical as temporary borrowing when the market is hard and not favourable to issue of stock or mortgages ;

(c) Enables works to be proceeded with, or purchase price paid at once, thus avoiding possible loss and inconvenience by delay ;

(d) Simple and certain method of obtaining large sums ;

(e) Economy in rate of interest compared with stock or mortgages ;

(f) Avoidance of possible bank overdraft and consequent charges ;

(g) No expense in paying interest by preparation of warrants, stamp duty, etc. ;

(h) Simplicity of records.

#### **Disadvantages.**

(a) Stamp duty on the bills may be a serious item as the duty is on the amount of the bill which provides money for a short term only ;

(b) Heavy cost of issue in respect of brokers' charges, etc. ;

(c) Possibility of the market hardening still further and amounting to a bad speculation ;

(d) Simple method of deferring the issue of a large, long-period loan ;

(e) Possibility of encouraging works which might otherwise wait.

### **BANK OVERDRAFTS**

#### **Advantages.**

(a) Money is obtained very quickly ;

(b) Simplicity of records ;

(c) Economy in cost of raising the money ;

(d) Economy in amount of interest payable thereon where the aggregate account is in credit.

**Disadvantages.**

(a) The borrowing is only temporary and must be replaced (a long term loan from a bank accompanied by a mortgage deed cannot properly be called an overdraft) ;

(b) No legal obligation to provide for redemption on a temporary loan by bank overdraft ;

(c) If the account of the local authority is not in credit in the aggregate when the overdraft is incurred the overdraft interest may be much heavier than that on ordinary loans ;

(d) Danger of incurring illegal payments in respect of overdraft charges.

(e) Loss of "set off" for income tax purposes, in certain cases, no tax being deducted from the interest payable to the bank.

**UTILIZATION OF SINKING FUNDS FOR  
NEW CAPITAL PURPOSES****Advantages.**

(a) Very considerable saving in charges such as expenses of issue, discount, stamp duty, printing, etc., if properly arranged ;

(b) Considerable annual saving in interest, to the extent of the difference between the interest payable on new loans and that earned by the accumulated funds ;

(c) Saving in cost of making and managing investments ;

(d) Avoidance of the loss arising by the non-allowance, as set off for income tax purposes, of interest on statutorily accumulating sinking funds not connected with the same rate fund ;



(e) There is a ready field for redemption fund investments.

#### Disadvantages.

(a) Only applicable to stock redemption funds except where power is obtained by local Act to apply mortgage sinking funds, though mortgage sinking funds may be pooled (and utilized for new capital purposes) *within rating funds* ;

(b) Considerable skill required in administration, etc. ;

(c) Funds should not be so used if they can be used more economically in other ways ;

(d) Objection to the general use of mortgage sinking funds. Unless completely consolidated, the use is restricted to keeping within rate funds.

(e) Not regarded as a transfer between funds for the purpose of calculating audit stamp duty, where accounts are subject to Government audit.

### HOUSING BONDS

#### Advantages.

(a) Saving by reason of exemption from stamp duty on issue ;

(b) Simplicity in administration ;

(c) May be accepted at full nominal value with accrued interest as purchase money for houses ;

(d) Power to issue housing bonds makes the other mortgages of the authority trustee investments ;

(e) As the loans are of small denomination encouragement is given to small investors, thus encouraging thrift and better citizenship ;

(f) Security embraces all rates, revenues and properties of the authority, including properties under housing schemes, and Government subsidies in respect of housing.

**Disadvantages.**

(a) Consent of the Ministry of Health to issue housing bonds is necessary ;

(b) Treasury approves the rate of interest ;

(c) Period not less than five years may be a disadvantage in times when the market becomes easy ;

(d) Transfers only by deed ;

(e) Heavy stamp duty on transfers, if not compounded for.

**BORROWINGS FROM PUBLIC WORKS LOAN COMMISSIONERS****Advantages.**

(a) Simplicity of records—loans received in large amounts—no sinking funds to create ;

(b) A ready means of obtaining money where local sources fail ;

(c) Rate of interest comparatively low, in the case of small authorities who cannot get good terms in the open market ;

(d) Half the gross proceeds of sale of savings certificates in the authority's area are available for borrowing, through the Commissioners ;

(e) Temporary advances for housing purposes are made subject to certain conditions, under Public Works Loans Act, 1920.

(f) The Commissioners prepare the mortgage deed.

**Disadvantages.**

(a) Limited to small authorities (for exceptions, see Chapter V) ;

(b) Rate of interest higher than need be paid by authorities who can borrow freely in the open market ;

(c) Not available for repayment of loans raised

elsewhere or for sanitary purposes, or for loans under local Acts ;

(*d*) Unexpended balance of a loan only applicable to purpose borrowed on same security as original loan ;

(*e*) Separate accounts must be kept for loans from Commissioners, and returns, supported by statutory declaration, have to be made to the Ministry of Health showing exactly how each loan has been expended.

(*f*) Extra cost in respect of fees and charges, in addition to stamp duty (*see* page 39).

#### PROPORTION OF PROCEEDS OF SALES OF NATIONAL SAVINGS CERTIFICATES

##### Advantages.

(*a*) Half the gross proceeds of the sales of National Savings Certificates in the local authority's area is now available for loans to that authority for any purpose for which the Public Works Loan Commissioners may make advances, irrespective of rateable value.

(*b*) Advantages (*a*), (*b*), (*c*) and (*e*) under " Borrowings from Public Works Loan Commissioners " apply here.

##### Disadvantages.

Disadvantages (*b*) to (*f*) under " Borrowings from Public Works Loan Commissioners " apply here.

## CHAPTER VII

### BORROWING WITHOUT SANCTION

**BORROWING** without the sanction of a State department is allowed in a few cases as under :—

- (1) Where the powers are contained in a local Act ;
- (2) For replacing existing loans which are falling due before the sanction has expired, but only for the unexpired portion of the original sanction ;
- (3) Borrowings on security of sewage works or land, under provisions of Section 235 of the Public Health Act, 1875 ;
- (4) Borrowings for payment of capital sums for the purposes of a financial adjustment under the Local Government Act, 1888, but the period must be sanctioned.
- (5) Borrowings by Stock issued under provisions of Section 70 of the Local Government Act, 1888, by county councils.

## CHAPTER VIII

### SECURITY FOR LOANS

IN many cases local authorities have obtained power by local Act to borrow money on the security of *all* its rates, revenues, funds and properties, and as a result one form of common mortgage deed has been adopted for securing all loans raised on mortgage under any statutory borrowing power.

Where this power has not been obtained loans may be raised only on security of particular undertakings, revenues or other property, in which case the special forms of mortgage prescribed by the Public Health Act, 1875 (Section 236), and the Municipal Corporations Act, 1882 (Section 240), have to be used.

Housing bonds are secured on all rates, revenues and properties of the local authority, including properties erected under housing schemes and Government subsidies in respect of housing.

## CHAPTER IX

### PAYMENT OF INTEREST ON LOANS

THE payment of interest on loans is effected in one of four ways :—

(1) **By Interest Warrants** (cheques) posted periodically as the interest becomes due. Income tax at the appropriate rate is deducted. The top portion of the document is a statement showing how the net interest is arrived at and acts as a certificate as to payment of so much tax by the mortgagee.

(2) **By Coupons** attached to the bond (covering the whole period) when sent to the holder, and being in the form of a cheque on the authority's banker, but not stamped with a revenue stamp. They show the gross interest only. The banker deducts tax at the current rate before paying it. They may be paid into the recipient's bank, but about a week elapses before credit is given, this being the period of collection. Though simple and economical to the local authority, not being negotiable instruments, coupons are a source of annoyance and trouble to the recipient by reason of difficulty of collection.

(3) **By Discount** in the case of bills of exchange. No actual interest is paid. The tenderer for the bill states the price he is prepared to give for £100 so many months hence. The difference between this amount and the nominal amount is his interest on the amount he *pays* for the bill. The same figure (i.e. difference) represents the interest payable by the local authority on the *net amount received* from the purchaser of the bill. No tax is deducted as it is not annual interest within the meaning of the Income Tax Acts.

(4) Under **Annuity Borrowings** interest is included in the periodical instalment, and along with the portion of such instalment that represents principal is debited to the current revenue account.

## CHAPTER X

### DIFFERENCE BETWEEN REDEMPTION AND REPAYMENT OF LOANS

THE two terms "redemption" and "repayment," when used in reference to paying off loans, are generally used indiscriminately. Apparently they are taken to be synonymous in meaning. It is here submitted that a distinction should be made between them.

It can reasonably be assumed that a sanction to borrow for a stated period is a sanction to re-borrow, if necessary, provided that the whole of the loans are discharged finally by a date not later than the end of the period sanctioned, counting from the first borrowing of such loans, and that at no time during such term is the authorized amount of borrowing power exceeded.

The contention is that when a loan is finally paid off it is *redeemed* or *discharged* once for all, and that such a redemption can take place only when it is effected by means of moneys specifically and compulsorily applicable for such purpose; i.e. sinking funds (including proceeds of the sale of properties bought out of the loan and borrowings in excess of requirements), and redemptions out of revenue account direct. Any re-payment out of capital account, suspense account or other account is not intended to be a final discharge of the loan but only a temporary measure pending the substitution of creditors.

It is contended that a sanction to borrow is a permission to incur liability of creditors for the *full* period granted, for the *full* amount, and that re-paying one creditor and replacing the loan by another is of no more importance or concern either to the State or



to the local authority than if the first mortgagee merely changed his name by means of a deed poll.

The fact that a new mortgagee has come on the scene to *replace* the old one does not imply that the loan has been *redeemed* or *discharged* but simply that the liability of the authority to one person has been *replaced by transfer* to another.

Thus one gets a meaning (so far as loans are concerned) of the terms "repayment" and "replacement" of loans totally different from the meaning of "redemption" and "re-borrowing" of loans.

It would appear that what is meant when the legislature makes reference in statutes to "re-borrowing" is, that at the *end of the loan period sanctioned* (and incidentally at the termination of the life of the asset bought out of the loan), if it is desired to repeat the project, i.e. to provide a new asset similar to the old one now worn out, the act would be *re-borrowing* for which a new sanction must be obtained.

The principal statutes governing the matter are the Public Health Act, 1875, the Municipal Corporations Act, 1882, and the Local Government Act, 1888.

**Public Health Act, 1875.** This statute authorizes, with the sanction of the (now) Ministry of Health, borrowing or re-borrowing for the purpose, *inter alia*, of discharging existing loans. It is generally contended, however, that sanction to re-borrow for replacement of loans falling due before the full term sanctioned has expired is not necessary. This view is strengthened by Section 234 (6) which reads—

Where money is borrowed for the purpose of discharging a previous loan, the time for repayment of the money so borrowed shall not extend beyond the unexpired portion of the period for which the original loan was sanctioned, *unless with the sanction of the (now) Ministry of Health.*

**Municipal Corporations Act, 1882.** This Act is silent

as to re-borrowing and the discharge of existing loans is not one of the purposes mentioned for which moneys may be borrowed.

**Local Government Act, 1888.** Section 69 authorizes, with the consent of the Ministry of Health, borrowing for the purposes set out in the Act, and amongst such purposes is "the purpose of paying off the whole or any part of such loan."

Sub-section 3 of Section 69 reads :—

A county council may from time to time, *without any consent* of the Ministry of Health, during the period which was fixed for the discharge of any loan raised by them under the Act . . . . borrow on the like security such amount as may be required for the purpose of paying off the whole or any part of such loan, or if any part of such loan has been repaid otherwise than by capital money, *for re-borrowing* (presumably it should read "to re-borrow") the amount so repaid, and for the purpose of this section "capital money" includes any instalments, annual appropriations, and sinking fund, and the proceeds of the sale of land or other property, but does not include money previously borrowed, for the purpose of repaying a loan.

The intention of this section is quite clear.

### NECESSITY OF SANCTION TO BORROW FOR REPLACEMENTS

It is generally contended that specific sanction to re-borrow for replacement is not necessary. The Local Government Act, 1888, states so, the Municipal Corporations Act, 1882, suggests it, and the Public Health Act, 1875, does not forbid it.

## CHAPTER XI

### METHODS OF REDEMPTION OF LOANS

WHERE the local authority has the right of discretion as to the mode of redemption of its loans it will, as far as possible, give due consideration to the following factors—

(1) An equitable apportionment of the cost of the work or service for which the debt has been incurred between present and future ratepayers ;

(2) An equitable apportionment of the burden over the various districts ;

(3) The nature of the purposes for which the loans have been raised ;

(4) The method of borrowing adopted ;

(5) The terms and conditions on which it can most economically and advantageously raise the required amounts.

The fact must not be overlooked that if borrowings are to be effected from the general public there is a strong dislike to redemption by the instalment and annuity methods. An investor prefers to have his capital returned to him intact when redemption time comes and to receive interest on his full loan during the whole period.

Loans may be redeemed in various ways, but the method of borrowing is an important factor in determining how the loan shall be redeemed. In dealing with loans raised by the 11 methods enumerated in Chapter V, No. 6 and No. 7 can be dealt with summarily, the treatment being self-explanatory.

The bills of exchange are met at maturity and are then no longer debt. The remedy for bank overdrafts

is obvious. Borrowings by the other methods are redeemed in one of the following three ways—

(a) Equal instalments of principal during the whole period of the loan, interest being paid on the diminishing balance. By this method the total debt charge to revenue decreases with every payment. The total debt charges over the whole period of the loan are less than under any other method.

(b) Equal annual instalments consisting of principal and interest; thus the amount of principal included in the annual payment increases yearly as the interest on the remaining balance of outstanding principal decreases. The charge to revenue is constant throughout the period. This is known as the *Annuity System*.

(c) Redemption of the whole loan in one amount by the accumulation of a fund consisting of annual charges to revenue of such a sum as will amount to the required figure on the expiration of the period for which the loan was sanctioned. Interest is paid on the full amount borrowed during the whole period. This is called the *Sinking Fund Method*. The annual charge to revenue is constant.

Annuities (No. 3), Public Works Loans (No. 10), and Saving Certificate Loans (No. 11) are paid off by the annuity method; Stock (No. 4) and Housing Bonds (No. 9) by the sinking fund method though the fund may be termed Redemption Fund. Loans raised by the other methods are redeemable by any one of the three methods (a), (b) or (c) in the discretion of the council and its advisors, but subject to agreement with the lenders.

It might here be mentioned with advantage that when short term loans fall due for repayment and the

mortgagee is not willing to renew, the repayment may be made out of capital account and re-borrowed for a term not exceeding the unexpired portion of the period originally sanctioned. For example, a borrowing power of £10,000 is granted for the provision of a public elementary school, for a period of 30 years. The money is raised by short term mortgages, of which £2,000 falls due for repayment after 16 years. This figure may be repaid out of capital account and re-borrowed (i.e. merely replaced) for a period not exceeding 14 years, viz. the unexpired portion of the 30 years sanctioned.

A practical example of the three methods of redemption, showing the comparative cost to revenue account under each, will illustrate their application.

Assume the loan is for £10,000 at 5 per cent.

### THE EQUAL FIXED INSTALMENT OF PRINCIPAL SYSTEM

The cost of redeeming a loan of £10,000 in 10 years at 5 per cent by the equal fixed instalment system would be as follows—

YEAR	Principal.	Interest.	Total Charge.
	£	£	£
1st .	1,000	500	1,500
2nd .	1,000	450	1,450
3rd .	1,000	400	1,400
4th .	1,000	350	1,350
5th .	1,000	300	1,300
6th .	1,000	250	1,250
7th .	1,000	200	1,200
8th .	1,000	150	1,150
9th .	1,000	100	1,100
10th .	1,000	50	1,050
	£10,000	£2,750	£12,750

## THE ANNUITY SYSTEM

The cost by the annuity system is  $\pounds 10,000 \times .12950457$  per annum =  $\pounds 1,295$  0s. 11d., and the total cost, therefore, is  $\pounds 1,295$  0s. 11d.  $\times 10 = \pounds 12,950$  9s. 2d.

This method costs  $\pounds 200$  9s. 2d. more than the fixed instalment system, but to counterbalance this, the annual charge is equal throughout the whole period of the loan, so that in the early years less money is required to be drawn from revenue. The following figures show the cost in each year by this method—

Year	Amount outstanding at end of year.			Principal paid off.			Interest			Total charge.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
1st	9,204	19	1	795	-	11	500	-	-	1,295	-	11
2nd	8,370	3	1	834	16	-	460	4	11	1,295	-	11
3rd	7,493	12	4	876	10	9	418	10	2	1,295	-	11
4th	6,573	5	-	920	7	4	374	13	7	1,295	-	11
5th	5,606	17	4	966	7	8	328	13	3	1,295	-	11
6th	4,592	3	3	1,014	14	1	280	6	10	1,295	-	11
7th	3,526	14	6	1,065	8	9	229	12	2	1,295	-	11
8th	2,408	-	4	1,118	14	2	176	6	9	1,295	-	11
9th	1,233	7	5	1,174	12	11	120	8	-	1,295	-	11
10th	-	-	-	1,233	7	5	61	13	6	1,295	-	11
				£10,000	-	-	£2,950	9	2	£12,950	9	2

## THE SINKING FUND SYSTEM

Calculations showing the annual sinking fund required to redeem a loan of  $\pounds 10,000$  in 10 years, the rate of accumulation being, say, 5 per cent, are given in the table on the next page.

The rate of interest on the loan has been taken at 5 per cent, and for simplicity the rate of interest on the sinking fund investments is also taken at 5 per cent.

It is assumed that at the end of each year the sinking fund contribution for that year, plus the interest on the fund already invested, will be invested at a rate of interest not less than 5 per cent. A lower rate may be (and generally is) adopted and it must always be remembered that it is safer to err on the side of prudence. If the sinking fund did not reach the amount required to redeem the loan at the expiration of the period the statutory requirements would not have been complied with. On the other hand, if the fund reaches the required amount too soon no harm is done; the revenue contribution is simply reduced or discontinued, while a reverse state of affairs, viz., an increase in the revenue contribution in the last year or years might, in the case of a small authority, have an unpleasant and embarrassing (though not illegal) effect.

Year ending 31st March.	Annual instalment charged to Revenue to accumulate at 5 per cent.			Annual interest earned on investment of the Fund.			Annual payments into the Sinking Fund. (Cols. 2 & 3.)			Total amounts in the Sinking Fund at end of each year (amount at end of previous year, plus Col. 4).		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
1924	795	-	11	-	-	-	795	-	11	795	-	11
1925	795	-	11	39	15	-	834	15	11	1,629	16	10
1926	795	-	11	81	9	10	876	10	9	2,506	7	7
1927	795	-	11	125	6	4	920	7	3	3,426	14	10
1928	795	-	11	171	6	9	966	7	8	4,393	2	6
1929	795	-	11	219	13	2	1,014	14	1	5,407	16	7
1930	795	-	11	270	7	10	1,065	8	9	6,473	5	4
1931	795	-	11	323	13	3	1,118	14	2	7,591	19	6
1932	795	-	11	379	12	-	1,174	12	11	8,766	12	5
1933	795	-	11	438	6	8	1,233	7	7	10,000	-	-
	7,950	9	2	2,049	10	10	10,000	-	-	-	-	-

### REDEMPTION OF IRREDEEMABLE ANNUITIES

Though the issue of perpetual annuities is not now sanctioned, there are in existence some dating back to the time when such a procedure was permissible.

A local authority having loans of this description may desire to redeem them, but without obtaining special power to do so from Parliament the only course open is to come to an agreement with the holders of the annuities to pay them off on terms acceptable to the annuitants.

The methods available for this latter plan are to offer—

(1) Cash, slightly more than the current market value of the annuities.

(2) Stock in exchange for the annuities, giving an amount sufficient to yield a slightly higher return to the annuitants than the annuities yield.

(3) Mortgages with advantages similar to those as in the case of stock (No. 2).

(4) A substituted annuity redeemable at the option of the local authority at par after proper notice.

A factor not to be overlooked in a contemplated adoption of any of the above methods is that action must not be outside the local authority's borrowing powers. For example, methods (2), (3) and (4) involve an increase in loan debt. There may be cases where for various reasons sanction of Parliament or the Ministry of Health would be required to raise new loans to replace the annuities to be redeemed.

If method (1) be adopted the cash paid *could* be charged to revenue or rate account without specific sanction. Another point to be borne in mind is that though the annuities are irredeemable, a sinking fund has generally to be accumulated equivalent to a



number of years' purchase (about 25) of the annuities. This fund is available in exercising method (1) and the insufficiency of the fund, when completed, is not likely to be of much magnitude; consequently the shortage, if charged to revenue or rate account, is not a heavy burden.

The market price of annuities is stated in terms of the "number of years' purchase" which the seller will take, or the buyer offer, per £1 of annuity.

### REDEMPTION OF IRREDEEMABLE STOCK

The creation of irredeemable stock has not been permissible for many years. There is, however, some such stock in existence. In many cases sinking funds have been accumulated either compulsorily, under provisions of the local Acts which authorized the stock, or voluntarily. In some instances the redemption fund is accumulated until it reaches that stage when the income from the investments of the fund is enough to pay the dividend on the stock.

Where it is desired to redeem stock of this nature effort will be made to buy it in, on the open market, without, of course, disclosing the name of the purchaser until the bargain is made.

Should this method fail to yield as much as is desired there is no way of making redemption compulsory (short of a local Act) on the part of the stockholders. Methods (1), (2) and (3) stated on page 65 as a means of endeavouring to discharge perpetual annuities are available for application in the case of irredeemable stock.

## CHAPTER XII

### COMPARISON OF METHODS OF REDEMPTION, SHOWING THE ADVANTAGES AND DISADVANTAGES AND THE COST TO THE LOCAL AUTHORITY

THE three methods of redemption may now be contrasted and compared. Firstly, the ultimate total cost in respect of debt charges will be compared, taking the figures given in the previous chapter.

	Method 1 (Equal fixed instalments)	Method 2 (Annuity)	Method 3 (Sinking Fund)
	£ s. d.	£ s. d.	£ s. d.
Principal	10,000 - -	10,000 - -	7,950 9 2
Interest	2,750 - -	2,950 9 2	5,000 - -
<b>Total charge</b>	<b>£12,750 - -</b>	<b>£12,950 9 2</b>	<b>£12,950 9 2</b>

These figures show that the total charge to revenue account is the least when the equal fixed instalment method is adopted, the annuity and sinking fund systems being more by £200 9s. 2d. A false impression is likely to arise resulting in a decision for the cheaper course, but the saving is more apparent than real, and when judged from a commercial and economical point of view there is really no difference, or, if any, it goes in favour of the apparently more expensive method. This is the reason: What makes the method appear dear is the fact that less principal is repaid (or provided for) in the earlier years, thus entailing the payment of interest on a larger outstanding balance, but to counterbalance this, the difference, being the amount by which the annual redemption of principal falls, is less than in the other circumstances and is

retained in hand or in the bank (as working balance), and is earning bank interest, or in the case of a commercial or trading undertaking may help to increase turnover. But in the case of non-trading departments of local authorities practically no interest accrues on the bank balance on revenue account because the year's requirements are obtained through the rate and consequently the ratepayers are asked for a less sum and so save the interest themselves in a direct manner.

The advantages and disadvantages of the methods and the circumstances for which they are suitable, may now be reviewed—

### FIXED INSTALMENT METHOD

The fixed instalment method is suitable where the authority is in a strong financial position and can bear the heavier cost in the earlier years, and where the work for which the loan is borrowed is of less really permanent benefit, and where the expenditure on repairs and upkeep is likely to increase year by year within the period of the loan.

The Advantages are—

(1) *Simplicity.*

(a) Of book-keeping records ;

(b) Of calculations ;

(c) Of procedure—no sinking funds and no investments to make ;

(d) Few transfers by mortgagees ;

(e) Less opportunity for fraud.

(2) *Economy.*

(a) Total cost least of all methods ;

(b) Economy in labour ;

(c) No investments to seek ;

(d) No loss by depreciation of capital value of investments.

**(3) Equity of Distribution of Charge.**

- (a) It involves a heavier charge in earlier years ;
- (b) This is fair because such earlier years receive the greater benefit by reason of newness of the asset and repairs being few, and such ratepayers ordered the works ;
- (c) More expensive repairs fall in years when the revenue charge for interest is lower.

**Disadvantages.**

- (1) The difficulty of borrowing from people who are prepared to receive back their capital by instalments ;
- (2) Higher rate of interest payable ;
- (3) Only one method of redemption available ;
- (4) When borrowed for long period, inability to pay off the loan should a more favourable market present itself ;
- (5) Heavy redemption charges in early years (*see* 3 (a), (b) and (c) above).

**THE ANNUITY METHOD**

The annuity method is favoured when the work is undoubtedly permanent.

**Advantages.**

- (1) Simplicity of the treatment in the accounts. (*See* 1 (a), (b), (c), (d) and (e) above) ;
- (2) Economy as compared with the sinking fund method including 2 (b), (c) and (d) above ;
- (3) Uniformity of the annual charge ;
- (4) Lower total cost than the sinking fund method.

**Disadvantages.**

- (1) The same as apply to the fixed instalment method (except No. 5) occur here, perhaps even more markedly because the lender does not know how much of his annuity represents capital, and so he may,

to use a commercial term in a domestic sense, be defraying revenue expenditure out of capital ;

- (2) More costly than fixed instalment method ;
- (3) Cost of repairs increase the total annual cost in later years.

### THE SINKING FUND METHOD

The sinking fund method is treated in more detail in Chapter XIII. Here it may be mentioned that where the mortgagees prefer to have their loans repaid in one lump sum, where the period sanctioned is a long one, where short and long term loans are both to be found and where the staff is competent, this is the method *par excellence*.

#### Advantages.

##### *Accumulating Sinking Fund.*

- (1) Loans may be raised in small sums for short periods ;
- (2) Lower interest, and wider markets open ;
- (3) If loan debt consists of stock, advantage may be taken of any fall in market value to redeem at a discount ;
- (4) Equal distribution of cost of loans ;
- (5) Sinking funds available for new capital purposes, where power is possessed ;
- (6) Sinking funds can be used to redeem loans as they fall due instead of finding an investment which probably means a saving of more interest than would accrue on the investment.

##### *Non-accumulating Sinking Fund.*

- (1) Simplicity of book-keeping records ;
- (2) Simplicity of calculations ;
- (3) Total cost less than in case of accumulating sinking fund ;

(4) No loss of tax from interest on investments by reason of non-allowance of dividends from investments of statutorily *accumulating* sinking funds as set-off for income tax purposes.

**Disadvantages.**

*Accumulating Sinking Funds.*

(1) Difficulty of finding suitable investments (but this is easily overcome) ;

(2) More complicated book records and calculations ;

(3) Cost of making and realising investments, and collecting interest thereon ;

(4) Possible loss through reduction in value of investments ;

(5) Loss of income tax on interest on investments of statutorily accumulating sinking funds where not allowed as set off ;

(6) Total cost heavier than under fixed instalment method of redemption ;

(7) Greater risk of fraud ;

(8) Cost of frequent borrowings for replacement purposes.

*Non-accumulating Sinking Funds.*

(1) Redemption charges not equally apportioned over whole period ;

(2) Heavy total charges in early years.

**SHORT-TERM SANCTIONS VERSUS LONG-TERM SANCTIONS**

The total amount to be provided by the ratepayers, including both interest and redemption provision, is less in the case of short period sanctions than in longer ones. For instance, if a twenty years period be substituted for what might have been forty years, the apparent total saving in the case of a loan of £10,000 (interest 5 per cent), is £10,000.

This is arrived at as follows—

	20 Years' Sanction.	40 Years' Sanction.
Redemption provision	£10,000	£10,000
Interest	£10,000	£20,000
Total cost	<u>£20,000</u>	<u>£30,000</u>

Several points must, however, be borne in mind before advocating the apparently cheaper course.

In the first place, if the period of utility of the assets to be obtained out of the borrowed money will extend to at least forty years, the provision of a fund sufficient to redeem the whole loan in twenty years is unfair to the ratepayers of the first twenty years, while the ratepayers of the second twenty years receive the benefit of the assets without contributing anything towards either interest or redemption.

Then further, ignoring the question of equity of distribution amongst persons, the ratepayers have to part with their money (in providing the redemption fund) earlier.

Money is worth money, whether in the possession of the local authority, the lender, or the ratepayer, and while the local authority with its good credit can borrow at four to five per cent interest, the average ratepayer has to pay five to six per cent for a similar accommodation.

This considered, it does not necessarily follow that by securing a short loan period a saving will be effected to the ratepayers who, as a whole, constitute the local authority.

This matter is dealt with in more detail in Chapter XX.

## CHAPTER XIII

### SINKING FUNDS AND REDEMPTION FUNDS OF LOCAL AUTHORITIES

#### DEFINITION AND KINDS OF SINKING FUNDS

A SINKING fund is a fund composed of sums of money set aside periodically to provide a definite amount for a specific purpose at a certain future date. The expression is used to cover any systematic accumulation of moneys where a fixed amount is required at a definite future date, and thus includes redemption funds which are sinking funds applicable to the redemption of stock as distinguished from mortgages.

There are two kinds of sinking fund, viz.

- (1) The Accumulating Sinking Fund, and
- (2) The Non-accumulating Sinking Fund.

The Stock Regulations permit the adoption of either kind.

The principal statutes regulating borrowing by mortgages, i.e. the Public Health Act, 1875, the Municipal Corporations Act, 1882, and the Local Government Act, 1888, either specifically state or infer that, where the provision for redemption is by means of a sinking fund, such fund must be of the accumulating type.

From one point of view, at least, it may be advantageous to adopt the non-accumulating variety (where possible). Taxed interest on the income from investments of statutorily *accumulating* sinking funds is not allowed as a set-off in respect of interest paid on loans,



while income from non-accumulating sinking funds, being credited to revenue account, is allowed as a set-off.

**Non-accumulating Funds** may be dealt with summarily. They are by far the simpler type. The annual contributions are equal and are calculated by dividing the total amount required by the number of years during which the required figure must accumulate. The instalments may, but need not, be invested, though in both cases *no* interest is added to the fund, hence the term "non-accumulating." Any interest accrued is usually credited to revenue account or is applied in reduction of the revenue contributions to the fund.

**The Accumulating Type** is a little more complex. In this case interest on the periodical investments of the fund is an important factor in computing the annual instalment. Thus the accumulating fund consists of the periodical setting aside of such fixed sums which, if invested each year together with all interest thereon as it accrues, will amount to the specific figure at the date on which the amount is required. It will thus be observed that the annual appropriation is smaller in the case of the accumulating type than in the case of the non-accumulating funds, as in the former the final figure consists of instalments plus compound interest, while the latter contains instalments only.

It does not follow, however, that the accumulating fund necessitating only a smaller debit to revenue is a more economical method than the non-accumulating fund, as will be seen presently.

### THE CALCULATION OF SINKING FUNDS

The method of calculating the non-accumulating

sinking fund is obvious. It involves merely a simple division of the amount to be accumulated by the number of years in the period. The computation of the accumulating sinking fund is more difficult. It is known that each instalment must be of such an amount that if invested each year together with the interest on the previous investments, the total accumulations at the end of the period will amount to the figure required. Suppose, by way of example, it is required to accumulate a sinking fund to provide £10,000 in 10 years, the rate of interest on investments being taken at 5 per cent per annum. If £1 per annum earning 5 per cent compound interest be calculated for 10 years it will be found that at the end of the tenth year the amount is £12·5778925. So if £1 per annum accumulates to £12·5778925, the annual figure required to accumulate to £1 is  $£1 \div 12\cdot5778925 = \cdot0795046$ . Therefore, if an annual instalment of £·0795046 produces £1 in 10 years, the necessary yearly contribution to attain the £10,000 mark is  $\cdot0795046 \times 10,000 = 795\cdot046$  or £795 0s. 11d.

It is not the general practice, however, to make such calculations whenever a sinking fund is created, but to use one of the several books of tables on the market. These tables show the equal annual sums to be set apart and accumulated at compound interest in order to provide £1 at the end of any number of years (generally terminating at 100) at various rates per cent. The annual contribution is given as a decimal of a pound (usually to 6 or 8 places). This figure has simply to be multiplied by the amount to which the sinking fund must accumulate, and thus the periodical revenue charge is arrived at. Let a practical illustration be taken.

By calculating as explained above one can form a

sinking fund table for oneself. Taking the same figures as before the table appears as follows—

Number of years during which the fund is to accumulate.	Annual amount to be set aside to provide £1.
1 . . . . .	1·0000000
2 . . . . .	·4878049
3 . . . . .	·3172086
4 . . . . .	·2320118
5 . . . . .	·1809748
6 . . . . .	·1470175
7 . . . . .	·1228198
8 . . . . .	·1047218
9 . . . . .	·0906901
10 . . . . .	·0795046

### SINKING FUND SCHEDULE

Let it be assumed that it is desired to create a sinking fund which will accumulate to £10,000 at the end of 10 years, the rate of interest being 5 per cent. It is customary, or at least advisable, to work out a schedule of accumulations as they should appear at the end of each year until the last.<sup>1</sup>

These calculations are made on the assumption that at the end of each year that year's revenue contribution, i.e. column (2), will immediately be invested together with the interest on the previous year's investments (in gilt-edged securities), the interest thereon being 5 per cent.

### DIFFICULTIES OF INVESTMENT

In connection with the investment many difficulties arise of which may be mentioned—

- (1) The inability always to find a suitable investment on the day in question ;
- (2) The date of redemption of such investment ;
- (3) The interest on it ;

<sup>1</sup> See Table on page 64.

(4) The possible fluctuation of the market price both of capital value and of the rate of interest ;

(5) The loss of income by deduction of income tax before receipt, and its not being allowed either as a set-off or otherwise.

Even when (1) and (2) are overcome, the interest question is apt to give rise to trouble inasmuch as in one year it may be below the figure while in another year it may be in excess. Whether too little or too great and whether by reason of fluctuation in the rate of interest or the inability to invest on the exact date, the result is that at the end of the sinking fund period the total of the fund is different from the figure for which the calculations were made. If the difference is an excess over requirements, there is no inconvenience, but in a reverse case the deficiency would have to be charged to the current year's revenue account. On a large sinking fund the discrepancy might be an important one. If there be depreciation in the capital value of the investments this is no doubt a worse calamity for obvious reasons. Probably the more convenient method, and one largely adopted, is to credit all interest on the investments to revenue account and to let the debit to the same account, i.e. the annual transfer to sinking fund, be the total of columns (2) and (3). In this way the fund will always reach the required figure, and all differences in interest will be automatically adjusted annually, a better plan than that of leaving the adjustment to the last year. Thus, according to the specimen figures in the table for the year, say, 1930, revenue account would be debited and sinking fund account credited with £1,065 8s. 9d. instead of £795 0s. 11d., but any interest earned would be credited to revenue account to help counterbalance the excess charge of £270 7s. 10d.

An alternative method, though it is not of much value except in special circumstances, is to pass income from invested sinking funds through an "Income on Investments Account," and to pay thereout to the sinking fund the actual amount of interest the fund ought to earn. If there is a surplus on the income from investments account all is well, but a deficiency is more probable.

### INVESTMENT OF SINKING FUNDS

If investment be decided upon in place of one of the alternatives dealt with later the proposed securities must be considered and the following information sought. Are the securities gilt-edged? Are they certain not to depreciate by the time of redemption? If these questions cannot be answered satisfactorily, it is better to seek a little longer.

Sinking funds of local authorities may be invested in certain securities only. Those established for the purpose of redeeming stock created under the Stock Regulations, 1891-1921, may by Articles 1 and 16 of the Stock Regulations, 1891, be invested in the following securities in addition to those specified later for sinking funds: Any mortgage, bond, debenture, stock, annuities, rent-charge, rent or other security of any local authority which has power to levy a rate or precept, excepting securities to bearer and the local authority's own securities.

Limitations on the investment of sinking funds other than those established under the Stock Regulations have the effect of confining investments to trustee securities.

The Trust Investment Act, 1889, and the Trustee Act, 1893, provide that a local authority may invest its sinking funds in trustee securities (except real

estate and its own securities) provided that it does not purchase at a higher price than 15 per cent premium any securities that are liable to be redeemed at a fixed time at a fixed price, nor any securities so redeemable which are at a price exceeding their redemption value unless more than 15 years will elapse before the time fixed for redemption. The list of trustee investments is set out in the Trustee Act, 1893, Section 1, as extended by the Colonial Stock Act, 1900, Section 1. The following is a short list of the principal securities in which local authorities may invest their sinking funds under the Public General Acts—

- British Government Stocks ;
- Stocks the dividend of which is guaranteed by Parliament ;
- Colonial Stocks ;
- Indian Government Stocks ;
- County Councils' Stocks ;
- Stocks of the Corporations of towns with population of 50,000 ;
- Metropolitan Water Board Stock ;
- Metropolitan Police Debenture Stock ;
- Nominal Debentures and Nominal Debenture Stock under the Local Loans Act, 1875 ;
- Bank of England and Bank of Ireland Stock ;
- British and Irish Railway Companies' Debenture Guaranteed and Preference Stocks, provided they have paid dividends on each of their ordinary stocks during each of the last ten years ;
- Stocks of railway and canal companies leased for 200 years or more to the railway companies above mentioned ;
- Certain Indian Railway Debenture Stocks and Annuities ;
- Debenture Guaranteed and Preference Stocks of British and Irish water companies incorporated by special Act of Parliament or charter and which have paid dividends of not less than 5 per cent on their ordinary stocks each year for the last ten years ;
- Mortgages of local authorities which have obtained sanction of the Ministry of Health to issue housing bonds.

## FACTORS GOVERNING INVESTMENT

If it be decided to invest sinking funds in redeemable stocks, consideration has to be given to the advisability or otherwise of selecting stocks at a discount, at par, or at a premium. One's judgment will be affected by the following matters—

- (1) The rate of interest on the stock ;
- (2) If purchased at a discount, the annual profit made in consequence of the appreciation of the capital value to par by the date of redemption ;
- (3) If bought at a premium the yearly loss arising out of a fall in the market value to par while the redemption time is approaching ;
- (4) That a higher premium than 15 per cent may not be paid for securities that are liable to be redeemed at a fixed price on a definite date ;
- (5) That securities redeemable at a fixed price on a definite date may not be purchased at a price in excess of their redemption value unless more than fifteen years will elapse before the time fixed for redemption ;
- (6) That the securities purchased should fall due for redemption before the stock period expires ;
- (7) Preference will generally be given to securities that will provide (if possible) the income necessary after allowing for deduction of income tax, and which at the time of investment stand at a discount and are redeemable at par ;
- (8) Profits on realization should not be taken credit for in any one year but rather used to reduce future contributions ;
- (9) Losses (if any) on realization should be made good immediately and not spread over future years ;
- (10) The credit of a large town is usually slightly better than that of smaller authorities, and legitimate advantage may be taken of this circumstance to the mutual benefit of both parties if it enables investments of sinking funds to be made at a good rate of interest. This may possibly effect a slight gain by raising new loans for further capital requirements at a lower rate of interest than is obtainable on investments of its sinking funds with a less fortunate authority ;

(11) The possibility of enhanced credit accruing by using sinking funds in reduction of debt.

### ALTERNATIVES TO INVESTMENT

(1) To let the money remain in the bank to the credit of the sinking fund account, there to earn bank interest (this amounts almost to an investment because it is placed out at interest);

(2) To apply the annual instalments in redeeming loans or debentures or in purchasing in the open market the authority's own stock for cancellation and extinction;

(3) To use the sinking fund as new capital.

There is something to be said for No. 1 quite apart from its simplicity. It helps to keep the aggregate account in credit; is always available at call when required, without any loss on realization, depreciation, stock brokers' charges, stamp duties, etc.; and (especially by arrangement with banker and even without) earns interest not much below that which it would earn if invested, by reason of the fact that no tax is deducted from bank interest at the source, and though such interest is taxable, if it is not credited to sinking fund it is allowed as set-off, but interest on investments of statutorily accumulating sinking funds is subject to a heavy deduction without any power of recoupment by means of "set-off." It is thus quite possible for bank interest to be the better yield.

With regard to method No. 2, it is logical that if any outstanding debt is bearing interest at a higher rate than the rate obtainable from an investment or from bank interest, and any such debt is falling due for repayment or can be made to do by giving notice to the holders, it is advantageous and economical to



redeem debt either by repaying mortgages or by purchasing stock on the open market through the authority's broker or banker. In the case of stock the market price is an important factor and the chief financial officer will determine whether or not it is economical to purchase after calculating the yield (or really saving) of interest by buying at the current price and comparing this with the return which the sinking fund moneys would produce from other channels. Incidentally, the usage of sinking or redemption funds in redemption of debt in this way may be an advantage over other methods of application of the funds by reason of the reduction of the total indebtedness of the local authority and simultaneously the reduction of the work connected therewith.

It may be added that to use sinking fund moneys in discharging debt (even before the date of compulsory redemption) is a direct compliance with the provisions of the Stock Regulations, the Public Health Act, 1875, the Local Government Act, 1888, the Local Loans Act, 1875, and (with the written consent of the Ministry of Health, which is ignored in practice) the Municipal Corporations Act, 1882.

#### THE USE OF SINKING (OR REDEMPTION) FUNDS AS NEW CAPITAL

It will readily be apparent that a considerable saving of money will ensue if the sinking or redemption funds are properly managed. Additional capital moneys are often required and the utilization for this purpose of accumulated funds may be the means of effecting a considerable saving in expenses of issue and discount on stock, stamp duty on mortgages, advertising, printing and stationery, etc., and the annual saving of the difference between the interest

which would be payable on new loans or stock and the interest being earned by the accumulating funds. In addition there should not be overlooked the facts that heavy income tax is deducted from revenue on invested funds, which revenue is not allowed as a set-off in all cases for income tax purposes, and that the seeking and making of investments costs money.

### DATE OF FIRST CONTRIBUTION TO SINKING FUND

There does not appear to be any general enactment specifying the date when the first or subsequent contributions to sinking funds must be made. By inference, drawn from a consideration of the objects of setting up a sinking fund, viz., to ensure the possession of means to discharge the debt within the period allowed by the sanctioning authority, i.e. so many years from the date of borrowing, and from various official recognitions of the uses to which such funds may be put from time to time, one may state that the accumulation is expected to be spread over the period of the sanction.

One date is definitely determined and that is the latest date by which the fund must be complete. That date is the expiration of so many years of the "date of borrowing."

Before considering what is meant by the term "date of borrowing" it is perhaps as well to state the chief methods in vogue to comply with the terms of the sanction—

(1) Some local authorities take the date of borrowing as the 31st of March of the financial year in which the borrowing actually takes place, and so in that particular year *no* contribution towards redemption is made, and automatically the full provision for redemption

is only made by the 31st March, so many years after borrowing, which is really a short time (varying from a few days to a year) *in excess of the period sanctioned*. But this difficulty can easily be surmounted by making the transfer from revenue account to sinking fund in respect of the last year of the period, at the *beginning* instead of the *end* of that financial year. It would not affect the accounts as published in the abstract.

(2) Another method is for revenue account in the year of borrowing to bear its proper share of contribution, based on the average date of borrowing during the financial year.

(3) To make a full year's contribution for the year in which borrowed.

#### SUSPENSION OF COMMENCING DATE OF SINKING FUND CONTRIBUTIONS

Though permission to suspend the annual contribution may in the case of revenue producing works, be given by the Ministry of Health in certain conditions for a period not exceeding five years, under authority of the Local Authorities (Financial Provisions) Act, 1921, and the Electricity Supply Act, 1922, it would appear to be quite in order to suspend or defer the commencement of the sinking fund contributions in the case of *any borrowed money, without sanction, for any period*, provided the sinking fund accumulated to the requisite figure "within the period sanctioned from the "date of borrowing."

#### DATE OF BORROWING

Some diversity of opinion exists as to what is, or should be, meant by the "date of borrowing" for the purpose of ascertaining the date from which the sinking fund period must commence.

It is contended by some that the date of the expenditure should be taken, while others insist that "borrowing" and "expenditure" dates are not necessarily the same. It is quite obvious that expenditure date cannot be adopted in all cases. For example—

If certain loan expenditure is made out of money already borrowed, the expenditure date is too late and the date of borrowing must be adopted.

On the other hand, if the expenditure is incurred first, and later, money is borrowed to meet it, it may reasonably be urged that even if the money was in the first place obtained from a temporary source, that borrowed later is to replace it, i.e. to *repay* it, and one would not *repay* money which had not previously been borrowed.

Sometimes capital expenditure is incurred and for some reason it is later decided not to meet it out of borrowed moneys. Obviously the "expenditure date" method of commencing a sinking fund period is wrong in this case, because no sinking fund is required at all.

A method which seems worthy of consideration as being adequate, reasonable, and safe is to take as the date from which the sinking fund period commences to run, the average date of borrowing or the date of expenditure, whichever occurs first, and either—

(a) To transfer the first contribution for a portion of the year in the financial year of borrowing, to be followed each succeeding year with a full year's figure except the last, which will be such an amount as will with the broken figure paid in the first year make up a year's contribution, the last transfer being made not later than so many years after the commencing date; or

(b) To charge no contribution in the first financial year but to make the transfer in respect of the last year at the beginning of that year.

## THE RATE OF ACCUMULATION OF SINKING FUNDS

The question as to what rate of interest should be taken into account in the calculation of sinking funds is a matter worth considering.

*Theoretically*, it is correct to calculate the sinking fund at the rate at which it ought to be possible to invest the moneys in authorized securities. Such rate should be very nearly, if not exactly, the same as that being paid by the local authority, because both classes of investment are in the same category. As the rate changes from time to time the fund should be adjusted. Another point to note is, that the interest will be received net, i.e. less income tax at the appropriate current rate, and it may be deemed advisable to take the net yield as the rate on which the sinking fund contributions should be based.

*In practice* a comparatively low rate (generally about 3 per cent), is adopted which aims at keeping on the "under" side so that there will be no deficiency in the sinking fund. This certainly is the more prudent, if not mathematically correct, course to adopt.

Where the actual revenue transfer to sinking fund consists of both contribution and interest (all interest received then going to the credit of revenue account, or its equivalent) no adjustment is necessary whatever rate has been used.

In all cases, no matter whether the rate of accumulation is low or high, the full total charge to revenue account is the same, because the basis of calculation of a sinking fund cannot alter the rate of interest actually received. But the apportionment of such full total charge over the period of accumulation is different.

*Example*—Loan of £10,000 for 10 years.

## SINKING FUND CALCULATIONS ON A 3% BASIS

Year	Annual Contribution.	Interest to be earned.	Total payments to Fund.	Total in Fund.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.
1st	872 6 1	- - -	872 6 1	872 6 1
2nd	872 6 1	26 3 5	898 9 6	1,770 15 7
3rd	872 6 1	53 2 6	925 8 7	2,696 4 2
4th	872 6 1	80 17 9	953 3 10	3,649 8 0
5th	872 6 1	109 9 8	981 15 9	4,631 3 9
6th	872 6 1	138 18 9	1,011 4 10	5,642 8 7
7th	872 6 1	169 5 5	1,041 11 6	6,684 0 1
8th	872 6 1	200 10 4	1,072 16 5	7,756 16 6
9th	872 6 1	232 14 1	1,105 - 2	8,861 16 8
10th	872 6 3	265 17 1	1,138 3 4	10,000 - -
	£8,723 1 -	£1,276 19 -	£10,000 - -	£ - - -

## SINKING FUND CALCULATIONS ON A 5% BASIS

Year	Annual Contribution.	Interest to be earned.	Total payments to Fund.	Total in Fund.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.
1st	795 - 11	- - -	795 - 11	795 - 11
2nd	795 - 11	39 15 -	834 15 11	1,629 16 10
3rd	795 - 11	81 9 10	876 10 9	2,506 7 7
4th	795 - 11	125 6 4	920 7 3	3,426 14 -
5th	795 - 11	171 6 9	966 7 8	4,393 2 6
6th	795 - 11	219 13 2	1,014 14 1	5,407 16 7
7th	795 - 11	270 7 10	1,065 8 9	6,473 5 4
8th	795 - 11	323 13 3	1,118 14 2	7,591 19 6
9th	795 - 11	379 12 -	1,174 12 11	8,766 12 5
10th	795 - 11	438 6 8	1,233 7 7	10,000 - -
	£7,950 9 2	£2,049 10 10	£10,000 - -	£ - - -

It will be observed from a comparison of the two tables that the total amount provided (column 4) is the same in both cases, though in no year during the period are the total payments to the fund the same. The lower the rate of accumulation the higher the total charge in earlier years, and the lower the charge in the later years.

While it is submitted that it is as well to keep the rate of accumulation prudently low, it must not be overlooked that the lower it is fixed the more nearly does the sinking fund approach the non-accumulating type, and corresponding to such proximity diminish the objects and advantages of the accumulating sinking fund over the non-accumulating type.

## CHAPTER XIV

### CONSOLIDATION AND EQUATION OF DEBT

CONSOLIDATION of existing debt means the amalgamation of many separate loans into one loan. A complete scheme of consolidation can be effected only by means of a local Act promoted by the local authority and by arrangement with the existing loan-holders. In some cases, however, partial consolidation may be effected by means of a provisional order under Sections 297 and 303 of the Public Health Act, 1875, e.g. debt contracted under local Acts and provisional orders. Parliament gave the Local Government Board power to sanction the consolidation of loans of local authorities by the Local Government Act, 1888, and the Public Health Acts (Amendment) Act, 1890, under which the periods of redemption are generally (though not necessarily) equated or averaged and sometimes varied or extended. It is possible to consolidate debt without equating the loan periods and vice versa.

Where loans are charged to different rates and revenues and the periods granted vary very considerably, it is advisable to keep them separate in calculating the equated period, otherwise the annual sinking fund charge on the consolidated loan might easily be increased to a considerable degree; for example, the consolidation of, say, 10-20 year loans with those of 50-80 years.

Before promoting the bill or applying for the provisional order, it is customary to approach the loan-holders and ascertain the terms they would be prepared to accept for the redemption of the loans in one sum, or the amount of stock they would take in lieu. These



terms will doubtless be influenced by the rate of interest on the existing loans and the probable rate obtainable by re-investing the money received in redemption. Thus the following three factors will be considered in contemplating the consolidation of debt—

- (1) The state of the money market ;
- (2) The amount payable to holders of existing securities as compensation ;
- (3) A comparison of the periods granted for redemption with the continuing utility of the works or schemes for which raised.

#### THE ADVANTAGES OF CONSOLIDATION AND EQUATION

- (1) Uniformity of the date on which the whole debt for the various purposes will be discharged ;
- (2) Uniformity of the charges for principal and interest during the period of the equated loan, thus giving a more equitable distribution between present and future ratepayers ;
- (3) Saving of an immense amount of labour by reason of the abolition of hundreds of intricate sinking funds ;
- (4) One sinking fund only, for each consolidated group of loans, and thus greater facility in the application of sinking funds ;
- (5) Saving in cost of management of loans ;
- (6) Saving effected by issuing stock on favourable terms, even after allowing for the capitalized commutation charges paid to holders of the old loans ;
- (7) Simplification of the repayment of the loans, thus obviating the necessity of appropriating comparatively small amounts to the redemption of particular loans ;
- (8) Simplicity in stating the loan debt.

**METHOD OF EQUATION AND CONSOLIDATION**

Outstanding loans should be grouped according to the purposes to which they apply, e.g. Borough Fund, District Fund, Electricity Works, Gas Works, Waterworks, Tramways, etc. The equated period is ascertained by multiplying each loan outstanding by the unexpired portion of the period allowed for repayment and (keeping each fund separate) dividing the sum of such products by the aggregate amount of loans outstanding. The result is the equated unexpired period for repayment of the consolidated loan. Loans relating to separate funds and undertakings should be kept separate and those expiring within the next few years should not be included in the scheme, but allowed to work out in the ordinary way.

*Example.* Assume a tramway undertaking in respect of which the following debt is outstanding on 31st March, 1924—

Date of Borrowing.	Amount borrowed.	Period sanctioned (years).	Amount outstanding, 31st March, 1924.	Period unexpired (years).	Product.
1907	£ 50,000	30	£ 22,000	13	£ 286,000
1909	30,000	20	12,000	5	60,000
1910	10,000	30	6,000	16	96,000
1911	10,000	15	2,900	2	5,800
1918	20,000	20	14,000	14	196,000
1923	20,000	20	19,500	19	370,500
			£76,400		£1,014,300

$\frac{1,014,300}{76,400} = 13$  years, the equated period dating from 31st March, 1924, of the consolidated loan of £76,400.

Future loans, viz., those borrowed after the date of consolidation, must be separately treated and should if possible be raised on such terms as will admit of redemption and consolidation at a convenient future date without compensation to the loan-holders.

## CHAPTER XV

### CONSOLIDATED LOANS FUNDS

#### (a) LOANS FUNDS UNDER STOCK REGULATIONS AND LOCAL ACTS CONTAINING THE MODEL STOCK CLAUSES

THE term includes a redemption fund account and a dividends fund account, both of which must be kept separately as required by the Stock Regulations, 1891-1921.

Redemption Fund is the title given to a sinking fund applicable to the redemption of stock under the Stock Regulations and the redemption of debt (stock and other forms) under some local Acts where the term is incorporated therein. In other cases the fund out of which debt is to be discharged is generally termed sinking fund.

The redemption fund is created to provide for the cancellation of the stock at or before the time fixed for its extinction. Article 18 of the Regulations of 1891, and Article 1 (2) of the Regulations of 1897, prescribe the accounts to be kept to record the redemption fund transactions.

These accounts are—

(1) An account showing the securities in which all sums paid into the fund are invested.

(2) A separate account for each undertaking or purpose.

(3) A separate account for each borrowing power so exercised.

The accounts must show—

(1) The stock chargeable on each undertaking or purpose.

(2) The stock redeemed or purchased and cancelled or extinguished.

Dividends Fund is the term given to the fund required to be established under Article 6 of the Stock Regulations, 1891, out of which will be paid the dividends on the stock issued.

There must be a separate dividends fund account for each purpose showing money paid into the fund as receipts from rents, profits of land, contributions from revenue accounts, and unclaimed dividends repaid to the fund.

The receipts and payments on the redemption fund account and the dividends fund account are as follows—

#### REDEMPTION FUND ACCOUNT

##### RECEIPTS.

- (1) Annual contributions from each fund to which stock is originally allocated.
- (2) Annual contributions from each fund to which stock is subsequently allocated by transfer of redemption funds for new capital purposes.
- (3) Interest on sums withdrawn from the redemption fund for new capital purposes.
- (4) Interest on sums withdrawn from the redemption fund and applied in extinction of stock.
- (5) Interest on investments of the fund.
- (6) Proceeds of sales of surplus lands and property.
- (7) Contributions from various funds to meet loss arising from (a) delay, etc. in investments; (b) realization of investments.
- (8) Profits on temporary investments of capital moneys.
- (9) Other receipts.

##### PAYMENTS.

- (1) Amounts applied in purchase of stock for extinction.
- (2) Amounts applied for new capital purposes.
- (3) Investment of balance.

DIVIDENDS FUND ACCOUNT

RECEIPTS.	PAYMENTS.
(1) Annual contributions from each fund to which stock has been allocated ( <i>gross</i> ), i.e. not less income tax.	(1) Dividends paid to stockholders ( <i>less tax</i> ).
(2) Rents and profits of property ( <i>less expenditure on rates, taxes, insurance, repairs, etc.</i> )	(2) Income tax.
(3) Income from temporary investments of any part of the proceeds of issue pending utilization.	

*The Principal Accounts* necessary are as follows—

- (1) Cash account.
- (2) Stock account.
- (3) Allocation of stock account.
- (4) Redemption fund account.
- (5) Sinking fund account.
- (6) Dividend account.
- (7) Investments account.
- (8) Interest on investments account.
- (9) Income tax account.
- (10) Stock redeemed account.
- (11) Expense of issue account.
- (12) Discount account.
- (13) Management expenses account.
- (14) Stock transferred to new capital purposes account.

Interest earned on investments is passed through the interest account out of which is transferred to the sinking fund the amount such fund should earn. Any surplus is carried forward to help in time of reverse circumstances, or the whole is transferred and the revenue contribution is reduced accordingly. If the interest fund is insufficient to allow a full transfer to the sinking fund, the whole is transferred along with

a further transfer from revenue account to make up the deficiency.

### LOANS FUND BALANCE SHEET

The Loans Fund balance sheet will contain—

LIABILITIES.	ASSETS.
(1) Stock issued	(1) Allocation of stock
(2) Sundry creditors	(2) Allocation of stock transferred
(3) Premiums on stock (if any)	(3) Allocation of stock redeemed
(4) Stock redeemed	(4) Expenses of issue
(5) Redemption Fund (balance at credit thereof)	(5) Discount on stock (if any)
(6) Interest unappropriated	(6) Investments
(7) Rents, etc., unappropriated	(7) Sundry debtors
(8) Excess sinking fund earnings	(8) Cash at bank and in hand

#### (b) LOANS FUNDS IN RESPECT OF MORTGAGE BORROWINGS

All provisions relating to loans raised by stock authorize a common security with a single redemption fund and one dividends fund, together with power to apply sinking funds to new capital purposes. No such corresponding method of treatment is available to the *whole* debt raised by the issue of mortgages except where the authority is obtained by local Act. The number of local authorities that have gained this privilege is considerable and is almost constantly being added to.

Where this basis of borrowing has been achieved a common form of mortgage, charged indifferently on the funds and revenues of the authority, is issued. This permits a complete consolidation of the mortgage loans, but unless the scheme authorized by the local Act covers the complete consolidation of existing debt as dealt with in Chapter XIV there will be the old mortgagees in being, charged on separate rate funds, and until these are cleared they must continue along with the new consolidated mortgages.

According to replies received (from 62 towns) by Mr. Lambert, Borough Treasurer of West Hartlepool (as stated in a lecture given before the North-Western Students' Society of the Institute of Municipal Treasurers and Accountants), more than half of the local authorities merge their specific mortgages with their common mortgages for administrative purposes, that is, they deal with all short-term mortgages in the same manner notwithstanding the difference in security, though there would appear to be no legal authority for this treatment. The replies also revealed that seven towns apply their sinking fund moneys to new capital purposes without statutory authority. So long as this is not treated as an investment of the sinking fund by the local authority in its own securities, but as a cancellation of debt on one service and the creation of a debt on another connected with the same rate fund, that is, a transfer of the mortgages from one "purpose" to another, there appears to be no objection to the course.

**Consolidation of Mortgage Debt without Specific Powers.** Without specific power conferred by local Act the consolidation (or pooling) of debt is permissible, but *within each rate fund only*. Thus within these limits it is apparently in order to pool the sinking funds and use them in the discharge of *any* of its loans, or for any new sanctioned purpose. Mr. Carson Roberts, in his book on *Accounts of Local Authorities*, states that such a procedure "is officially recognized."

### (c) A COMPLETE CONSOLIDATION OF ALL LOANS AND LOANS FUNDS

A complete consolidation of the whole of the debt services of a local authority is the ideal sought in this phase of its financial operations.



Such a scheme requires that—

(1) All capital moneys received should be paid into one Consolidated Loans Fund Account. These moneys comprise—

(a) All loans received ;

(b) All moneys provided for the redemption of debt.

(2) Out of this fund will be paid all moneys on capital account. These payments comprise—

(a) All loans repaid (replacements to be re-borrowed) ;

(b) All loans redeemed ;

(c) All capital expenditure charged against loan moneys ;

(d) All investments of surplus not immediately required.

(3) There should be one security only for all loans and that security should be the whole of the property and assets, rates and revenues, or other income of the authority.

(4) All loans should rank *pari passu*.

(5) The rate of interest charged by the Consolidated Loans Fund to the various purposes to which advanced should be arranged on a fair and equitable basis. (See further notes on this later in present chapter.)

(6) Discount and expenses of issue in respect of stock issues, as reduced by premiums on issues and discount on redemption be regarded as a purpose for which a borrowing power has been exercised in respect of the Consolidated Loans Fund, and that the debt charges thereon be apportioned with other expenses of the fund, over all services according to the net debt outstanding.

(7) A portion of the Consolidated Loans Fund, ascertained by experience and known circumstances, be

retained in a comparatively liquid form to be available in case of eventualities and to avoid a compulsory borrowing at an inopportune time.

Probably the most outstanding feature of a fund on the lines indicated above is the passage of all redemption provision moneys through the Consolidated Loans Fund Account.

This is important as it confers the right to apply such contributions, if desired, to new capital purposes as well as to redemption of debt. By this means such accumulations immediately lose their identity and are available for any of the purposes set out under item (2) above. This is reasonable, because the object aimed at by law in requiring provision to be made for the redemption of debt is achieved as soon as the requisite contribution has been made from revenue account to the loans fund, as once the money is transferred to this fund it is precluded from the possibility of its ever again being applied to revenue purposes.

The claim that all money provided for redemption should be paid into the Consolidated Loans Fund leads on to a consideration of the

#### **DISTINCTION BETWEEN REDEMPTION OF CAPITAL EXPENDITURE AND REDEMPTION OF MONEYS BORROWED**

It is necessary to realize that there is a difference between the redemption of capital expenditure and the redemption of the moneys borrowed to finance that expenditure, if the full benefits are to be obtained from the creation of a Consolidated Loans Fund approaching as nearly as possible to the ideal.

The currency of a loan from a lender to the loans fund has no relation to the sinking fund period within which advances made by the loans fund to meet

capital expenditure are redeemed. When the loan falls due to be paid off the fund must meet its obligation.

Advances to meet capital expenditure are made for a prescribed period, viz. that authorized by the sanctioning body as being the maximum period within which the debt created to meet such expenditure must be redeemed.

**Redemption of Capital Expenditure** is effected whether the money contributed from revenue account is invested, used in redemption of loans, or applied to new capital purposes.

### ADVANTAGE OF COMPLETE CONSOLIDATION

If the consolidation is complete and all loans are on the same security, available moneys in the fund may be applied to *any* sanctioned capital expenditure. Where, however, any mortgage deed or agreement with the lender earmarks the loan to any specific purpose such obligations must not, of course, be disregarded.

### A CONSOLIDATED INTEREST FUND

With the creation of a complete Consolidated Loans Fund is necessarily involved a Pooled Interest Fund which generally results in an average charge for interest in respect of all borrowings and consequently on all advances to the various capital purposes.

Objections may be raised against the equalization of interest charges, the principal ones being—

(a) It is not fair to pool the interest on a loan effected for a long period at a time when interest was at a low rate, when such loan was borrowed for a particular service, with new borrowings to meet

capital expenditure of an entirely different description, effected at a much higher rate of interest.

(b) When the various contributions towards redemption are pooled and applied either in discharge of loans or to new capital purposes the identity of such contributions is lost, and it is impossible to know with any degree of accuracy how much of any particular contribution has been applied in any particular direction.

(c) If the average rate of interest chargeable by the consolidated fund is less than the current rate, then if applied to advances for purposes in connection with which grants are made by the Government towards revenue expenditure, e.g. education, housing, etc., the local authority will receive a smaller grant in consequence.

(d) A complete Consolidated Loans Fund is not suitable to cover loans advanced by the Public Works Loan Commissioners (including the half-proceeds of the sale of savings certificates), and the issue of housing bonds, because the latter are available for one purpose only, viz., housing; and further, the security given to holders of such bonds includes the Government subsidy, which security cannot be accorded to other loan-holders, and the rate of interest on housing bonds is fixed by the Ministry of Health, and in certain cases is payable without deduction of tax, and there is the right to tender housing bonds in purchase of houses.

Comments on the objections raised may be summarized as follows—

(1) The local authority is one entity, and in effecting borrowings, no matter at what date or rate of interest or how many, it has exercised one statutory right, viz., that of borrowing for permanent works

properly sanctioned, and in every case it has done so in discharge of one of its functions as a local authority.

(2) It cannot be correct to charge one service a greater rate of interest than another.

(3) The question as to whether or not a grant is received in respect of a particular service should not enter into the question.

(4) If it be desired, particular purposes for which money is required to be raised in times when the actual rate of interest is much above the average could be charged for a (short or long or the whole) period a rate of interest higher than the average. This could apparently apply to State-aided services, and to trading undertakings whose charges for supplies, etc., are restricted to the making of a fixed maximum profit.

(5) Even if borrowings from the Public Works Loan Commissioners, including the proportion arising from savings certificates, could not be brought into the scheme, the exclusion involved could not be regarded as a serious obstacle to the scheme.

(6) With regard to loans raised by the issue of housing bonds, effort might be made to overcome the difficulties, failing which this class of borrowing would come in the same category as those mentioned in comment (5).

#### **BASIS ON WHICH INTEREST IS ALLOCATED IN RESPECT OF ADVANCES FROM A CONSOLIDATED FUND**

The total interest paid is usually allocated to the respective accounts in proportion to the outstanding debt on each, but a variety of ways of applying this principle is in vogue. These are—

(1) On the debt outstanding at the beginning of the year.

(2) As No. (1) plus the equated debt of the current year.

(3) On the daily balance of debt.

(4) One year's interest on debt at beginning of year—the balance of interest in proportion to the allocation to new sanctions at the end of the year.

(5) In proportion to the average debt throughout the year.

(6) The current half-year's allocations are first charged at the prevailing rate from the date of allocation, the balance *pro rata*.

(7) From date of allocation.

(8) Broken period loans on actual allocations from date thereof, balance *pro rata* on debt outstanding at commencement of period.

(9) On average or equated amount of debt outstanding during the year.

### THE PRINCIPLE OF A CONSOLIDATED LOANS FUND

No new principle is involved in the establishment of a complete Consolidated Loans Fund.

The principle of common security, one redemption fund, one dividends fund, application of sinking funds to new capital purposes, has been in existence for a considerable period so far as stock is concerned.

## CHAPTER XVI

### THE RELATIONSHIP BETWEEN REDEMPTION OF DEBT AND DEPRECIATION OF CAPITAL EXPENDITURE

As stated in Chapter I, the maximum period sanctioned by the Government department responsible, within which full provision for redemption of loans must be made is almost invariably granted after taking into account the life of the assets or period of utility of the undertaking or services to be provided out of the borrowings.

### DIFFERENCE BETWEEN CAPITAL MONEYS OF MUNICIPAL AND INDUSTRIAL CONCERNS

The greater part of industrial capital involves no compulsion to redeem the capital invested. In fact, in the case of public limited liability companies capital may not be returned without consent of the Court. A waterworks, gas, or tramway company, for example, is under no obligation under the general law to provide for the redemption of its capital, but a local authority owning similar undertakings *must* make that provision for *all* its debt.

The contention held for a long time, principally by non-municipal men, that a local authority was failing in the fulfilment of its obligations if it neglected to provide adequately for depreciation of its capital assets *as well as* for the redemption of debt, was founded largely on the allegation (correct or otherwise) that the period granted for redemption of debt was much in excess of the life of the assets which occasioned the debt, and consequently, from an accountancy

point of view as also from an economical standpoint, the position was unsound. Sooner or later the assets would cease to be of value though debt would be outstanding. Other objections were that redemption of debt was a statutory requirement peculiar to local authorities and quite apart from the prudence of providing for depreciation, and that sometimes equated periods were granted for the redemption of both short-lived and long-lived assets, which resulted in the need for renewal of the short-lived ones before the equivalent sinking fund was complete.

Undoubtedly the contention is, or was, correct so far as the allegation is, or was, true.

The number of persons holding these views is probably diminishing, and the reason for this *may* be that in practically all cases sanctions are granted for periods that put all doubt on one side.

### PERIODS FOR REDEMPTION OF DEBT

To emphasize this fact the following extracts from the "Report of the Select Committee on the Repayment of Loans by Local Authorities," issued in 1902, are quoted—

Par. 6.—The Local Government Board (now the Ministry of Health), being charged with the general supervision of local finance, takes into its consideration in fixing the period for redemption not only the probable useful life of each part of an undertaking for which a loan is desired, but also the probable future condition of localities with regard to debt, in order that the ratepayers of the future may not be unduly burdened, and so rendered less able to discharge efficiently the duties that are likely to come upon them.

Par. 12.—In addition to the statutory limitations upon the periods for repayment already mentioned, there is a further provision, acting as a check in the case of some loans, to which the committee desire to call attention.

If the borrowing authority obtains the loan from the Public Works Loan Board, the period for repayment is determined by the Commissioners who are empowered by statute to make regulations governing all the conditions of these loans.



Section 11 of the Public Works Loans Act, 1875, directs the Commissioners in making such regulations to have regard to the durability of the work and to the expediency of the cost being paid by the generation of persons who will immediately benefit.

The general policy of the Commissioners is "to hold out inducements to accept short periods for repayment instead of throwing as much of the burden as possible upon posterity." One of these inducements is the acceptance of a lower rate of interest for a short term than for a longer one.

A comparison of the figures representing the actual debt outstanding with capital expenditure, will, in the majority of cases, emphasize that the sanctioning authority has exercised its powers in this connection to the full.

With comparatively few exceptions the value of capital assets on a pre-war basis (in order to eliminate abnormalities that have arisen in recent years) is much in excess of the debt now outstanding against such properties. It is not infrequent to find very substantial buildings acquired out of loan moneys in the first instance, but which are now absolutely free of debt, and are represented in the balance sheet as offset by "Surplus" or "Debt Redeemed."

### EXTENSION OF PERIOD OF REDEMPTION IN CERTAIN CASES

When special reasons have been cited to show satisfactorily that exceptional provisions for the redemption of debt should be sanctioned, the relief, where granted, takes the form of—

- (1) A longer period for redemption ;
- (2) Suspension of sinking fund provision ;
- (3) Capitalization of interest in the case of works needing a long period to construct.

Wherever relief is given, very good reasons must be brought forward.

Suspension of sinking funds and capitalization of

interest were reported on, and not unfavourably, in the 1902 report referred to, where circumstances justify the application.

The principle of allowing a suspension of sinking fund contributions and the modification of provisions for the redemption of loans has since been authorized by statute. [Local Authorities (Financial Provisions) Act, 1921, and the Electricity Supply Act, 1922.]

Section 4 of the 1921 Act provides that the annual provision for the redemption of debt may be suspended where the expenditure is for the construction of new or extension or alteration of existing works of a revenue producing character while the expenditure remains unremunerative. The Ministry of Health or other sanctioning authority determines the period of suspension, but it may not exceed a term of five years from the commencement of the financial year next after that in which the expenditure commences to be incurred.

Section 5 provides that where the local authority has been unable to make the required provision for redemption of debt owing to circumstances arising out of the war a scheme varying the statutory provisions may be submitted to the Ministry of Health which, if approved, will have effect as if enacted by statute. But the security, rights and remedies of the lenders must not be prejudiced or affected.

#### CREATION OF RENEWALS FUNDS

In order that contingencies such as premature obsolescence may be provided against, the Select Committee recommended the prudence of the creation of a fund which would be available in such circumstances. It was recommended "that the authority should be empowered to fix the method of repayment in all

cases and to provide for the establishment of a Repairs Fund where necessary.”

It would appear, however, that, except in the case of trading undertakings, in the absence of specific power obtained by means of a local Act, the legality of the establishment of any such fund, be it termed “repairs,” “renewals,” “depreciation,” “reserve,” “suspense,” “equalization,” or similar term, is doubtful.

#### **REDEMPTION PROVISION EQUIVALENT TO DEPRECIATION PROVISION**

Provision for the redemption of loan debt within the periods prescribed by the sanctioning authority is now generally regarded as equivalent in effect to the writing down (or providing for renewal) of the assets which occasioned the debt within the period of their lives or continuing utility.

That the contention is practical and sound, that the compulsory redemption of debt by local authorities is an effectual method of providing for depreciation, may be proved as stated in the fourth paragraph on page 106.

## CHAPTER XVII

### REGISTRATION OF STOCK

THE registration of stock is effected in some cases by a banker on the corporation's behalf, while in others the work is done by an officer of the local authority—generally the Borough Treasurer.

Much of the procedure which rightly falls under the heading of registration of stock has already been dealt with in Chapter V, where the subject of stock issues is treated. It is not proposed here to repeat what has already been written.

### ALLOTMENT LETTERS

Allotment letters are sent to those whose tenders are accepted. They contain information as to the payment of instalments, and state that when the amount is fully paid the letter will, on being endorsed and sent to the registrar, be converted into registered stock. The banker receiving the moneys furnishes the lenders with receipts for instalments paid.

### INSCRIBED STOCK

Requests may be made that certain stock, the receipts for which are shown on the face of the letter of request, may be inscribed in the books.

### STOCK REGISTER

A stock register will be kept in which is opened an account in the name of the corporation. This account is credited with the total issue, and debited with the amount of the holding of individual stockholders, the personal accounts of the stockholders being credited.

A specimen ruling is as follows—

**STOCK REGISTER**  
**STOCKTOWN CORPORATION 5% REDEEMABLE STOCK**  
**£500,000 NOMINAL VALUE AT £98 PER £100**

Date	No. of Allotment Letter.	From or to	Fo.	Dr.	Cr.	Balance	Remarks
1924 Aug. 9		Nominal value of issue		£	£	£ s. d.	
"	1	A.B.	2	10,000	500,000		
"	2	C.D.	3	20,000			
"	3	E.F. etc.	4	15,000 etc.			
				<u>£500,000</u>	<u>£500,000</u>		

A.B.

*Lyndale, Claremont Road, Buxton, Gentleman.*

Date.	No. of Transfer.	From or to	Dr.	Cr.	Balance.	Remarks.
1924 Aug. 9	1	Stocktown Corporation	£	£	£ s. d.	
				10,000		

C.D.

*198 Spring Gardens, Manchester, Incorporated Accountant.*

Date.	No. of Transfer.	From or to	Dr.	Cr.	Balance.	Remarks.
1924 Aug. 9	2	Stocktown Corporation	£	£	£ s. d.	
				20,000		

### FORM OF TRANSFER

A form of transfer is filled in prior to the acceptance of a transfer. It should show the full names and addresses of transferor and transferee, the consideration to be paid, and the amount of stock to be transferred.

### ORDINARY TRANSFERS

The transfer instrument should be examined very carefully, special attention being paid to all signatures including those of witnesses ; amount of stock standing to the transferor's credit ; stamp duty required (if not compounded for) ; agreement with power of attorney, if any ; comparison with stock certificate produced along with transfer instrument ; whether any notice of " Distringas " has been filed.

Before actually making the transfer, the registrar sends a notice to the transferor (*not his broker*), to the effect that a transfer has been received out of his name, of a certain amount of stock, and that in the absence of a reply objecting thereto within a specified period (about four days) it will be duly registered.

The transfer will be recorded in the Register of Transfers, and in the Stock Register.

The old certificate will be cancelled and a new one issued along with a balance certificate, if necessary.

The transfer fee will be charged and recorded.

### TRANSFERS ON TRANSMISSION BY DEATH

It is necessary to examine the probate or letters of administration, taking notice that they are genuine (and signed by the registrar), and the will for instructions as to treatment of stock. Unless held as trustee the sworn amount of the estate must exceed the amount of stock held, otherwise a transfer must not be registered. Certificate of death or burial, and certificate of identity, if required (*see* page 113) will also be examined.

Records will then be made in the transfer and stock registers and certificates dealt with by issue of new ones or endorsement of the old ones.

Specimen signatures of the executors or the persons

entitled must be procured, generally from the solicitors acting for the executors or other persons.

### TRANSFERS IN RESPECT OF TRANSMISSION ON MARRIAGE

The certificate of marriage, and the certificate of identity (if required) will be examined. Entries in the registers and endorsement of certificates will then be dealt with.

### CERTIFIED TRANSFERS

A certified transfer is one which contains a certificate by the registrar of the stock to be transferred, to the effect that the transferor holds sufficient stock to cover the transfer when lodged for registration. A registrar on certifying a transfer makes a memorandum in the transferor's account to this effect, but does not, of course, make the debit on the transferor's account until the transfer is actually lodged for registration.

The customary method in dealings of this kind is for the transfer deed to be completed by the transferor and forwarded, together with the stock certificate, to the registrar for certification. The registrar, after checking the documents with the stock register, signs the transfer and returns it to the transferor, who passes it on to the transferee, who in due course lodges it for registration.

The registrar's signature on the transfer deed is an official guarantee that the transfer will be made when the form is completed and lodged with him, and incidentally that it is reasonably safe for the purchaser to pay for the stock.

The dealings will usually be made through the brokers of the seller and buyer instead of with the

principals direct, except the notice to transferor that a transfer out of his name has been presented, which *must* be sent to the transferor and *not to his broker*.

The registrar's certificate on the transfer deed usually consists of a statement written (or printed) on a portion of the certificate, such as the following—

Stock Certificate for £..... forwarded to  
the Registrar's office by .....  
.....*Registrar.*

### CERTIFICATE OF IDENTITY

This is required where there is any doubt whatever as to the identity of the transferor in the case of a transfer on marriage or in respect of a deceased person, or if the registered address differs materially. It must be duly completed and stamped.

### STOCK ACCOUNTS IN THE NAMES OF BODIES CORPORATE

It is necessary in dealing with bodies corporate to obtain a form of request to open a corporate account duly filled in with a specimen of the corporate seal and the signatures of persons entitled to sign transfers on behalf of the corporate body.

It is of much importance and should be referred to in connection with every dealing in the stock concerning the body, any differences being properly inquired into.

### DIVIDENDS BY POST

Requests are often made that dividends be paid to bankers, or other nominees. The signatures on the request form should be carefully examined, and, if in order, the request is duly registered and complied with.



### DIVIDENDS BOOK

A dividends book is prepared from information drawn from the stock register, and contains particulars of the name and address of the stockholder ; a reference to the stock register ; details of dividend for the period showing warrant number, amount of stock held, period held, rate of dividend, amount of income-tax deducted, and the net amount of the dividend payable.

Additional columns may be inserted in order that one opening in the book will suffice for several periodical payments.

### DIVIDEND WARRANTS

Dividend warrants will be written from the dividends book and posted the evening before the date the dividend is due. The top portion of a dividend warrant is accepted by the Inland Revenue authorities as a voucher in support of claims for the repayment of income-tax.

### REGISTER OF TRANSFERS

A register of transfers is kept in which all transfers are recorded, and this is the posting medium for all transfers of stock. The book contains columns with headings such as the following: No. of transfer ; Date of transfer ; Date of registration ; From whom transferred ; Amount of stock ; Stock Register No. ; No. of cancelled certificate ; Stock Ledger folio ; To whom transferred, showing name, address and description ; Register No. ; No. of new certificate ; Stock Ledger folio ; Consideration money ; Remarks.

### STOCK CERTIFICATE

As soon as the stock issue is *fully* registered subsequent transfers are easy to check. As the old

certificates are cancelled new ones for the same value are issued. Only new ones equivalent to those cancelled will be signed and issued.

A form of stock certificate is as follows—

£. . . . . No. . . . .

COUNTY BOROUGH OF STOCKTOWN

5% Corporation Redeemable Stock Certificate

(This stock is redeemable at par at the option of the Corporation on or after the . . . . . day of . . . . . 19. . . . . and must be redeemed, or purchased and extinguished within . . . . . years of its creation.)

REDEEMABLE 1944—1984

This is to Certify that . . . . . is the proprietor of . . . . . pounds . . . . . s. . . . . d. of *Stocktown Corporation Redeemable Stock*, subject to the Acts of Parliament relating thereto.

Given under the Common Seal of the Mayor, Aldermen and Burgesses of the County Borough of Stocktown, by order of the Council this . . . . . day of . . . . . 19 . . . . .

.....

Mayor.

.....

Town Clerk.



.....

Registrar

## CHAPTER XVIII

### GOVERNMENT RETURNS IN RESPECT OF BORROWINGS

LOCAL authorities must make certain returns to the Ministry of Health in connection with loans as follows—

#### (1) RETURNS *RE* STOCK UNDER THE STOCK REGULATIONS, 1891-1921

These must be in the prescribed form, made up to the 31st March annually and forwarded to the Ministry of Health within seven weeks after that date, duly verified by statutory declaration of the clerk, treasurer or other authorized officer of the local authority. The return relates to the stock and the redemption fund accounts, and contains 51 columns as follows—

- (1) Name of Corporation.
- (2) Act or Order under which abstract is made.
- (3) Designation of stock in respect of which the abstract is made.
- (4) Distinctive title of fund to which the abstract relates.
- (5) Period for which abstract is made, viz., year ended . . . . .
- (6) Rate of interest on stock.
- (7) Average price of each issue of stock.

#### BORROWING POWERS

- (8) Purpose and account in respect of which borrowing power is exercised.
- (9) Act of Parliament, Provisional Order, or sanction authorizing borrowing.
- (10) Amount of borrowing power.

Amount of borrowing power exercised up to commencement of year—

(11) (a) By the issue of stock.

(12) (b) By the application of part of Loans Fund and transfer to the account of the borrowing power exercised of stock previously charged on another account.

Amount of borrowing power exercised up to end of year—

(13) (a) By the issue of stock.

(14) (b) By the application of part of Loans Fund and transfer to the account of the borrowing power exercised of stock previously charged on another account.

(15) Total borrowing power exercised by the issue or transfer of stock and otherwise up to end of year.

(16) Period within which loan is repayable.

(17) Date when first instalment or payment to Loan Fund became due.

(18) Rate of interest on which payments to Loan Funds are based.

#### STOCK ACCOUNT

Amount of stock issued on or transferred to each account up to commencement of year—

(19) (a) Stock originally issued on the account.

(20) (b) Stock transferred to the account.

Issue, transfers, and extinction of stock on each account during year—

(21) Amount of new stock issued.

(22) Amount of stock transferred to the account.

(23) Amount of stock transferred from the account.

(24) Account from or to which transferred.

(25) Amount of stock extinguished.

(26) Total amount of stock transferred from or

extinguished on each account up to commencement of year.

(27) Total amount of stock transferred from or extinguished on each account up to end of year.

(28) Amount of stock remaining (i.e. neither transferred nor extinguished) on each account at end of year.

#### LOANS FUND ACCOUNT

(29) Amount received and paid to Loans Fund during year from sales of surplus land, etc.

(30) Rents and profits of land or other property not appropriated or made applicable to other purposes than the Loans Fund and paid into that fund during year.

(31) Amount having formed part of any sinking fund, and paid into Loans Fund during year.

Amount carried to Loans Fund during year as interest on investments—

(32) Of Loans Fund.

(33) Of sums received for issue of stock and invested as not applied.

(34) Amount carried to Loans Fund during year as the equivalent of dividends on stock redeemed or interest on part of the fund applied in extinction of stock.

(35) Amount carried to Loans Fund during year for payment of dividends on unredeemed stock or stock not transferred to another account.

(36) Amount carried to Loans Fund during year for redemption of stock, and not included in previous columns.

(37) Rate, fund, or revenue from which payments in last three preceding columns were made.

(38) Total carried to Loans Fund from all sources during year.

Amount standing to credit of Loans Fund at commencement of year—

(39) For payment of dividends.

(40) For redemption of stock.

(41) Amount of dividends paid during year.

(42) Amount paid for redemption of stock during year.

Amount applied to borrowing power on other account during year—

(43) Amount.

(44) Account to which transferred.

(45) Total carried to Loans Fund for redemption of stock up to end of year.

(46) Total paid for redemption of stock up to end of year.

(47) Total applied to borrowing powers on other accounts up to end of year.

Amount standing to credit of Loans Fund at end of year—

(48) For payment of dividends.

For redemption of stock—

(49) Uninvested.

(50) Invested.

(51) Description and nominal amount of securities in which invested.

## (2) RETURNS *RE* STOCK, MORTGAGES, AND OTHER FORMS OF BORROWING UNDER LOCAL ACTS AND GENERAL STATUTES

In respect of stock, returns relating to stock and redemption fund accounts are required as above.

In respect of mortgages, etc., returns relating to sinking funds and instalment loans must be made up and verified as specified above for stock.

### (3) RETURNS *RE* LOANS FROM THE PUBLIC WORKS LOAN COMMISSIONERS

Separate accounts for these loans and returns (supported by statutory declaration as to verification) must be made to the Ministry of Health and to the Commissioners generally, showing exactly how each loan has been applied (Public Works Loans Act, 1882).

### (4) EPITOME OF ACCOUNTS

This return (formerly called the Local Taxation Return or A and B Return) or, in the case of those local authorities subject to the district audit, Financial Statement to the Ministry of Health, showing, *inter alia*, particulars of all loans borrowed, expended, redeemed, outstanding ; sinking funds in hand ; etc.

## CHAPTER XIX

### STATISTICS RELATING TO LOANS AND BORROWING POWERS

THERE are few sections of a local authority's activities which, from the financial point of view, are more worthy of the collection of considerable statistical information than that relating to loans and borrowing powers. To enumerate with illustrations all the various tables and statements of value would occupy too much space. Then, again, many forms to be found in use and in annual abstracts of accounts are based on purely local conditions and local ideas.

The following statements are considered advisable and useful, but are to be taken as a general guide only. They may be altered and augmented according to individual requirements—

(1) Statement of Borrowing Powers, Sinking Funds and Secured Debt.

(2) Statement showing Net Increases and Decreases in Secured Debt during the past Financial Year, under Departmental Headings.

(3) Summary Statement showing Total Secured Debt over a period of years.

(4) Statement showing Rates of Interest paid on Secured Debt under Departmental Heads (with an average rate calculated for comparative purposes).

(5) Statement showing Amount of Loans Falling Due for Redemption under Departmental Heads, for each year till whole Debt is Redeemed, analysed under various kinds of loans.

(6) Statement showing Amounts paid in Interest during the past Financial Year, under Departmental Heads.



(7) Summary Statement showing Total Capital Outlay, under Departmental Heads.

(8) Statement showing New Borrowing Powers Received during past Financial Year.

(9) Statement showing Actual Numbers and Amounts of Loans Negotiated during each Year over a Period, stating New Loans, Renewals, etc., separately.

(10) Statement showing Investments of Funds Available for Redemption of Debt.

(11) Statement showing Total Sinking Funds, and Redemption Funds.

As many of the statements referred to above are self-explanatory, specimen rulings are unnecessary. In view of the remarks in the latter part of the first paragraph of this chapter together with the exigencies of space, specimen rulings will be confined to Nos. (1) and (7).

#### **No. 1—STATEMENT OF BORROWING POWERS, SINKING FUNDS AND SECURED DEBT**

This statement is probably the most important, most useful, and most suitable to adopt for purposes of illustration.

Many forms, similar in some respects though vastly different in other ways, are in use. Probably in no two towns is exactly the same form adopted. It is proposed to set out the columns of three of such statements calculated to be typical of what such a statement should contain.

**Illustration (a).** The statement is prepared in sections under departmental heads. Each section is totalled and carried to a summary at the end, which summary statement then shows the aggregated

information relating to the whole of the local authority.

<i>Column</i>	1. Act of Parliament or Sanction.
„	2. Purpose.
„	3. Amount of Borrowing Powers.
„	4. Capital Expenditure against Borrowing Powers.
„	5. Borrowing Powers Exercised.
„	6. Period of Redemption—
	(a) Authorized (years).
	(b) From 31st March last.
	(c) Unexpired Period (years).
„	7. Contribution to Sinking Fund—
	(a) During past year.
	(b) Total to date.
„	8. Borrowing Powers less Sinking Fund and Debt Redeemed (Nominal Debt).
„	9. Secured Debt, 31st March.
„	10. Subsisting Borrowing Powers—
	(a) Borrowing Powers Unexercised.
	(b) Loans Repaid which may be Re-borrowed.
„	11. Amount of Sinking Fund Unapplied.
„	12. Remarks.

### Illustration (b).

<i>Column</i>	1. No.
„	2. Purpose.
„	3. Date of Sanction.
„	4. Years originally Sanctioned.
„	5. Amount Sanctioned to be Borrowed.
„	6. Capital Expenditure.
„	7. Unexpended Borrowing Powers.
„	8. Sinking Funds in Hand.
„	9. Loans Redeemed.
„	10. Balance of Expenditure.
„	11. Loan Redeemable at 31st March

### Illustration (c).

<i>Column</i>	1. Purpose of Loan.
„	2. Authority for Borrowing Powers (i.e. Act of Parliament).
„	3. Date of Sanction.
„	4. Term of Sanction (years).
„	5. Amount authorized to be Borrowed.
„	6. Amount Borrowed during the past Financial Year.
„	7. Total Amount Borrowed.
„	8. Contributions to Sinking Fund—
	(a) During past Financial Year.
	(b) Total to date.
„	9. Debt Redeemed—
	(a) During past Financial Year.
	(b) Total to date.

**Illustration (c)—*contd.***

- Column* 10. Debt Outstanding—  
 (a) Mortgages.  
 (b) Stock.  
 „ 11. Amount in Sinking Fund—  
 (a) Invested.  
 (b) Not Invested.

**No. 7—SUMMARY STATEMENT SHOWING  
 TOTAL CAPITAL OUTLAY UNDER  
 DEPARTMENTAL HEADS**

- Column* 1. Purpose (Shown under Funds and Departments).  
 „ 2. Total Outlay at Commencement of Financial Year.  
 „ 3. Outlay during Year.  
 „ 4. Receipts and Credits during Year.  
 „ 5. Total Net Capital Outlay at end of Financial Year -  
 (a) Remunerative and Realizable.  
 (b) Unremunerative but Realizable.  
 (c) Unremunerative and Unrealizable.  
 (d) Total.  
 „ 6. Loans Allocated.  
 „ 7. Borrowing Powers.  
 „ 8. Unexhausted Borrowing Powers.  
 „ 9. Expenditure in Excess of, or without, Sanction to  
 Borrow.  
 „ 10. Debt Redeemed and Sinking Fund in Hand.  
 „ 11. Total Net Capital Outlay to date *less* Debt Redeemed  
 and Sinking Funds in hand, i.e. Debt outstanding.

## CHAPTER XX

### CAPITAL EXPENDITURE DEFRAIDED OUT OF CURRENT REVENUE

WHEN expenditure of a capital nature is contemplated the usual custom is to apply for a sanction to borrow the money for the *longest* possible term. Probably this arises because the longer the period during which provision for redemption is to be made the smaller is the *annual* debt charge falling on the rates. But the fact should not be overlooked that the *total ultimate* cost to the local authority will be greater as a consequence. The reason is because interest on the full unredeemed loan is accruing and being paid all the time, and the sooner the debt is discharged the earlier the annual interest thereon ceases. It is the interest, and not the provision for redemption, that causes the chief difference in ultimate total cost.

It would appear to be a more prudent course instead of requesting a lengthy loan period to determine what is the largest annual charge revenue or rate account can bear and then seek a sanction for a term involving that amount. Even if sanction be given to borrow for a longer period, there is no obligation to exercise it to the full extent. It will be remembered that the consent given is for a period "not exceeding so many years from date of borrowing."

Many persons, including members of a council, have the impression that if work is carried out with loan moneys the expenditure does not burden the rates.

Though it may seem strange it is nevertheless a fact that the reverse is nearer the truth.

### EFFECTS OF LONG AND SHORT TERM LOANS COMPARED

To charge capital expenditure to loan account directly increases current and future rates for a very long time, while, on the other hand, to defray the same expenditure out of current rates actually keeps subsequent rates down.

A loan of £10,000 borrowed at 5 per cent interest for a period of fifty years involves a total charge on the rates during that period of £27,388 7s. 5d. (made up of £25,000 for interest, and £2,388 7s. 5d. for sinking fund contributions). If borrowed for thirty years the total cost is £19,515 8s. 8d. (being £15,000 for interest and £4,515 8s. 8d. for redemption). A similar loan for ten years entails a total cost of only £12,950 9s. 2d. (being £5,000 for interest and £7,950 9s. 2d. for discharge of principal).

The same amount of capital expenditure, viz., £10,000, defrayed out of current rates direct involves a maximum charge of £10,000, there being no interest and no redemption to provide for.

Shown in concise form, and including other periods, the situation is as follows—

Period Years.	TOTAL COST.			Percentage of total cost in excess of prin- cipal amounts.
	Redemption of Principal.	Interest.	Total.	
80	£ 824	£ 40,000	£ 40,824	308-24
60	1,697	30,000	31,697	216-97
50	2,388	25,000	27,388	173-88
30	4,515	15,000	19,515	95-15
10	7,950	5,000	12,950	29-50
charged to rev- enue or rates direct. }	10,000	—	10,000	Nil.

## ANNUAL DEBT CHARGES GREATER THAN CAPITAL EXPENDITURE OUT OF LOANS

A reference to the financial transactions of almost any town is likely to reveal a startling surprise, viz., that the annual amount paid for interest on debt and provision for redemption greatly exceeds the amount expended on capital works.

## LOCAL AUTHORITIES HAVE NO "REAL" CAPITAL EXPENDITURE

There is really no such thing as capital expenditure in the case of a local authority in the sense that expenditure is defrayed out of capital and not out of revenue. Rather is it revenue expenditure which it is decided shall, instead of being charged in the accounts of the current year, be spread over a period. No matter how long the period of the loan it must in the end be provided wholly out of revenue.

While it is apparently quite within the bounds of legality to defray the whole of each year's capital expenditure out of current revenue, it may not be practicable nor equitable. Nevertheless the cutting down of periods of future borrowings to an absolute minimum with a view to getting as near to the ideal as possible is undoubtedly worth consideration.

**Suggestions for Alteration of Present System.** Where the financial position is very good the advisability of carrying the idea to a further extent may be considered. Procedure would probably be on lines similar to the following—

(a) Separate all existing loans into two general classes—

(i) those redeemable within a comparatively short period, say for example, 10 years, and

(ii) those which cannot be paid off until a date further distant than 10 years, except with consent of the lenders ;

(b) further divide the loans coming under (a) (i) between

(i) those which automatically fall due for final discharge by reason of the expiration of the sanctioned period, within the 10 years, and

(ii) those which *could* run under the respective sanctions for longer than 10 years ;

(c) recalculate the sinking funds or redemption funds in respect of the loans coming under (b) (ii) (except, of course, those redeemable on the instalment or annuity system) based on the assumption that only 10 years of the authorized term remains ;

(d) arrange with lenders, where possible, in respect of debt falling under (a) (ii) for redemption in 10 years time (without paying more compensation than is economically sound finance) ;

(e) such of the loan holders as would not fall in with the suggestion in (d) above would hold the only loans that would remain outstanding after the expiration of 10 years.

The suggestions made in the above paragraph are purely imaginery, but at the same time appear to be quite within the bounds of possibility without the consent of any Government department and without any question of illegality, provided the increased charge falling on any section of a rating fund would not exceed a rate limit, where such a limit is in force.

The greatest difficulty to overcome is that of the increased charge falling on the rates during the ensuing 10 years. If the ratepayers could not stand the strain or would not consider as a reward a reduction in future rates and the early immunity from debt

(which is very probable), an alternative to abandoning such a project would be a lengthening of the transition period.

So far as charging current capital expenditure to current revenue account is concerned, the introduction of an Equalization Suspense Account suggests itself, but in the absence of specific power, obtained by means of a local Act, such procedure would appear to be illegal. In years when the actual capital expenditure fell short of the average the transfer of the balance would be equal to creating a reserve, while the reverse circumstances might involve an overdraft which, though like a loan, would not be supported by a sanction and might be construed into an unauthorized borrowing.



## CHAPTER XXI

### MISCELLANEOUS MATTERS

#### STAMP DUTY ON LOAN CAPITAL

STAMP duty is payable on all borrowings except those of a purely temporary nature, i.e. those redeemable within twelve months from the date of borrowing. Thus temporary bank overdrafts, bills of exchange, and any other form of loan raised for a term not exceeding one year do not come within the definition of "Loan Capital" for the purpose of calculating the duty payable in accordance with the provisions of the Stamp Act and the Finance Acts.

**Stock.** The duty is on an *ad valorem* scale being at the rate of two shillings and sixpence per £100 of loan (or fraction of £100) raised for *new capital purposes*, but only sixpence per £100 of loan in respect of that raised and applied for the purpose of conversion or consolidation of existing debt.

(*Note.*—Where the issue is for conversion or consolidation the full 2s. 6d. per cent is paid in the first instance, but a repayment of 2s. per cent is made if the account has been delivered to the Inland Revenue Commissioners and paid).

The local authority must deliver within one month of issue, to the Commissioners of Inland Revenue, an account of the stock. On the basis of the figures in this statement the local authority pays its stamp duty. An additional duty of £10 per cent on the duty payable is charged if the authority neglects to deliver the account within the prescribed period of one month, and a further £10 per cent on the duty payable for each further month of neglect.

In respect of transfers of stock, stamp duty is payable as follows—

If no compounding agreement has been entered into between the local authority and the Inland Revenue Commissioners under provisions of the Stamp Act, 1891, stock is transferable by deed only (not merely by book entry), and requires to be duly stamped as a deed, in which case the duty is an *ad valorem* one at the rate of £1 per cent.

Agreements are usually entered into with the Commissioners under Section 115 of the Stamp Act, 1891 (as amended by Section 38 of the Finance Act, 1920), whereby stamp duties on transfers of stock are compounded for. In these circumstances transfers may be made free of stamp duty and thus the marketability of the stock is favourably affected, and the practice is much appreciated by stockholders.

The amount payable is known as "Composition for Stamp Duty," and is at the rate of two shillings per cent per annum on the nominal amount of stock outstanding.

**Mortgages and Annuities.** The stamp duty on new loans is an *ad valorem* one, at the rate of 2s. 6d. per cent on the amount borrowed, and is paid by the local authority on each deed separately by means of an impressed stamp affixed at the Inland Revenue Office. The duty is the same irrespective of the period of the loan. For duty purposes a renewal is classed as an agreement and a duty of 6d. is payable. To effect a renewal at this rate of duty the stamping must be done before the expiry of the bond. Stamp duty on transfers of mortgages is an *ad valorem* duty of £1 per cent, a mortgage bond being considered a marketable security.

**Loans on Deposit.** Sometimes a deposit receipt only

is given, bearing the usual receipt stamp (twopence). If the receipt contains a statement to the effect that a mortgage deed will be issued on application by the depositor, apparently a sixpenny agreement stamp is required. When a mortgage deed is requested it must be stamped as stated in the section relating to stamp duty on mortgages.

**Bills of Exchange.** Bills of exchange issued by local authorities require the same stamp duty (*ad valorem*) as do commercial bills of exchange.

**Housing Bonds.** Housing bonds are exempt from stamp duty on *issue* but not on *transfer*, in respect of which it is desirable to compound for stamp duty, otherwise the ordinary *ad valorem* duty of 2s. 6d. per cent is chargeable.

**Utilization of Sinking Funds.** If mortgage deeds are made out in respect of the new borrowing, stamp duty consistent with the nature of the bond is required.

Where the application of the sinking funds is merely a book transfer appropriating loans from one purpose to another within the same fund, no duty is payable.

**Public Works Loans (including proportion of National Savings Certificates).** The deeds are prepared by the Commissioners, and the stamp duty is the same as that applicable to mortgages and annuities. In addition, certain fees are payable (*see* page 39).

**Stamp Duty on Transfers.** The cost of stamp duty on transfers (where not compounded for) is usually borne by the transferor or the transferee and not by the local authority. Though it does not matter to the latter body it is interesting to note that the stamp duty on a transfer is £1 per cent as compared with 2s. 6d. per cent (mortgages and stock) and *nil* (housing bonds) on a new deed, and if the liability fell on the

local authority it would be economical to make out new bonds in all cases of transfer.

Stamp duty in respect of transfers is payable on the transfer value and not on the nominal amount of the loan.

### FORGED TRANSFERS ACTS, 1891-1892

The objects of the 1891 Act were to authorize the establishment of a fund by local authorities and public companies so that means would be available for the payment of compensation for losses on forged transfers of stock or mortgages.

The fund may be accumulated by—

(1) Crediting it with fees charged to the transferee and being not more than one shilling per £100 of loan transferred ;

(2) Accumulation of income ;

(3) Reserve of capital ;

(4) Insurance.

A local authority is given power to borrow any sums it has to pay as compensation in respect of forged transfers, on the security of its property, etc., for a period not exceeding five years. The loan is generally charged on the same security as that given the original lenders.

Where compensation is paid, the local authority still retain the same rights or remedies against the persons liable for loss as the person compensated would have had.

The 1892 Act provides that persons receiving compensation need not necessarily have contributed to any fund out of which compensation is paid, and that a fee of one shilling per cent may be charged on every £100 of loan transferred with a minimum charge equal to that for £25.

**LOCAL AUTHORITIES (FINANCIAL PROVISIONS)  
ACT, 1921**

(as amended by the Local Authorities (Emergency Provisions)  
Act, 1923).

The chief provisions of this statute are as follows—

Section 3. (1) Authorizes borrowing on short term loans, temporary loans, or bank overdraft, with the consent of the Ministry of Health, such sums as the local authority may from time to time resolve, but not exceeding in the aggregate at any time the maximum amount sanctioned by the Minister. Borrowing may be for the purpose of providing temporarily for current expenses incurred in the execution or performance of its powers and duties (including the payment of any sums due by it to meet expenses of other authorities).

(2) Sums borrowed shall be charged on the funds, properties, rates and revenues of the local authority *pari passu* with all other mortgages, stock and other securities affecting the same.

(3) Amounts borrowed (under this section) along with interest thereon must be repaid out of the revenue received in respect of the financial year in which the expenses were incurred. The Minister had power to extend the term of redemption for a period not exceeding ten years, if satisfied that the particular circumstances of the case justified such a course in respect of money borrowed under this section before 1st April, 1924.

(5) Powers under this section are in addition to and not in derogation of any other borrowing powers of the local authority.

Section 4 gives power to local authorities to suspend the annual sinking fund provision in cases where money is borrowed for the construction of new, or extension

or alteration of existing works of a revenue-producing character while the expenditure remains unremunerative, but only for a period (determined by the sanctioning authority) not exceeding five years from the commencement of the financial year next after that in which such expenditure commences to be incurred.

Section 5 authorizes the submission to the Minister of Health, for his approval, of a scheme varying the statutory provisions regarding the redemption of any loans where the local authority is unable to make the required provision owing to circumstances arising out of the war. But the rights, remedies and security of any mortgagee or other person from whom the loans were raised shall not in any manner be prejudiced or affected.

Section 6. Money borrowed before 1st April, 1924, if certified by the Minister of Health to have been borrowed for the purpose of any work undertaken by the authority with a view to the provision of employment for unemployed persons, and money borrowed under provisions of this Act for the purpose of providing temporarily for current expenses, shall not be reckoned as part of the debt of the local authority for the purposes of any enactment limiting the powers of borrowing by the authority.

Section 7 provides that for the purposes of this Act the term "local authority" means the council of any borough and any authority whose accounts are subject to audit by district auditors.

### SINKING FUND REGISTERS

A separate sinking fund is necessary for each borrowing power or part of a borrowing power exercised,

### SINKING FUND REGISTER.

Purpose of Loan { *Provision of a Public* } Date of Sanction *8th November, 1924.*  
*Elementary School* { *at* ..... }

Amount of Loan sanctioned £20,000. Date of Borrowing *9th August, 1926.* Amount Borrowed £12,000 (*part of £20,000*)  
 Period sanctioned 30 years. Rate of Accumulation *3 per cent.*

Year ending 31st March.	Annual Instalment charged to Revenue Account.	Annual Interest on Investment of Fund.	Total Annual Payments into Fund (Cols. 2 and 3).	Total Amount of Fund at end of each year (Amount at end of previous year plus col. 4).	Loan outstanding at commencement of year.	Amount Re-deemed.	Loan outstanding at end of year.	Amount withdrawn from Fund.	How amount withdrawn is applied
1	2	3	4	5	6	7	8	9	10

**NOTE.**—Sometimes other columns are to be found showing interest on amounts withdrawn, actual amount of sinking fund in hand at beginning and end of each year, etc. Much of the additional matter is purely statistical and varies locally.

and tables or schedules should be compiled to show the amount which must be set aside annually and the amount of the fund at the end of each year during the period of accumulation, as suggested in Chapters XII and XIII.

At this juncture it may not be out of place to state for the benefit of the young student that provision for redemption of debt must be made *from the date of the borrowing of the money*, not from the date of the sanction, and *for the amount borrowed*, not the amount of the sanction. For example, a sanction to borrow for a period of 30 years may be received on the 1st April, 1924, authorizing a sum of £20,000. It may happen that no money is expended or borrowed until 1926, and then only £12,000 is raised. A sinking fund table is prepared showing the sums required to provide a fund to redeem a loan of £12,000 in 30 years from 1926. In the following year a further £4,000 is borrowed and in 1928 the work is completed, so far as the local authority intend to go on with it, at a total cost of £18,769. Further sinking fund tables are prepared in respect of the later borrowings as follows: One for £4,000 for 30 years from 1927, and one for £2,769 for 30 years from 1928. If the balance of the sanction (£1,231) is never spent, no provision for redemption is, of course, required.

Sinking fund tables or schedules are generally written up in a register, either a bound book or on the loose-leaf principle. Many forms of register are in existence, varying according to the local ideas of the officers responsible. Some contain only columns 1-5 of the form shown on the opposite page, while others are very elaborate and contain much detail. The ruling shown will serve as a general guide.



## OBSOLETE CAPITAL EXPENDITURE (SUPERSEDED WORKS)

It sometimes happens that assets become prematurely obsolete. Where the expenditure thereon has been capitalized though defrayed out of revenue account, the value may be written off against the "surplus" item appearing in the balance sheet under the heading of "Revenue Contributions to Capital Outlay." Where defrayed out of loans and the assets cease to be of value before the loan period has run out, and consequently before the sinking fund is sufficient to redeem the debt, the expenditure necessary for the replacement of such obsolete portion may be dealt with in one or more of the following ways—

(1) By replacing the obsolete asset out of revenue account ;

(2) By replacing it out of a depreciation fund, or renewals fund, if available ;

(3) By replacing it out of general reserve fund or surplus, provided there is sufficient available and that such fund or surplus is represented by sufficient cash or liquid assets. Otherwise, though the fund may be enough, lack of cash makes the transaction physically impossible.

(4) By borrowing the amount. The Ministry of Health will now sanction the full cost of the new works, but require that the debt outstanding on the old works be redeemed out of revenue or reserve.

There is very little difference between these methods. A certain portion of the capital expenditure becomes obsolete, i.e. the whole of the expenditure less the amount of debt redeemed or provided for. This portion is an absolute loss, and must be charged in the accounts as such, and must be defrayed out

of one or more of the funds mentioned above (1), (2) and (3).

Exactly the same applies under all four methods, though, if (1), (2) or (3) be adopted and new complete assets are replaced *in their entirety*, such portion as was offset by provision for redemption of debt is not a loss but either a creation of further reserve fund or surplus or a retention of such funds at their full figure.

### SALES OF LAND OR PROPERTY

The proceeds of sales of property, etc., bought out of loan capital should be paid into the sinking fund or redemption fund, and if the amount be appreciable the fund should be re-calculated and the benefit of the sale spread over the remaining period.

### RE-CALCULATION OF SINKING FUND CONTRIBUTIONS

In making an alteration in the annual contribution to a sinking fund, care must be taken that the new figures are on a correct basis. A moment's reflection will show that to ascertain the total of the fund at the date of re-adjustment and to calculate the new annual contribution by apportioning the amount still to be provided for over the remainder of the period, is wrong, because this overlooks an important factor, viz., that of the compound interest (on the balance of the fund at that date) which will also be credited to the fund.

Probably the simplest method to adopt is as follows—

(a) From the original amount of loan deduct the amount in the sinking fund at the date of the readjustment ;

(b) Calculate the annual contribution for a new sinking fund for the remainder of the period of the original fund on the balance of the loan remaining to be provided for ;

(c) From the result of (b) deduct one year's interest at the rate at which the sinking fund is accumulating on the amount of the fund at the date of readjustment ;

(d) The result of (c) is the annual revenue contribution to the sinking fund for the remainder of the period.

An alternate method is to reduce the annual contribution to the sinking fund after the date of readjustment by an amount equivalent to an annuity for the redemption of the amount specially paid into the fund at the rate at which the fund is accumulating, in the remaining period of the fund ; or, which amounts to the same thing, find out what the present balance of the sinking fund will amount to at compound interest (the rate at which the fund is being accumulated) by the end of the sinking fund period and deduct this amount from the total to which the fund must accumulate. The new contribution will be based on the provision of the balance in the remainder of the period.

*Example.* A sinking fund, accumulating at 3 per cent for 30 years, is created to redeem a loan of £10,000. At the end of 10 years £1,000 being the proceeds of the sale of a capital asset is paid into the sinking fund. The annual contribution may be reduced as follows—

Amount in fund at end of 10 years, including the	£	s.	d.
special payment thereto of £1,000	.	3,409	12 2
Deduct from the original loan of	.	10,000	- -
Leaving	.	£6,590	7 10

	£	s.	d.
Calculate the contribution for a new sinking fund on this amount for 20 years at 3 per cent and one gets (i.e. $.03721571 \times \text{£}6,590$ 7s. 10d.)	245	5	3
Deduct from this one year's interest at 3 per cent on $\text{£}3,409$ 12s. 2d.	102	5	9
New Annual Contribution from the 11th year onward	<u>£142</u>	<u>19</u>	<u>6</u>

**Alternative Method.**

£3,409 12s. 2d. in fund at end of 10 years will amount at 3 per cent compound interest in 20 years to	6,158	2	9
Therefore, the new sinking fund contribution from the 11th year onward will be calculated on the basis of providing $\text{£}3,841$ 17s. 3d. (i.e. $\text{£}10,000 - \text{£}6,158$ 2s. 9d.) in 20 years on a 3 per cent basis.	142	19	6

**CALCULATIONS WITHOUT TABLES**

To ascertain the number of years during which a sum of money will approximately double itself at compound interest divide the figure 69 by the rate of interest.

To ascertain the annual contribution in respect of a loan repayable by the annuity method, when no annuity table is available, calculate the contribution on a sinking fund basis and add to this one year's interest on the full capital amount. The result is the figure sought.

The annual sinking fund contribution may be calculated by the method described on page 75.

**SURPLUS LOANS**

The treatment of surplus loans may be considered under four headings—

(a) Where a sanction is exceeded (a surplus borrowing).

(b) Temporary overborrowings in respect of borrowings for replacement of loans.

(c) Stock raised in excess of immediate requirements but needed shortly.

(d) Mortgages raised in excess of immediate requirements but needed shortly.

**Class (a)—Surplus Borrowings.** Those in class (a) may arise in any of the following circumstances—

(1) Where more money is borrowed than spent, though the amount sanctioned is not exceeded.

(2) Where more money is spent than sanctioned, though the amount borrowed does not exceed the sanction.

(3) Where more money is spent and borrowed than authorized by the sanction.

**Methods of Treatment** are: In the case of (1) the surplus represents an unexpended balance and is perfectly legal. The surplus money, if mortgages, may be dealt with by returning it to the lenders, if agreeable to them, and if returned within a year of borrowing it no sinking fund need be set aside on such amount repaid. If the mortgagees will not take it back, and where the local authority does not wish to return the money, it may be applied to another sanction. If not dealt with within a year of borrowing, it should be treated as debt and sinking fund provision set aside on it. The unspent amount may then be paid into the sinking fund and used to redeem loans as they fall due, or may be invested or utilized in any way in which a sinking fund may be dealt with. If the amount is sufficient to warrant it the sinking fund may be readjusted. If the surplus arises by way of stock the circumstances are similar, except that of returning it to the lenders.

In the case of (2), if the expenditure in excess of sanction is considerable, further borrowing powers may be sought to cover it. If not sanctioned, or if no sanction be applied for, the excess should be charged against the current revenue or rate account, not

overlooking the fact that expenditure included in a rate estimate must not be more than six months old and that bank interest on overdraft, in a case such as this, is illegal and is a personal liability on the individual responsible.

In the case of (3), further borrowing powers may be sought, and if obtained the trouble is ended. Failing this method the excess borrowing over the sanction may be applied (with the consent of the lender if necessary) to another borrowing power and the excess expenditure then remaining, over the amount of loan remaining, may be defrayed out of current rate or revenue account. A further way out of the difficulty is to arrange (if possible) for a return of the excess borrowing over the sanction to the lenders and then charge the excess expenditure to current rate or revenue account. In all these methods under case (3) action should be taken within a year of borrowing so that the loan will not appear as debt in excess of powers available in the annual abstract of accounts.

**Class (b)—Temporary Overborrowings.** It often happens that borrowings are effected for replacement of loans falling due before the sanction has expired. The loans may be due for repayment at or about the end of the financial year, and to avoid an overdraft at the bank money is borrowed to replace that which is about to be repaid. Sometimes the repayment is not claimed within the financial year, or a renewal is effected after the money has been borrowed for replacement. In these circumstances there is an overborrowing of a temporary nature. It is not usually shown in the abstract of accounts (unless applied to an available sanction) as debt outstanding against a borrowing power, but as a temporary overborrowing to be rectified during the next financial year.

**Class (c)—Stock Raised in Excess of Immediate Requirements.** Sometimes more money is raised by stock than is *immediately* required but which must be kept in a fairly liquid form in order to be available as soon as further capital expenditure requires it.

Surplus moneys of this description must be invested in temporary securities (Stock Regulations, 1891).

In view of the fact that the money must be at call or short notice, the only investments available are probably Treasury bills and short term loans to other corporations.

Interest earned on such temporary investments should be credited to Dividends Account. Any capital profits made on realising the securities should be credited to Redemption Fund.

On the other hand, care should be taken to avoid possible losses by reason of a lower rate of interest being earned on these temporary investments than is being paid on the stock. Any loss of this kind should be borne by the various funds of the local authority in proportion to the stock allocated.

**Class (d)—Mortgages Raised in Excess of Immediate Requirements.** Mortgage loans are raised as required, and consequently there is not much likelihood of circumstances similar to those stated in the previous section relating to stock, arising to any appreciable extent. Where there is a small temporary surplus borrowing in excess of immediate requirements, but to be wanted shortly, probably the best method is to place the money in the bank, there to earn bank interest which is added gross (no tax deduction), which in view of the short period it will stay there and the small amount of such surplus, is not likely to involve much loss in respect of interest received being less than interest paid on it.

### TEMPORARY OVER-REPAYMENTS

A temporary over-repayment sometimes arises where loans fall due for repayment before the end of the period sanctioned for borrowing. Where the lenders will not renew, the loans are usually paid out of capital account and replaced by re-borrowing. Sometimes it happens that at the end of the financial year the repayments have not been completely replaced, in which case the over-repayment is not treated as a redemption of debt to the extent of the over-repayment, but is shown in the abstract of accounts as a temporary over-repayment to be rectified during the next financial year.

### BORROWING FROM PERSONS WHOSE CONTRACTUAL CAPACITY IS DEFECTIVE

It often happens that offers of loans are made by persons not in possession of full unrestricted power legally to deal with moneys to which they are morally or temporarily entitled. Some local authorities refuse to have loan transactions with persons of this description, not because it would be illegal to do so, but largely because of the difficulties which *might* arise if the authority carries out its obligations fully.

The two principal classes of individuals whose offers of loans are not welcomed are minors and trustees.

**Minors.** A minor is lacking in *full* contractual capacity. Consequently a local authority is apt to decline a loan from one because he is not able, if still under age, to give a valid discharge on its redemption, nor to transfer it during his period of minority. If he dies he cannot have made a valid will. Though quite in order to pay him the interest, a loan even for a fixed period extending beyond his deficient stage is a possible cause for difficulties to arise as just stated.



**Trustees.** Some corporations refuse to recognize a trust so far as its loan dealings are concerned. Money is, of course, accepted from trustees but only in their personal names without reference to their capacity. The reasons for the objection to admitting trusts into their loan books are principally because on repaying the loan it is contended that the local authority must see that the money is properly applied according to the terms of the trust, also that trustees may change from time to time and it would be necessary to be satisfied of the alteration in the persons acting. The risk of having to probe into these affairs in certain circumstances is the principal deterrent.

**Executors.** The same disinclination to admit executors is not found. An executor takes his power from the will or from the Court, and consequently such is easily proved. On his death the office passes to his co-executor, if any, failing which his own executor takes his place.

#### OFFICIAL DEFINITIONS OF TERMS

The following definitions and explanations are given in "The Report of the Select Committee on the Application of Sinking Funds in Exercise of Borrowing Powers"—

"Loans Fund" is the title given by numerous local Acts (passed in 1880 and subsequent years, and containing what are usually known as the Model Stock Clauses or similar provisions) to the fund to be established for the redemption of the stock issued by municipal corporations under the authority of those local Acts, and for the payment of dividends on the stock. It is, therefore, not solely a sinking fund for the discharge of capital. Accounts are kept as part of the Loans Fund Account, showing separately the

amounts set aside for redemption of stock and for payment of dividends.

“Redemption Fund” is the title given by the Stock Regulations of the Local Government Board, issued under the Public Health Acts Amendment Act, 1890, to the fund to be established for the redemption of stock issued by a local authority under those regulations. The same title is given by the Stock Regulations of the Board, issued under the Local Government Act, 1888, and the Metropolitan Water Act, 1902, to the accounts to which are carried the moneys required to provide for the redemption of stock issued under and subject to those regulations by County Councils and the Metropolitan Water Board. Thus, generally speaking, a “Redemption Fund” is a sinking fund applicable to the redemption of stock under the Board’s Stock Regulations. The same title is given, however, to the fund established for redemption of stock under the Liverpool Corporation Loans Act, 1894, and to the fund established under the Leeds Corporation (General Powers) Act, 1901, for the redemption not only of stock but also of other classes of corporation debt.

“Sinking Fund” (the term used in the local taxation returns) is the term generally applicable to the fund set aside for the repayment of debt; but when used in contradistinction to “Loans Fund” or “Redemption Fund” it would generally apply to a fund set aside for the repayment of ordinary mortgage or debenture debt under local or general Acts, although it would also apply to a fund set aside for redemption of debenture stock under the Local Loans Act, 1875, or a few special stocks under local Acts.

The Finance Act, 1899, Section 8 (5) defines the term Loan Capital as follows—

**Loan Capital.** Any debenture stock, county stock,

corporation stock, municipal stock, or funded debt, by whatever name known, or any capital raised by any local authority, corporation, or body of persons formed or established in the United Kingdom, which is borrowed or has the character of borrowed money, whether it is in the form of stock or any other form, but does not include any County Council or Municipal Corporation bills repayable not later than 12 months from their date, or any overdraft at the bank or other loan raised for a merely temporary purpose over a period not exceeding 12 months. The expression "local authority" includes any County Council, Municipal Corporation, District Council, Dock Trustees, Harbour Trustees, or other by whatever name called.

### BORROWING FOR WORKING CAPITAL

It is just as essential for local authorities to have working capital as it is for commercial concerns. This necessity applies both to trading undertakings and to rate funds, and unless power to provide a working balance is obtained by some means, bank overdrafts in the early part of a financial year are almost inevitable, as expenditure has in many cases to be met before income is received.

Within recent years several local authorities have obtained power by local Act to provide a working balance: by creating a reserve of a certain portion of the revenue in the case of trading undertakings; by raising an amount by rate in the case of rate funds; or by means of a specific loan. The loan method has much to recommend it, as overdrafts are avoided, the fund is not liable to appropriation in aid of rates or revenues even in cases of emergency, and the interest and redemption charges are charged annually as a

revenue expense. Ultimately the loan is redeemed, but the working balance remains.

General statutory power to provide a working balance has been available for many years so far as Scotland is concerned, but in England, except in respect of the power that was available in connection with education purposes for a short time until the repeal of the Education (Provision of Working Balance) Act, 1903, by the Education Act, 1918, no general statutory authority was in existence until the passing of the Local Authorities (Financial Provisions) Act, 1921. This Act authorizes borrowing by temporary loan or bank overdraft to provide temporarily for current expenses. The loan must be redeemed, along with interest, out of revenue received in respect of the financial year in which the expenses are incurred. But up to the 1st April, 1924, the Minister of Health had power to extend the period of redemption for a term not exceeding ten years. The provisions of this Act are dealt with more fully on pages 134 and 135.

### INVESTMENTS IN TREASURY BILLS

**Sinking Funds.** Where it happens that a portion of a sinking fund will most probably be wanted at an early date for a specific purpose, e.g. redemption of debt, transfer for new capital purposes, or investment in a more permanent security, resort is sometimes had to temporary investment by buying short term Treasury bills. These are purchased at a discount and met at par, the interest on the investment being the difference between the cost and the redemption prices (calculated on the cost price), for the period of the bill. For example, a three months' Treasury bill bought at 99 per cent would yield one pound interest on a £99 investment for 3 months, which

equals approximately £4 0s. 10d. per cent per annum.

No tax is deducted at the source, so the local authority receives its interest gross, but is liable for assessment on the amount as income. If the investment is one of a sinking fund the interest is earmarked to the sinking fund (from the Inland Revenue point of view) whether actually credited to that fund or not, and consequently the interest (or discount) received is not used for paying interest on the corporation's debt and cannot be used as a set-off for income-tax purposes.

Before investing in Treasury bills careful consideration is needed, as, for example, the net yield of such a course might be less than either bank interest on the money or the saving of bank overdraft charges where the retention of the money in the bank instead of buying the bills would prevent overdrawing in the aggregate.

**Capital Moneys.** Sometimes more money is received on loan (stock or mortgages) than is *immediately* required. The purchase of Treasury bills is a means of putting out the money to good use in certain cases. The discount is liable for assessment to income-tax. Considerations as to the advisability of investing in this way would include, in addition to those set out in the last paragraph of the preceding section relating to sinking funds, whether or not, as the moneys are capital moneys, if borrowed on mortgage it would be more economical to lower the rate of interest for new loans and so keep down the surplus on capital account. The saving might easily be greater than the net yield from Treasury bills. In deciding on this plan thought would be given as to whether, when the need of much capital money is required, sufficient can be obtained quickly enough at a rate not higher

than that in operation before the reduction was effected (the normal rate). If not, the loss by offering a higher interest might outweigh the saving, but if so, then a double benefit has been effected, viz., the avoidance of loss by investing surplus capital moneys in Treasury bills, and the fact that what actually did come in at the lowered rate effects a further saving in interest.

#### UTILIZATION OF THE POLICE FUND FOR NEW CAPITAL PURPOSES AND FOR REDEMPTION OF DEBT

Though capital moneys of the old Police Pension Fund should now be retained as capital investments of the Police Fund, the Secretary of State has intimated that he is prepared to approve as an alternative to investment the application of the uninvested balance of capital and future repayments to the capital account towards the cost of any new permanent police buildings or in reduction of existing debt in respect of police buildings.

#### DATES FOR PAYMENT OF INTEREST AND REDEMPTION OF LOANS

Convenient dates for the payment of interest on loans and the redemption of debt are the last days of the months in which the ordinary quarter days fall. If actual quarter days are adopted and the accounts are to be strictly correct it is necessary to calculate the accretions of interest between 25th and 31st March in order that the books may be correct at the close of the financial year. This involves a considerable amount of work, and though it is often ignored on the ground that the additions at the end of the year balance those at the beginning of it, the position is not absolutely accurate. Where the interest day is

taken as 31st March accuracy is achieved without effort. The dates of redemption are made to coincide also, to simplify interest calculations.

Some local authorities adopt the actual quarter days for both interest and redemption purposes, while others allow repayments (and interest thereon) to fall on any date in the year.

### THE MONEY MARKET

A reading of one or more of the books mentioned on page 23 will convey the importance of a good knowledge of this branch of finance. The state of the money market has a very important bearing on the time at which an issue of stock can most conveniently and economically be made; the price of issue; and the rate of interest to be paid. Further, as the financial officer has to enter into negotiations with bankers and brokers it is imperative that he should not be at a disadvantage through ignorance.

It may be of interest to note that from a broker's point of view, *any time* is the "right" time to go on the market, as he is out to make fees (which is his business). On the other hand a banker is apt, perhaps, to be more cautious, because he is concerned in finding the money for underwriting purposes.

An understanding of the intricacies of the money market is also a necessity in connection with the raising of loans by bills of exchange, bank overdrafts, and, indeed, any form of borrowing and redeeming of debt. And the knowledge is none the less advantageous in connection with the making of investments of sinking funds, etc.

**PART II**  
**Accounting in Connection with Loans and  
Borrowing Powers**

**CHAPTER XXII**

ACCOUNTING PROCEDURE IN CONNECTION WITH  
LOANS AND BORROWING POWERS

OPINIONS differ as to which is the best method of recording transactions relating to loans, consequently the form of accounts depends largely on the views of the individual compiling them and to what extent, if at all, he is prepared to depart from what may appear to be the statutory requirements or restrictions regarding those accounts.

In illustration of this, the method of dealing with interest received or earned on investments of a sinking fund may be reviewed.

The annual contribution to a sinking fund on the accumulating principle is based on the assumption that the instalments will be invested at a certain rate of interest, which interest will be credited to the sinking fund.

If a portion of the fund is used in discharging loans as an alternative to investment it is quite obvious that the fund will, in consequence of the loss of interest on investments, fail to amount to the necessary sum to redeem the whole loan at the date on which the loan period expires, unless such loss of revenue is made up from some other source.

It is necessary, by statute, that when a portion of an accumulating sinking fund is applied in redemption



of debt, a contribution must be made from revenue account annually of such a sum as the portion so applied would have earned if it had been invested instead. It is not, however, permissible by law to charge all the interest which investments should earn to revenue account and to offset this (and incidentally, adjust the total of the sinking fund each year automatically), to credit all interest actually received on investments to revenue account.

Suppose a sinking fund is being accumulated on a 3 per cent basis and when it has reached £1,000 it is decided to discharge a loan of that amount bearing 5 per cent interest instead of leaving the amount invested at 3 per cent, the sinking fund loses compound interest on the £1,000 at 3 per cent, which for the first year after its application is £30. This £30 must be contributed from revenue account to sinking fund. The revenue account, however, saves the payment of interest at 5 per cent on the £1,000 loan, viz., £50, and thus makes a profit of £20.

On making the transfer from revenue account to sinking fund, of £30, doubt may arise as to whether it should be termed interest or redemption. It seems hardly proper to term it interest on loan when no loan is outstanding in respect of it, and consequently it has to be expressed as an additional contribution to the sinking fund for redemption of debt.

An extraordinary circumstance now exists. The result of discharging a loan increases the charge to revenue for redemption of debt and decreases the charge for interest on loans.

From the revenue account standpoint, it does not matter whether the charge made against it for redemption of debt is applied to pay off loans or is invested. For the moment the difference between the rate of

interest payable on the loan and the rate the sinking fund is calculated to earn is disregarded.

From an accounting standpoint revenue should, in consequence of having provided a sum towards redemption of debt, have immediate credit (and so from year to year) in the shape of interest *saved* (if the amount has been applied in reducing debt), or *earned* if the amount is invested.

Under the present statutory conditions, revenue gets the credit if the redemption contribution is *applied*, but gets no credit if it is not applied.

Some general observations concerning loan matters may be outlined, following which illustrations of loans transactions will be given.

(1) A separate ledger account should be opened for each main purpose for which a sanction is exercised.

(2) Columnar ledgers serve admirably to record the analysis of expenditure under sub-headings for each main purpose.

(3) Actual expenditure should be carefully watched in the light of the amount sanctioned and the amount borrowed.

(4) Overspendings should immediately be noted and suitable action taken.

(5) An application for further sanction should, if necessary, be made, accompanied by reasons therefor.

## CHAPTER XXIII

### ACCOUNTING RECORDS IN RESPECT OF BORROWING, SPENDING, AND REDEMPTION

The entries shown in journal entry form are as follows—

#### BORROWING AND SPENDING

		Dr.	Cr.
		£	£
(1) For borrowing of £20,000 by mortgage	Capital Cash A/c Dr. To Mortgage Loan A/c	20,000	20,000
(2) For expenditure on assets	Capital Outlay A/c Dr. To Capital Cash A/c	20,000	20,000

#### ACCUMULATING THE SINKING FUND

		Dr.	Cr.
		£	£
(3) Revenue contribution (£1,700)	Revenue A/c Dr. To Sinking Fund A/c	1,700	1,700
(4) Investment of fund	Sinking Fund Investment A/c Dr. To Revenue Cash A/c	1,700	1,700
(5) Interest on fund	Sinking Fund Cash A/c Dr. To Sinking Fund A/c	51	51
(6) Investment of interest	Sinking Fund Investment A/c Dr. To Sinking Fund Cash A/c	51	51
(7) Payment of interest on loan to mortgagees	(a) Revenue A/c Dr. To Mortgages Interest A/c (b) Mortgages Interest A/c Dr. To Revenue Cash A/c Income Tax Suspense A/c	1,000  1,000	  1,000 775 225

(And so on each year until the end of the period when the sinking fund would stand with a credit of £20,000, and the investments account would stand at a like figure.)

## REDEMPTION OF THE DEBT

		Dr.	Cr.
		£	£
(8) Realization of investments	Sinking Fund Cash A/c		
	Dr.	20,000	
	To Sinking Fund Investments A/c		20,000
(9) Redemption of the loan	Mortgages Loan A/c		
	Dr.	20,000	
	To Sinking Fund Cash A/c		20,000

(If the life of the asset has coincided with the loan period, the loan has now been paid off and the asset is of no value, and so may be written off against the balance standing to the credit of Sinking Fund A/c.)

## WRITING-OFF BOOK-VALUE OF ASSET AGAINST SINKING FUND BALANCE

		Dr.	Cr.
		£	£
(10) Closing the A/cs	Sinking Fund A/c	Dr. 20,000	
	To Capital Outlay (Asset) A/c		20,000

**Assuming the Asset still had a Value of £5,000 though the Debt is paid off**

(11) Transfer of portion to be written off	Sinking Fund A/c	Dr. 15,000	
	To Capital Outlay (Asset) A/c		15,000
(12) Writing off Sinking Fund balance	Sinking Fund A/c	Dr. 5,000	
	To Loans Redeemed (Surplus) A/c		5,000

The balance sheet at this date would stand as follows—

## BALANCE SHEET

LIABILITIES		ASSETS
<i>Surplus A/c</i>		Capital Outlay
Loans Redeemed		(Stating the Asset)
<u>£5,000</u>		<u>£5,000</u>

If the loan had been redeemable on the annuity or instalment system, the entries would have been as follows: (1) and (2) above, the same; in place of

(3) to (9) there would have been an annual transaction showing—

		Dr.	Cr.
		£	£
For annual payment to lender being interest £1,000 and part of principal £2,000.	(a) Revenue A/c	Dr. 3,000	
	To Revenue Cash A/c		3,000
	(b) Mortgages Loan A/c	Dr. 2,000	
	To Loans Redeemed A/c		2,000

As regards (10) to (12) the Asset Account would be written off against Loans Redeemed Account.

The working of the following short problem shown in journal entry form will better illustrate the transactions—

*Example.*

The Corporation of Newville decide to erect a Town Hall. They apply to the Ministry of Health for the necessary sanction and the borrowing of £30,000 to cover the cost. After making due inquiry the Ministry's consent is received, the details of which are—

- £8,000 for land, repayable in 50 years.
- £18,000 for buildings, repayable in 25 years.
- £4,000 for heating and engineering, repayable in 10 years.

The land is purchased and the work of erection commenced, and completed during 1924, when the following was the apportioned cost on capital account—

	£	s.	d.
Land . . . . .	8,000	-	-
Buildings . . . . .	17,538	-	-
Engineering, etc. . . . .	3,942	-	-
	<hr/>		
	£29,480	-	-
	<hr/>		

During the year 1924 £29,600 was raised from various mortgagees: £8,000 for land, £17,600 for buildings, and £4,000 for engineering. The Corporation in 1925 set aside out of revenue to sinking fund for the

redemption of the debt (keeping separate accounts for each purpose) £68 18s. 4d. for land, £482 14s. 8d. for buildings, and £348 18s. 4d. for engineering, etc., all of which were invested at 5 per cent in 1926, and the same amounts were set aside in 1926 and duly invested together with the interest on the 1925 items. In 1927 the Corporation were required to repay £2,000 of the loan for the land and the whole of the sinking fund in hand was used, the balance being re-borrowed. Record these transactions by journal and ledger accounts.

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		Dr.			Cr.		
		£	s.	d.	£	s.	d.
1924	Land (Town Hall Account) Dr.	1	8,000	-	-		
	To X	2			8,000	-	-
	For purchase of land						
	Town Hall Capital Expenditure Account Dr.	1	21,480	-	-		
	To Contractors	3			21,480	-	-
	For building £17,538 -- and engineering £3,942 --						
	Bank (Capital Account) Dr.	4	29,600	-	-		
	To Sundry Mortgagees	5			29,600	-	-
	For loans received on mortgage						
	Sundry persons Dr.	2/3	29,480	-	-		
X £8,000							
Contractors £21,480							
To Bank (Capital Account)	4			29,480	-	-	
Being payments to sundry creditors							
1925	Town Hall Revenue Account Dr.	6	900	11	4		
	To Sinking Fund Account	7			900	11	4
	Land £68 18 4						
	Buildings £482 14 8						
	Engineering £348 18 4						
	Being transfer to Sinking Fund Account for year						
Sinking Fund Investment A/c Dr.	8	900	11	4			
To Bank A/c (Sinking Fund A/c)	4			900	11	4	
Being investment of Sinking Fund							

## JOURNAL—contd.

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
1926	Town Hall Revenue Account Dr.	6					
	To Sinking Fund Account	7			900	11	4
	Land		£68	18	4		
	Buildings		£482	14	8		
	Engineering		£348	18	4		
	Being transfer to Sinking Fund Account for year						
	Bank A/c (Sinking Fund A/c) Dr.	4			27	-	4
	To Sinking Fund Account	7					
	Land		£2	1	4		
	Buildings		£14	9	8		
	Engineering		£10	9	4		
	Being interest on Sinking Fund Investments						
	Sinking Fund Investment A/c Dr.	8			927	11	8
	To Bank A/c (Sinking Fund A/c)	4					
	Being investment of Sinking Fund						
Bank (Capital) Account Dr.	4			139	18	-	
To Sinking Fund Investment (Land) Account	8						
Being realization of Sinking Fund Investment (Land) as part repayment of mortgage							
Bank (Capital) Account Dr.	4			1,860	2	-	
To Sundry Mortgagees	5						
Being loans raised as part repayment of mortgage							
Mortgagee Dr.	5			2,000	-	-	
To Bank (Capital) Account	4						
Being loan repaid							
Sinking Fund Account (Land) Dr.	7			139	18	-	
To Surplus (Loans Redeemed A/c)	9						
Being loan redeemed out of Sinking Fund provision							

## CHAPTER XXIV

### ACCOUNTING IN RESPECT OF BORROWING BY SHORT TERM MORTGAGES

FOR the purpose of illustrating the accounting records in a complete way the example in the previous chapter (XXIII) may be taken, the transactions being shown in ledger form and a balance sheet prepared on the closing date of the period.

#### LEDGER ACCOUNTS

(1) <i>Dr</i>	CAPITAL OUTLAY ACCOUNT		Cr. (1)
		£	
To X. Purchase of Land . . . . .	J.	8,000	
„ Contractors—			
Building . . . . .	J.	17,538	
Engineering . . . . .	J.	3,942	
		£29,480	

(2) <i>Dr</i>	" X " ACCOUNT (PURCHASE OF LAND)		Cr. (2)
		£	
To Bank A/c . . . . .	J.	8,000	
			£
		By Land for Town Hall . . . . .	J.
			8,000

(3) <i>Dr</i>	CONTRACTORS' ACCOUNT		Cr. (3)
		£	
To Bank A/c . . . . .	J.	21,480	
			£
		By Building Town Hall . . . . .	J.
		„ Engineering Work . . . . .	J.
		£21,480	£21,480







SINKING FUND INVESTMENT ACCOUNT		Cr. (8)	
(8) D	£	s.	d.
To Cash . . . . .	900	11	4
" " . . . . .	927	11	8
	<u>£1,828</u>	<u>3</u>	<u>-</u>
To Balance brought down. . . . .	1,688	5	-
			J.      £ C.      139 18 .      1,688 5 . <u>£1,828 3</u>

SURPLUS ACCOUNT (LOANS REDEEMED)		Cr. (9)	
(9) Dr.	£	s.	d.
By Sinking Fund A/c . . . . .			139 18 -

BALANCE SHEET

Liabilities.	£	s.	d.	Assets.	£	s.	d.
Loans on Mortgage . . . . .	29,460	2	-	Capital Outlay (at cost) as per Capital A/c . . . . .	29,480	-	-
Surplus and Sinking Fund.				Sinking Fund Investment . . . . .	1,688	5	-
Sinking Fund A/c—				Bank A/c.			
Balance at credit thereof . . . . .	1,688	5	0	Capital A/c . . . . .	120	-	-
Loans Redeemed . . . . .	139	18	-				
	<u>1,828</u>	<u>3</u>	<u>-</u>				
	<u>31,288</u>	<u>5</u>	<u>-</u>	Revenue A/c.	31,288	5	-
Revenue A/c.				Balance at debit thereof . . . . .	1,801	2	8
Bank A/c.							
Balance overdrawn . . . . .	1,801	2	8				
	<u>£33,089</u>	<u>7</u>	<u>8</u>		<u>£33,089</u>	<u>7</u>	<u>8</u>

## CHAPTER XXV

### ACCOUNTING RECORDS IN RESPECT OF THE APPLICATION OF LOANS FUND ACCOUNTS TO BORROWINGS BY MORTGAGES

THE book-keeping entries are—

- |   |                  |  |
|---|------------------|--|
| (1) On receipt of cash.   | <i>Dr.</i>       | Mortgage Loans Cash A/c.                         |
|   | <i>Cr.</i>       | Mortgage Loans Fund A/c (a).                     |
|   | <i>Dr.</i>       | Mortgage Loans Fund A/c.                         |
|   | <i>Cr.</i>       | Mortgage Debt A/c.                               |
| (2) On application of loans to meet capital expenditure   | <i>Dr.</i>       | Allocation of Mortgage Debt A/c (Various Funds). |
|   | <i>Cr.</i>       | Mortgage Loans Cash A/c.                         |
| (3) On providing for redemption of debt.  | <i>Dr.</i>       | Revenue A/c (of appropriate fund).               |
|   | <i>Cr.</i>       | Cash A/c (of appropriate fund).                  |
|   | <i>Dr.</i>       | Mortgage Sinking Fund Cash A/c (b).              |
|   | <i>Cr.</i>       | Mortgage Sinking Fund A/c.                       |
| (4) On dealing with mortgages falling due for repayment (to be replaced).                                     | <i>Dr.</i>       | Mortgage Debt A/c.                               |
|   | <i>Cr.</i>       | Mortgage Loans Cash A/c.                         |
| (5) If not sufficient money available to effect replacement of loans falling due more money must be borrowed. | As No (1) above. |  |

Any money standing to the credit of Mortgage Loans Fund Account or Sinking Fund Account, i.e. after—

(i) effecting all re-borrowings for replacement purposes; and

(ii) providing requirements for new capital expenditure chargeable on the same funds or revenues

For explanation of notes (a) and (b) see page 167.

as the other loans passing through the Mortgages Loans Fund Account ;  
 may be retained in hand (i.e. in the bank) until required for capital purposes if any further requirements are likely to be needed shortly, or may be applied in *redemption* of loans falling due, in which case the book-keeping entries are—

- |  |     |  |
|--|-----|--|
| (6) On application of moneys in <i>redemption</i> of loans.        | Dr. | Mortgage Debt A/c.                                       |
|  | Cr. | Mortgage Sinking Fund Cash A/c.                          |
|  | Dr. | Mortgage Sinking Fund A/c.                               |
|  | Cr. | Mortgage Redeemed A/c.                                   |
| (7) On providing for and paying interest on loans.                 | Dr. | Revenue A/c of appropriate fund (interest on mortgages). |
|  | Cr. | Revenue Cash A/c (with gross interest due).              |
|  | Dr. | Mortgage Interest Cash A/c. (with gross interest due).   |
|  | Cr. | Mortgage Interest A/c.                                   |
|  | Dr. | Mortgage Interest A/c.                                   |
|  | Cr. | Cash (with net amount of interest paid).                 |
|  |     | Income Tax Provision A/c (with tax deducted).            |
| (8) On investment of Mortgage Loans Fund (or Sinking Fund) moneys. | Dr. | Mortgage Sinking Fund Investments A/c.                   |
|  | Cr. | Mortgage Sinking Fund Cash A/c                           |
| (9) On application of moneys for new capital purposes.             | Dr. | Mortgage Debt Transferred A/c.                           |
|  | Cr. | Allocation of Mortgage Debt A/c.                         |
|  | Dr. | Mortgage Sinking Fund A/c.                               |
|  | Cr. | Mortgage Sinking Fund Cash A/c.                          |
| (10) On receiving interest on investments of fund.                 | Dr. | Mortgage Sinking Fund Cash A/c.                          |
|  | Cr. | Mortgage Sinking Fund A/c.                               |

The liability of the local authority to the lenders will appear in the balance sheet of the Consolidated Loans Fund, and the liability of the various services in respect of the net debt outstanding will be shown

in the respective balance sheets as amounts due to the Consolidated Loans Fund.

*Note (a)* According to the degree of completeness of consolidation so will this account, here styled Mortgage Loans Fund Account, have to be divided or consolidated. If the consolidation is only effective within funds then a separate Mortgage Loans Fund Account will be kept for each fund or pool.

*Note (b)* If a most complete consolidation is effected with power to pass all sinking fund contributions to the Loans Fund Account direct, or indirectly through a Sinking Fund Account, then the entries would be, if direct : all debits and credits to Sinking Fund Account would be to Loans Fund Account instead ; if indirect : the entries would be as shown, followed by transfers from Sinking Fund Account to Loans Fund Account.

## CHAPTER XXVI

### ACCOUNTING IN RESPECT OF BORROWING BY STOCK

#### Illustration No. 1.

SHOWING THE ISSUE OF STOCK AT A PREMIUM ;  
ONE YEAR'S TRANSACTIONS, AND A BALANCE  
SHEET AS AT ONE YEAR AFTER ISSUE

THE Corporation of Borrowville in 1921 issued 6 per cent Redeemable Stock at  $101\frac{1}{4}$  to raise moneys in respect of the following sanctions: Police stations, £10,000; tramways, £120,000; street improvements, £50,000. The costs of issue were: Underwriting commission, 1 per cent; stamp duty,  $\frac{1}{8}$  per cent; printing, £100; other expenses, £900. Prepare the accounts of the Loans Fund in respect of the issue and show the records of the first year's transactions of the Redemption and Dividends Accounts, the contributions towards redemption being: Borough fund, £200; tramways fund, £4,200; and district fund, £1,500. Prepare a balance sheet of the Loans Fund as at a year after date of issue.

LOANS FUND CASH ACCOUNT

Particulars.	Account to Credit.	Folio.	Amount	Particulars	Account to Debit.	Folio.	Amount.
			£				£
To Issue of 6% Stock at 101½ to produce				By Borough Fund			
10,000				" Tramways "			
120,000				" District "			
50,000					Allocation of Stock to Accounts	1	180,000
100							
900				" Expenses of Issue—			
				Printing			
				Commissions			
181,000				Underwriting			
1,808				Stamp Duty			
226					Expenses of Issue	3	3,034
" Contributions from Revenue				" Stockholders for Dividends on Stock			
A/c for				less tax @ 6s.			
(1) Dividend				£10,846 - £3,254			
Borough Fund					Dividend Fund	4	7,592
Tramways "							
District "							
(2) Redemption							
Borough Fund							
Tramways "							
District "							
				" Balance carried down		C.	9,154
" Balance brought down							<u>£199,780</u>
							<u>9,154</u>



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			£	£
6% Redeemable Stock	<i>Dr.</i>	2	2,260	
To Expenses of Issue A/c		3		2,260
Premium on Issue of Stock used in payment of Expenses of Issue.				
Allocation of Stock to A/cs	<i>Dr.</i>	1	774	
To Expense of Issue A/c		3		774
Allocation of net Expenses of Issue to Capital A/cs in proportion to money raised, viz., Borough Fund £43, Tramways £516, District Fund £215.				
Dividends Fund A/c	<i>Dr.</i>	4	3,254	
To Income Tax Provision A/c		6		3,254
Amount deducted from dividends paid to stockholders.				

(1) <i>Dr.</i>		ALLOCATION OF STOCK TO ACCOUNTS			<i>Cr.</i> (1)	
To Cash	C.B.	£	180,000			
„ Expenses of Issue A/c	J.		774			
			<u>£180,774</u>			

(2) <i>Dr.</i>		6% REDEEMABLE STOCK ACCOUNT			<i>Cr.</i> (2)	
To Expenses of Issue A/c. (Premium)	J.	£	2,260	By Cash	C.B.	£
„ Balance down	C.		180,774			183,034
			<u>£183,034</u>			<u>£183,034</u>
				By Balancedown	C.	180,774

(3) Dr.		EXPENSES OF ISSUE OF STOCK ACCOUNT		Cr. (3)	
To Cash	C.B.	£ 3,034	By 6% Stock A/c (Pre- mium) .	J.	£ 2,260
			„ Allocations of Stock to A/cs .	J.	774
		<u>£3,034</u>			<u>£3,034</u>

(4) Dr.		DIVIDENDS FUND ACCOUNT		Cr. (4)	
To Cash— Stock- holders .	C.B.	£ 7,592	By Cash .	C.B.	£ 10,846
„ Income Tax Provision A/c .	J.	3,254			
		<u>£10,846</u>			<u>£10,846</u>

(5) Dr.		REDEMPTION FUND ACCOUNT		Cr. (5)	
			By Cash .	C.B.	£ 5,900

(6) Dr.		INCOME TAX PROVISION ACCOUNT		Cr. (6)	
			By Dividends Fund A/c	J.	£ 3,254

BALANCE SHEET

		<i>Assets.</i>			
<i>Liabilities.</i>		Allocation of Stock to Accounts	Net Ex- penses of Issue.	Stock.	
	£		£	£	£
6% Redeemable Stock . . . . .	180,774	Borough Fund . . . . .	10,000	43	10,043
Income Tax Provision Account . . . . .	3,254	Tramways . . . . .	120,000	516	120,516
Redemption Fund . . . . .	5,900	District Fund . . . . .	50,000	215	50,215
			<u>£180,000</u>	<u>774</u>	<u>180,774</u>
		Cash . . . . .	. . . . .	. . . . .	9,154
					<u>£189,928</u>

## Illustration No. 2.

SHOWING THE ISSUE OF STOCK AT A DISCOUNT,  
AND ILLUSTRATING THE ADOPTION OF A  
COLUMNAR CASH BOOK, CONTAINING ANALYSIS  
COLUMNS FOR CONVENIENT POSTING TO THE LEDGER

The County Borough of Stocktown obtained in 1921 powers to issue £3,000,000 6 per cent Stock at 98 through the Bank of England. The moneys were received as follows—

On application . . . . .	£ 150,000	5%	1st September, 1921.
On allotment . . . . .	1,290,000	43%	1st October, 1921.
On first and final call . . . . .	1,500,000	50%	1st November, 1921.
	<u>£2,940,000</u>	<u>98%</u>	

The expenses of issue amounted to £60,000 made up thus—

Stamp duty at 2s. 6d. per cent . . . . .	£ 3,750
Commission paid to Bank of England . . . . .	39,250
Discounts allowed for prepayment . . . . .	8,000
Printing, stationery, advertising, etc. . . . .	9,000
	<u>£60,000</u>

The net proceeds of the stock, £2,880,000 (i.e. £3,000,000 less discount £60,000 and expenses of issue £60,000), were allocated to the following purposes—

Gasworks . . . . .	£ 480,000
Electricity undertaking . . . . .	720,000
Waterworks . . . . .	1,200,000
Borough Fund . . . . .	192,000
District Fund . . . . .	288,000
	<u>£2,880,000</u>

## The following transactions took place—

		£	
1922			
March	1.	Paid composition for stamp duty (half year) . . . . .	1,500
"	15.	Received fees for registration of transfers . . . . .	15
"	31.	Contributions to Dividends Fund (half year) . . . . .	90,000
"	"	" to Redemption Fund (5 months) . . . . .	24,214
"	"	" for expenses of management, etc. . . . .	1,800
"	"	Paid half-year's dividend on stock (less tax) . . . . .	63,000
"	"	" to Borough Fund proportion of salary, etc., of registrar and staff . . . . .	315
"	"	Made transfer to various accounts in respect of income tax assessment . . . . .	27,000
April	1.	Invested £6,000 of Redemption Fund with another corporation . . . . .	6,000
"	"	Purchased for cancellation (at 97½ inclusive of stamp duty) £6,000 of stock . . . . .	5,858
Sept.	1.	Paid composition for stamp duty on £2,994,000 stock outstanding . . . . .	1,497
"	30.	Paid dividend on stock (less tax) . . . . .	62,874
1923			
March	1.	Paid composition for stamp duty on £2,994,000 stock . . . . .	1,497
"	31.	Paid dividend on stock (less tax) . . . . .	62,874
"	"	" insurance premiums on property . . . . .	5
"	"	" rates on property . . . . .	55
"	"	" proportion of salaries etc. of registrar and staff . . . . .	768
"	"	Made transfer to various accounts in respect of income tax assessments . . . . .	53,892
"	"	Applied £60,000 of Redemption Fund for new capital purposes to tramways account . . . . .	60,000
"	"	Received from various revenue amounts for dividend on stock . . . . .	179,640
"	"	Transfer fees on registration of stock . . . . .	20
"	"	Rents of property . . . . .	200
"	"	Received interest on investment with Blanktown Corporation (less tax) . . . . .	252
"	"	Contributions to Redemption Fund (1 year) . . . . .	58,307
"	"	Contributions to Redemption Fund in respect of loss of interest on amounts withdrawn . . . . .	560
"	"	Contributions for expenses of management, etc. . . . .	3,742
"	"	Bank interest received . . . . .	94

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		Fo.	Dr. £	Cr. £
1922				
Mar. 31	Expenses of Issue A/c <i>Dr.</i> To 6 per cent Redeemable Stock A/c . . . . . Being discount on issue of £3,000,000 6 per cent stock.	4 1	60,000	60 000
..	Dividends A/c <i>Dr.</i> To Stockholders A/c . . . . . Being half-year's dividend on £3,000,000 6 per cent stock.	8 7	90,000	90,000
..	Stockholders A/c <i>Dr.</i> To Income Tax Commissioners A/c . . . . . Being tax deducted from half-year's dividend.	7 9	27,000	27,000
..	Redemption Fund A/c <i>Dr.</i> To Expenses of Issue A/c . . . . . Being Sinking Fund provisions for redemption of discount and expenses of issue.	13 4	969	969
			<u>£177,969</u>	<u>£177,969</u>
1922				
April 1	Allocation of Stock Transferred A/c <i>Dr.</i> To Allocation of Stock A/c . . . . . Being £10,000 redemption moneys applied to new capital purposes (tramways).	3 2	10,000	10,000
1923				
Mar. 31	Redemption Fund A/c <i>Dr.</i> To Expenses of Issue A/c . . . . . Being discount on purchase of £6,000 6 per cent stock for cancellation.	13 4	142	142
..	6 per cent Redeemable Stock A/c <i>Dr.</i> To Stock Redeemed A/c . . . . . Being purchase of £6,000 6 per cent stock for cancellation.	1 5	6,000	6,000

JOURNAL—*contd.*

1923		Fo.	Dr. £	Cr. £
Mar. 31	Allocation of Stock Redeemed A/c <i>Dr.</i>	6	6,000	
	To Allocation of Stock A/c Being allocation of stock redeemed.	2		6,000
..	Allocation of Stock Transferred A/c <i>Dr.</i>	3	60,000	
	To Allocation of Stock A/c Being £60,000 redemption moneys applied to new capital purposes (housing).	2		60,000
..	Dividends A/c <i>Dr.</i>	8	179,640	
	To Stockholders A/c Being one year's dividend (less tax) on £2,994,000 6 per cent stock.	7		179,640
..	Stockholders A/c <i>Dr.</i>	7	53,892	
	To Income Tax Commissioners A/c Being tax deducted from one year's dividend.	9		53,892
..	Interest A/c <i>Dr.</i>	12	847	
	To Redemption Fund A/c Being interest on Sinking Fund accumulations.	13		847
..	Redemption Fund A/c <i>Dr.</i>	13	2,366	
	To Expenses of Issue A/c Being Sinking Fund provisions for redemption of discount and expenses of issue.	4		2,366
			<u>£318,887</u>	<u>£318,887</u>







(1) SIX PER CENT REDEEMABLE STOCK ACCOUNT

Dr.		Cr.	
1923 Mar. 31	To Stock Redeemed A/c . . . . . " Balance carried down . . . . .	1922 Mar. 31 £ 6,000 2,994,000 <hr/> £3,000,000	C.B.1 J1 2,940,000 60,000 <hr/> £3,000,000 <hr/> 2,994,000
		1923 Apr. 1	By Cash (proceeds of issue) . . . . . " Expenses of Issue A/c. (discount on issue) . . . . .  By Balance brought down . . . . .

(2) ALLOCATION OF 6 PER CENT REDEEMABLE STOCK ACCOUNT

Dr.		Cr.	
1922 Mar. 31	To Cash : Net Proceeds of Issue transferred to following Accounts— Gas A/c . . . . . £480,000 Electricity A/c . . . . . 720,000 Waterworks A/c . . . . . 1,200,000 Boro' Fund A/c . . . . . 192,000 District Fund A/c . . . . . 288,000 <hr/> C.B.1 2,880,000 <hr/> £2,880,000	1922 Mar. 31	By Balance carried down . . . . .
1922 Apr. 1	To Balance brought down . . . . .	1922 Apr. 1 2,880,000	By Allocation of Stock Transferred A/c . . . . . J1 By Allocation of Stock Transferred A/c . . . . . J1 " Allocation of Stock Redeemed A/c . . . . . J1 " Balance carried down— Gas . . . . . £467,000 Electricity . . . . . 702,000 Water . . . . . 1,166,000 Boro' Fund . . . . . 188,000 District Fund . . . . . 281,000 <hr/> C 2,804,000 <hr/> £2,880,000

**(3) ALLOCATION OF STOCK TRANSFERRED ACCOUNT**

Dr.		Cr.	
1922 Apr. 1	To Allocation of Stock Account— Redemption Funds allocated to Tramways Capital A/c . . . . .	1923 Mar. 31 £	By Balance carried down . . . . .
		10,000	C
1923 Mar. 31	" Allocation of Stock Account— Redemption Funds allocated to Housing (A.S.) Capital A/c . . . . .	60,000	
		<u>£70,000</u>	
1923 Apr. 1	To Balance brought down . . . . .	70,000	<u>£70,000</u>

**(4) EXPENSES OF ISSUE ACCOUNT**

Dr.		Cr.	
1922 Mar. 31	To Cash (expenses of issue) " Stock A/c. (discount on issue) . . . . .	1923 Mar. 31 £	By Redemption Fund A/c (Sinking Fund pro- vision for year) . . . . .
		60,000	J.1
		60,000	C
		<u>£120,000</u>	
1922 Apr. 1	To Balance brought down . . . . .	1923 Mar. 31 £	" Balance carried down . . . . .
		119,031	J.1
		<u>£119,031</u>	C
1923 Apr. 1	To Balance brought down . . . . .	116,523	<u>£119,031</u>

(5) STOCK REDEEMED ACCOUNT

Dr.		Cr.	
		1923 Mar. 31	By 6 per cent Redeemable Stock A/c. . . . .
			J.1
			£ 6,000

(6) ALLOCATION OF STOCK REDEEMED ACCOUNT

Dr.		Cr.	
1923 Mar. 31	To Allocation of Stock A/c . . . . .	J.1	£ 6,000
	Gas . . . . .		£1,000
	Water . . . . .		2,000
	Boro' Fund . . . . .		1,000
	District Fund . . . . .		2,000

(7) STOCKHOLDERS' ACCOUNT

Dr.		Cr.	
1922 Mar. 31	To Cash . . . . .	C.B.1	£ 63,000
	" Income Tax Commissioners A/c . . . . .	J.1	27,000
			£90,000
1923 Mar. 31	To Cash . . . . .	C.B.1	125,748
	" Income Tax Commissioners A/c . . . . .	J.1	53,892
			£179,640
		By Dividends . . . . .	J.1
			£90,000
		By Dividends . . . . .	J.1
			179,640
			£179,640

(8) DIVIDENDS ACCOUNT

Dr.		Cr.	
1922 Mar. 31	To Stockholders . . . . .	J.1	1922 Mar. 31 £90,000
1923 Mar. 31	To Stockholders . . . . .	J.1	1923 Mar. 31 £179,640
		By Cash . . . . .	C.B.1
			£90,000
		By Cash . . . . .	C.B.1
			£179,640

(9) INCOME TAX COMMISSIONERS ACCOUNT

Dr.				Cr.	
1922	To Cash	1922	By Stockholders' A/c	J.1.	£27,000
Mar. 31		Mar. 31			
1923	To Cash	1923	By Stockholders' A/c	J.1	£53,892
Mar. 31		Mar. 31			

(10) RENTS ACCOUNT

Dr.				Cr.	
1923	To Cash (Rates, Insurance, etc.)	1923	By Cash (Rents)	C.B.1	£
Mar. 31	" Balance unappropriated carried down	Mar. 31			200
					200
		1923	By Balance unappropriated brought down	C.	140
		Apr. 1			

(11) INVESTMENT ACCOUNT

Dr.				Cr.	
1923	To Cash—Blanktown Corporation				
Mar. 31					

(12) INTEREST ACCOUNT

Dr.				Cr.	
1923	To Redemption Fund (Interest on accumulations)	1923	By Cash—Interest on investment	C.B.1	£
Mar. 31	" Balance (excess earnings) carried down	Mar. 31	" " Contributions in lieu of dividends	"	252
			" " Bank Interest	"	560
					116
					£928
		1923	By Balance (excess earnings) brought down	C.	81
		Apr. 1			

Dr.		(13) REDEMPTION FUND ACCOUNT		Cr.		
1922 Mar. 31	To Expenses of Issue A/c (amount provided for redemption) . . . . .	J.1 C.	£ 969 23,245	1922 Mar. 31	By Cash—Contributions from various Revenue A/cs . . . . .	C.B.1 £24,214
	" Balance carried down . . . . .		<u>£24,214</u>			
1923 Apr. 1	To Cash— Amount applied as new capital . . . . .	C.B.1	10,000	1922 Apr. 1	By Balance brought down . . . . .	C
	Purchase of Stock . . . . .	C.B.1	5,858	1923 Mar. 31	" Cash—Contributions from various Revenue A/cs . . . . .	C.B.1
	" Expenses of Issue A/c (discount on purchase of stock applied in redemption) . . . . .	C.B.1	60,000		" Interest A/c for interest on accumulations . . . . .	J.1
	" Expense of Issue A/c (amount provided for redemption during year) . . . . .	J.1	142			58,307 847
	" Balance carried down . . . . .	J.1 C.	2,366 4,033	1923 Apr. 1	By Balance brought down . . . . .	C
			<u>£82,399</u>			<u>£82,399</u>
						4,038

Dr.		(14) EXPENSES OF MANAGEMENT, ETC., ACCOUNT		Cr.		
1922 Mar. 31	To Cash—Composition for stamp duty and expenses of management . . . . .	C.B.1	£ 1,815	1922 Mar. 31	By Cash— Registration Fees . . . . .	C.B.1 15
			<u>£1,815</u>		Contributions from various Revenue A/cs : . . . . .	C.B.1 1,800
						<u>£1,815</u>
1923 Mar. 31	To Cash—Composition for stamp duty and expenses of management . . . . .	C.B.1	3,762	1923 Mar. 31	By Cash— Registration Fees . . . . .	C.B.1 20
			<u>£3,762</u>		Contributions form various Revenue A/cs : . . . . .	C.B.1 3,742
						<u>£3,762</u>

BALANCE SHEET AS AT 31ST MARCH, 1923

<i>Liabilities and Surplus.</i>	£	£	<i>Assets, Outlay, etc.</i>	£	£
6% Redeemable Stock	6,000	2,994,000	Allocations of Stock—		
Surplus			Gas . . . . .	467,000	
Stock Redeemed			Electricity . . . . .	702,000	
Redemption Fund—			Waterworks . . . . .	1,186,000	
Gas . . . . .	£309		Borough Fund . . . . .	188,000	
Electricity . . . . .	161		District Fund . . . . .	281,000	2,804,000
Waterworks . . . . .	1,070		Allocation of Stock Transferred—		
Borough Fund . . . . .	1,322		Tramways . . . . .	10,000	
District Fund . . . . .	985		Housing . . . . .	60,000	
Tramways . . . . .	186		Expenses of Issue . . . . .	120,000	70,000
Excess Sinking Fund Earnings	4,033		Less Amount written off . . . . .	3,477	116,523
Rents Unappropriated . . . . .	81		Allocation of Stock Redeemed—		
	140		Gas . . . . .	1,000	
	—	10,254	Waterworks . . . . .	2,000	
			Borough Fund . . . . .	1,000	
			District Fund . . . . .	2,000	
			Investments—		6,000
			Blanktown Corporation Mortgage . . . . .		6,000
			Cash at Bank . . . . .		1,731
		£3,004,254			£3,004,254

**Illustration No. 3.**

**SHOWING A FURTHER ISSUE OF STOCK AND  
INCORPORATING PREVIOUS ISSUES AND BALANCES  
IN THE ACCOUNTS**

Compile a Revenue Account and a Balance Sheet as at 31st March, 1921, in respect of the undertaking to which the following particulars relate—

BALANCES AT 31ST MARCH, 1920.		£	£
<i>Cr.</i> —	3½% Redeemable Stock . . . . .	407,000	
	3%           "           . . . . .	137,500	
	2½%           "           . . . . .	110,000	
	Loans on Mortgages . . . . .	100,000	
	Sundry Creditors on Revenue A/c . . . . .	19,000	
	Contractors' Specification Deposits A/c . . . . .	150	
	Sinking Funds . . . . .	15,000	
	Stock and Loans redeemed . . . . .	119,000	
	Capital expenditure defrayed from Revenue . . . . .	2,500	
	Revenue A/c . . . . .	1,000	
<i>Dr.</i> —	Property, permanent works, etc. . . . .		855,240
	Cash . . . . .		27,910
	Sundry debtors on Revenue A/c . . . . .		5,000
	Stocks as per valuations (Revenue A/c) . . . . .		9,000
	Sinking Fund investments . . . . .		14,000

**TRANSACTIONS FROM 1 APRIL, 1920, TO 31 MARCH, 1921**

**Expenditure.** Property, permanent works, etc., £155,200; Revenue Account, viz. sinking fund contributions £26,500; other items, £140,000. Payments (including transfers) in respect of: Capital accounts, £155,200; expenses of issue of stock, £2,000; deposits returned £80; revenue accounts, £169,240; loans on mortgages repaid out of sinking funds, £5,000; 3 per cent redeemable stock redeemed out of sinking fund, £6,000 at 55 per cent.

**Income.** Revenue accounts, £167,500. Receipts (including transfers): Proceeds of issue of £148,400, 6 per cent redeemable stock at 99; loans on mortgages raised £10,000; sinking funds, £27,000; specification deposits, £50; revenue account, £165,200.

The cash balance on revenue account at the end of the year was £1,960



LOANS FUND CASH ACCOUNT

Dr.

Cr.

1920	1921	1921	1921	1921	1921
Mar. 31	Mar. 31	Mar. 31	Mar. 31	Mar. 31	Mar. 31
Dr.	Dr.	Dr.	Dr.	Dr.	Dr.
To Balance . . . . .	£ 20,780	£ 1,000	£ 6,150	By Sundry Creditors (Capital)	£ 155,200
" 6% Redeemable Stock . . . . .	146,916	—	—	" Capital A/c—Expense of Issue	2,000
" Loans on Mortgages . . . . .	10,000	—	—	" Deposits A/c . . . . .	—
" Sinking Fund A/c . . . . .	—	27,000	—	" Sundry Creditors (Revenue)	5,000
" Deposits A/c . . . . .	—	—	50	" Sinking Fund A/c . . . . .	3,900
" Sundry Debtors . . . . .	—	—	165,200	Do. . . . .	—
	£177,676	£28,000	£171,400	" Balance . . . . .	20,476
To Balance . . . . .	20,476	19,700	2,080		£177,676
					£28,000
					£171,400

SUNDRY CREDITORS' ACCOUNT

Dr.

Cr.

1921	1921	1921	1921	1921	1921
Mar. 31	Mar. 31	Mar. 31	Mar. 31	Mar. 31	Mar. 31
Dr.	Dr.	Dr.	Dr.	Dr.	Dr.
To Cash . . . . .	£ 155,200	£ 155,200	£ 19,000	By Balance . . . . .	£ 19,000
" " . . . . .	169,240	169,240	—	" Property, Permanent Works, etc.	£155,200
" Balance . . . . .	—	—	324,440	" Revenue A/c . . . . .	166,500
			16,260		321,700
			£340,700		£340,700
				By Balance . . . . .	16,260

SUNDRY DEBTORS' ACCOUNT

Dr.							Cr.
1920							
Mar. 31	To Balance	.	.	.	.		£ 165,200
1921							
Mar. 31	" Revenue A/c	.	.	.	.		7,300
							£172,500
1921							
Mar. 31	To Balance	.	.	.	.		
							£172,500

REVENUE ACCOUNT

Dr.							Cr.
1920							
Mar. 31	To Stocks as per valuations	.	.	.	.		£ 1,000
1921							
Mar. 31	" Sundry Creditors	.	.	.	.		167,500
"	" Balance	.	.	.	.		9,000
							£177,500
							2,000

**SINKING FUND ACCOUNT**

<b>Dr.</b>							<b>Cr.</b>
1921							
Mar. 31	To Cash (Mortgages)			1920	By Balance		£
"	" " (Stock) £6,000 at 55			Mar. 31	" Cash		15,000
"	" " Balance			1921			27,000
				Mar. 31			<u>£42,000</u>
							33,700
				1921	By Balance		
				Mar. 31			

**CONTRACTORS' SPECIFICATION DEPOSITS ACCOUNT**

<b>Dr.</b>							<b>Cr.</b>
1921							
Mar. 31	To Cash			1920	By Balance		£
"	" Balance			Mar. 31	" Cash		150
				1921			50
				Mar. 31			<u>£200</u>
							120
				1921	By Balance		
				Mar. 31			

BALANCE SHEET, 31ST MARCH, 1921,

<i>Liabilities.</i>		£	<i>Assets.</i>		£
6% Redeemable Stock.			Property, Permanent Works, etc.—as at 31st March, 1920		£855,240
Cash proceeds . . . . .		£146,916	Additions this year—		
Discount, per contra—Capital A/c . . . . .		1,484	Per contra—Sundry Creditors A/c . . . . .		155,200
3½% Redeemable Stock—as at 31st March, 1920			"    Cash A/c, Expenses of Issue . . . . .		2,000
3% Redeemable Stock—as at 31st March, 1920 . . . . .		£137,500	"    6% Stock discount . . . . .		1,484
<i>Deduct—</i>			Stocks, as per valuations . . . . .		1,013,924
Amount redeemed during year . . . . .		6,000	Sinking Fund Investments . . . . .		14,000
2½% Redeemable Stock—as at 31st March, 1920			Sundry Debtors (Revenue A/c) . . . . .		7,900
Loans on Mortgages—as at 31st March, 1920 . . . . .		£100,000	Cash—		
<i>Deduct—</i>			Capital A/c . . . . .		£20,476
Amount repaid during year . . . . .		5,000	Sinking Fund A/c . . . . .		19,700
<i>Add—</i>			Revenue A/c . . . . .		£1,960
Loans raised during year . . . . .		10,000	Deposits A/c . . . . .		120
					2,080
		105,000			
Sundry Creditors (Revenue A/c) . . . . .		901,900			
Contractors' Specification Deposits A/c . . . . .		16,260			
		120			
		918,280			
<i>Surplus Account.</i>					
Stock and Loans Redeemed—as at 31st March, 1920 . . . . .		£119,000			
Additions this year—					
3% Redeemable Stock . . . . .		6,000			
Loans on Mortgages . . . . .		5,000			
		130,000			
Sinking Funds . . . . .		33,700			
Capital Expenditure defrayed from Revenue—as at 31st March, 1920 . . . . .		2,500			
		166,200			
Revenue A/c . . . . .		2,000			
		168,200			
		£1,086,480			
					£1,086,480
					42,256

## CHAPTER XXVII

### ACCOUNTING PROCEDURE IN CONNECTION WITH SUNDRY MATTERS CONCERNING LOANS AND BORROWING POWERS

#### I. OPERATION OF SINKING FUNDS IN THE REDEMPTION OF LOANS

THE fund having accumulated to the required amount, the investments, if any, will be realized and the proceeds applied in discharging the debt. Assume the realization to have taken place and the position to be as revealed by the following balance sheet—

BALANCE SHEET			
<i>Liabilities.</i>		<i>Assets.</i>	
	£		£
Stock . . . . .	30,000	Cash and other	
Mortgages . . . . .	20,000	Assets . . . . .	100,000
Sinking Fund . . . . .	50,000		
	<u>£100,000</u>		<u>£100,000</u>

Redeem the debt and the position is—

BALANCE SHEET			
<i>Liabilities.</i>		<i>Assets.</i>	
Sinking Fund . . . . .	£50,000	Assets . . . . .	£50,000
	<u>£50,000</u>		<u>£50,000</u>

As the purpose for which the sinking fund was established has now passed, the term Sinking Fund is now a wrong appellation and should be altered to "Surplus" or "Loans Redeemed." It is evident that if the assets are of full value, i.e. £50,000 (the amount of the debt originally incurred to obtain them) depreciation must have been provided for in addition to sinking fund. As there is no liability outstanding,

any value attaching to the assets thus represents the excess of the sinking fund provision over actual depreciation and such depreciation, if not already provided for, may now be deducted from the surplus on the liabilities side and the asset reduced to its actual value.

Assuming no depreciation fund to be raised and that the asset which cost £50,000 has a present value of £15,000 the balance sheet after the adjustment will be as under—

BALANCE SHEET	
<i>Liabilities.</i>	<i>Assets.</i>
Surplus (or Reserve Fund) (being loans redeemed) . . . £15,000 <hr style="width: 20%; margin-left: auto; margin-right: 0;"/>	Assets (present value) £15,000 <hr style="width: 20%; margin-left: auto; margin-right: 0;"/>

## 2. UTILIZATION OF SINKING FUNDS FOR NEW CAPITAL PURPOSES

The customary method of accounting, and incidentally that provided for in the Stock Regulations, is to transfer an amount of debt from the old to the new borrowing power, to the extent of the sinking fund utilized. Prior to the Stock Regulations, 1921, the transfer could be effected only at par, but now it may be at such a figure as the Minister of Health may sanction. This enables the fund to be utilized equitably. For example, it might not be considered equitable to transfer a portion of an old stock at 3 per cent to a new purpose on a different rating fund at par, when new money would cost much more in interest.

As regards the account from which the debt and the sinking fund are transferred the effect is the same

as if a portion of the debt had been redeemed, and as regards the new borrowing power, as if a new debt had been raised.

### Illustration No. 1.

Let the following balance sheet represent the state of affairs *before* the transfer is effected—

BALANCE SHEET			
<i>Liabilities.</i>	<i>£</i>	<i>Assets.</i>	<i>£</i>
Stock (or Mortgages)—			
Old Purpose . . . . .	100,000	Sundry Assets . . . . .	140,000
Sinking Fund, balance at credit thereof . . . . .	40,000		
	£140,000		£140,000

£30,000 of the Sinking Fund is applied as new capital; the position then is—

BALANCE SHEET			
<i>Liabilities.</i>	<i>£</i>	<i>Assets.</i>	<i>£</i>
Stock (or Mortgages)—			
Old Purpose . . . . .	70,000	Sundry Assets . . . . .	140,000
New Purpose . . . . .	30,000		
Loans redeemed . . . . .	30,000		
Sinking Fund, balance at credit thereof . . . . .	10,000		
	£140,000		£140,000

### Illustration No. 2.

A corporation decides to utilize £10,000 of its 3 per cent stock (electricity account) sinking fund for capital purposes on tramways account. Show the entries in journal form and state what rate of interest it would be reasonable to charge to the tramways account with reasons therefor.

JOURNAL	Dr.	Cr.
	£	£
<i>Loans Fund Accounts—</i>		
Stock Redemption Fund . . . . . Dr.	10,000	
To Cash . . . . .		10,000
(Appropriation of sinking fund moneys to new capital purpose)		
3% Stock Transferred A/c . . . . . Dr.	10,000	
(Tramways Capital A/c)		
To Allocation of 3% Stock A/c . . . . .		10,000
(Electricity Capital A/c)		
(Transfer of stock at par)		
<i>Tramways Accounts—</i>		
Capital Cash A/c . . . . . Dr.	10,000	
To 3% Stock A/c . . . . .		10,000
(Sinking fund moneys received from loans fund for new capital purposes)		
<i>Electricity Accounts—</i>		
Sinking Fund A/c (for Redemption of Stock) . . . . . Dr.	10,000	
To Debt Redeemed A/c (Surplus) . . . . .		10,000
(Sinking fund moneys appropriated to new capital purpose)		
3% Stock A/c . . . . . Dr.	10,000	
To Loans Fund A/c (for Redemption Provision)		10,000
Transfer of debt		

NOTE.—Although debt is reduced on Electricity Account that department's annual contribution to redemption provision is not reduced but continues for the full original period. This applies in all cases of debt redemption out of sinking fund moneys.

**Rate of Interest.** There appears to be justification for charging the tramways account  $4\frac{1}{2}$  per cent interest (being the current rate at which new loans could be obtained). The tramways account would make a net gain in consequence of the saving in expenses of raising new moneys. If the market value of the stock at the time of transfer is, say £66 $\frac{2}{3}$ , a transfer at this rate instead of par would then produce to the lending fund  $4\frac{1}{2}$  per cent.

An alternative method of using sinking funds for new capital purposes is to treat the accommodation as an investment of the fund with the new capital purpose



fund. In these circumstances no transfer of debt is effected. It is purely an investment of the sinking fund.

This method is not permissible under the general law (Stock Regulations and Trust Investment Acts). It would have to be obtained by local Act. There is no statutory authority to utilize mortgage sinking funds as new capital (otherwise than within the same rating fund), except that obtained by local Act which might also give power to treat such lendings as investments of the sinking funds.

### 3. CONVERSION OF STOCK TO STOCK OF ANOTHER DENOMINATION

#### Illustration.

An issue of £150,000, 4 per cent stock in exchange for £100,000 6 per cent (i.e. at a premium of 50 per cent).

JOURNAL	<i>Dr.</i>	<i>Cr.</i>
6% Stock A/c . . . . . <i>Dr.</i> To 4% Stock A/c . . . . . (Conversion of 6% Stock to 4% Stock)	£ 100,000	£ 100,000
Discount on Conversion of 6% Stock A/c . <i>Dr.</i> To 4% Stock A/c . . . . . (Discount on conversion—apportionable to the various funds in proportion to the allocation of the £100,000 6% stock at time of conversion)	50,000	50,000
4% Stock Allocation A/c . . . . . <i>Dr.</i> To 6% Stock Allocation A/c . . . . . (Re-allocation of 6% stock, apportionable as £100,000 6% stock stood at time of conversion)	100,000	100,000
4% Stock Allocation A/c . . . . . <i>Dr.</i> To Discount on Conversion of 6% Stock A/c . (Allocation of discount on re-allocation of 6% stock apportionable to the various funds in proportion to the allocation of the £100,000 6% stock at time of conversion)	50,000	50,000

**4. CONVERSION OF MORTGAGES TO STOCK  
BY THE ISSUE OF £112,500 4 PER CENT STOCK  
IN EXCHANGE FOR £100,000, 5 PER CENT  
MORTGAGES**

**Illustration.**

JOURNAL	Dr.	Cr.
Mortgages Loan A/c . . . . . Dr.	100,000	£
To 4% Stock A/c . . . . .		100,000
(Being conversion of mortgages to stock)		
Discount on Conversion of Mortgages to Stock A/c . . . . . Dr.	12,500	
To 4% Stock A/c . . . . .		12,500
(Being discount on conversion of mortgages to stock)		
Allocation of 4% Stock A/c . . . . . Dr.	12,500	
To Discount on Conversion of Mortgages to Stock A/c . . . . .		12,500
(Being allocation to the various accounts of the discount on conversion of mortgages to stock, in same proportion as the alloca- tion of the mortgages stood at the time of conversion)		

**5. REVENUE CONTRIBUTIONS TO CAPITAL  
OUTLAY**

It sometimes happens that it is inexpedient or impossible to charge certain capital expenditure to loan account. This arises in circumstances such as the following—

(a) Where loan sanctions are spent up and it is not considered advisable to apply for further borrowing powers ;

(b) Where the expenditure is of a capital nature though comparatively small in amount and not worth while seeking borrowing powers ;

(c) When writing-back loan repayments (treated in further detail in next section).

**Illustration.**

Journal entries are as follows—

JOURNAL		
Capital Expenditure A/c . . . . .	<i>Dr.</i>	
To Revenue contributions to Capital Outlay		
A/c . . . . .		
(or Surplus A/c)		

**6. WRITING-BACK LOAN REPAYMENTS**

This matter sometimes arises on a re-organization of an accounting system by reason of the fact that the value of capital assets has been written down to the extent of debt redeemed. The method adopted to put the capital expenditure accounts on a proper basis is generally as follows—

(1) A trial balance and balance sheet are prepared before the adjustment.

(2) A careful investigation is made of books and accounting records to obtain full particulars of all debt redeemed showing separately under the various purposes for which the money was raised, repayments out of—revenue account; sinking fund account; and capital account (re-payments re-placed).

(3) Capital expenditure accounts will now be debited with the amount of debt redeemed out of revenue and sinking funds respectively. Credits will be made of the appropriate amounts to “Debt Redeemed out of Revenue Account,” and to “Debt Redeemed out of Sinking Fund Account.” Repayments out of capital account, replaced, do not affect the capital expenditure accounts.

(4) Capital expenditure accounts also require to be debited and surplus account (under appropriate sub-headings) credited with property in the ownership of the local authority which has not been purchased out

of borrowed moneys, e.g. revenue contributions to capital outlay, gifts, etc.

(5) Some local authorities, where the surplus account permits, write down unrealizable capital expenditure such as sewers, land purchased for street widening, etc., by the amount of debt redeemed, while some others place no value on them at all for balance sheet purposes in order that the whole of the assets shown in the aggregate balance sheet represent saleable properties.

(6) A new trial balance and balance sheet may now be drawn up.

## 7. STATING CAPITAL EXPENDITURE IN THE BALANCE SHEET

**Capital Accounts.** There are two methods of stating capital accounts in general use—

(a) Where the year's receipts are debited and the payments credited, or vice versa, separate accounts being kept for each sanction or work. The balance of this account represents unspent loans or spendings in anticipation of borrowings ;

(b) Where the accounts show in detail : expenditure in previous years, expenditure during the current year, and total to date ; loans outstanding at the commencement of the financial year, loans received during the year and total to date, followed by particulars of loans redeemed and revenue contributions to capital outlay. This method is the double-account system modified to suit the requirements of local authorities.

**Balance Sheet.** There are several methods of stating capital expenditure in the balance sheet. The principal are—

(1) Where capital expenditure is shown at cost and

capital assets not purchased at the valuation when acquired, without any reduction (on the assets side) in respect of debt redeemed, depreciation, unrealizability, etc. ;

(2) Where assets are shown at full, less a deduction in respect of debt redeemed ;

(3) Where assets are shown at full, less sinking fund provision ;

(4) Where assets are shown at full, less depreciation provision ;

(5) Where assets are reduced by *actual* depreciation, irrespective of depreciation *provision* or debt redemption.

Opinions differ widely as to the best method, and while the following suggestion does not purport to be ideal it is given as an illustration of a very prudent and perhaps highly desirable method where circumstances permit.

State the assets in the balance sheet at cost (or valuation where not purchased) and show as a deduction in an inner column the *actual depreciation* that has taken place so far as can be ascertained (to reduce the assets to real present-day value). Omit if possible all unrealizable assets such as land used in street widening ; expenditure on sewers ; costs of local Acts, etc (If these cannot be omitted they may be reduced by redemption provision). The amount by which the assets are written down or written off is deducted from surplus account on the liabilities side, leaving the remaining surplus a real surplus in its literal meaning.

## PART III

### CHAPTER XXVIII

#### TEST QUESTIONS AND PROBLEMS

1. On the reconstruction of a tramway track the old rails are sold for £1,000. The original cost was £2,000, funds for the redemption of which are accumulated to the extent of 60 per cent of the original cost. Show in journal form the entries required to effect the adjustment.

2. What principles should guide you in considering whether or not a Depreciation Fund should be established in addition to provision for redemption of debt in the case of a tramways undertaking ?

3. A public benefactor makes a gift of £10,000 to a corporation for the provision of a public library. The actual cost of the library was £10,000. What entries would you make in the books of the local authority, and how would you state the asset in the balance sheet ?

4. As registrar of stock and bonds, to what essential points would you give attention on receiving a transfer form on the sale of stock to the value of £1,000 by A to B, and what steps should be taken to guard against the possibility of a forged transfer ?

5. Your corporation is desirous of extending the Town Hall at an estimated cost of £5,000. The Ministry of Health refuse to give sanction to the borrowing of the requisite sum. Can the local authority proceed with the work ? If so, can the cost be treated as capital expenditure ?

6. Assuming the corporation (as stated in the previous question) decide to effect the Town Hall extension in spite of all threats of members of the council opposed to the scheme, what entries would you, as borough treasurer, make in the books of account ?

7. A member of your council, opposed to the principal of borrowing money at interest, makes a proposal to apply for Parliamentary sanction to issue currency notes to the extent of its capital requirements (say a million pounds). He contends that no interest will be payable on the money ;

that the cost of printing the notes will be negligible and can be charged to current revenue (rate) account ; and that provision for redemption of the million pounds will be made within 50 years by the withdrawal from circulation, and cancellation of £20,000 of the notes annually. As chief financial officer what observations would you make to your Finance Committee ?

8. A local authority has sold for £10,000 a portion of its freehold property which it acquired fifteen years ago for £7,500. The amount of debt outstanding against the original cost is £6,000. How would you treat this matter in the books ?

9. Your Finance Committee is divided in opinion as to the period for which sanction should be sought in connection with a proposed application for borrowing powers. Some members favour the longest possible period permissible under the statutes concerned, while others desire a much shorter term. As chief financial officer you are asked to advise the committee on the effect of both proposals, and to state what considerations in your opinion as a municipal financial expert should be taken into account in deciding on a period.

10. Outline the system under which local authorities in England and Wales are empowered under the general law to raise money by loan.

11. What safeguards are there, if any, against an improper use of the power to raise money by loan ?

12. A corporation having power to utilize its 3 per cent Stock Redemption Fund for new capital purposes transferred at par £10,000 to the credit of Gasworks Capital Account. Show the entries in the accounts of—

(a) The Gas Committee, and (b) the Loans Fund.

13. Show the entries in the books on the assumption that the transfer (mentioned in the previous question) is effected at a rate deemed to be more equitable, say at a time when the ordinary rate on corporation short-term mortgage loans is  $4\frac{1}{2}$  per cent.

14. Outline the procedure in registration of housing bonds.

15. A gas company has a 5 per cent mortgage debt of £30,000 and a share capital (fully paid) of £80,000. Your corporation acquires the undertaking on the following terms : The mortgages are taken over at an interest rate of  $4\frac{1}{2}$  per cent (the corporation's current rate) in consideration of an

added premium of 10 per cent. The shareholders accept an equivalent to their holding in  $4\frac{1}{2}$  per cent mortgages. The costs of the transfer amount to £5,000. Show the entries in the books of the corporation.

16. Do you recommend the payment of interest on loans by interest warrants or by coupons ?

17. To what points would you give consideration in deciding by what method loans should be redeemed, assuming all methods were equally available ?

18. If your local authority had issued Irredeemable Stock many years ago and had accumulated a redemption fund sufficient to redeem it—

(a) What would guide you as to whether or not redemption is advisable ?

(b) Assuming you thought it best to redeem, how would you proceed ?

19. Your local authority raises money by mortgage loans continuously throughout the year. When do you consider the first and the last contributions to sinking fund should be made ?

20. Are there any circumstances in which sinking fund provision may be—

(a) suspended, (b) deferred, and (c) discontinued permanently ?

21. The chairman of the Finance Committee asks you to explain the effect of high and low bases in connection with the calculation of sinking funds. What would you tell him ?

22. Draw out *pro forma* accounts (omitting figures) illustrating—

(a) A Redemption Fund, (b) a Dividends Fund, and (c) a Loans Fund balance sheet.

23. In what way, if any, can the principle of a Consolidated Loans Fund be applied to mortgage borrowings ?

24. Your corporation is promoting a private bill and you are asked by the town clerk to advise him as to powers you think ought to be taken to effect a complete consolidation of all loans, with a view to acquiring all advantages, if any, attaching to one complete Consolidated Loans Fund. Outline the powers (omitting legal phraseology) you wish to obtain.

25. Your Finance Committee is divided in opinion as to the equity of transferring sinking fund moneys for new capital purposes at par or at some other figure. As chief financial



officer you are requested to state the pros and cons of both methods so that a decision can be arrived at as to whether to apply to the Ministry of Health for power to transfer at a figure other than at par. Outline your views.

26. What basis do you recommend on which interest should be allocated to the various funds liable in respect of advances from a consolidated fund ?

27. A certain proportion of the machinery in the electricity department of a local authority having become worn out a considerable time before the term allowed by loan sanction expires, it has been decided to charge the balance of the outstanding cost to Reserve Fund. Show how the following accounts would be affected, taking the amount to be provided out of the Reserve Fund as £1,000, and giving imaginary figures for each account. The £1,000 is to be carried to the credit of Sinking Fund—

Reserve Fund.  
Capital Account.  
Sinking Fund Account.  
Balance Sheet.

28. A local authority owning an electrical undertaking, after working for 10 years, decide to dispose of a portion of the plant which has become useless. The original value was £2,000, and the amount paid into the Sinking Fund £800. A sum of £500 is received for the sale of the plant. Make the necessary adjustments in the books accordingly.

29. State how you would deal with the balances of the following loans which had been received, but owing to the work in respect of which the loans were raised having been executed more cheaply than was expected, were not wholly required, viz., a loan from—

- (a) The Public Works Loan Commissioners ;
- (b) Sundry mortgagees.

30. Prepare a register of borrowing powers, showing the necessary entries from the time of receiving the sanction to the actual raising of the money.

31. It is important that the borrowing powers of a local authority should not be exceeded. State what steps you would take to prevent any over-spending of a borrowing power.

32. What do you know of the attitude of the Government sanctioning departments with regard to the charging of the salaries and wages of permanent employees to capital account ?

33. Is there any difference between loan expenditure and capital expenditure? If so, what is it?

34. Assume the Ministry of Health is about to hold an inquiry in your town before sanctioning a borrowing power, what information would you prepare for submission to the inspector?

35. What are the restrictions, if any, to the borrowing powers of local authorities?

36. In what circumstances are the proceeds of the sale of national savings certificates available for loans to local authorities?

37. Mention a dozen important points to be borne in mind when contemplating an issue of stock.

38. Your local authority creates a 4½ per cent Redeemable Stock which produces more money than is immediately required. What would you do with the excess borrowing?

39. Assuming you decided to invest the excess moneys raised (referred to in the previous question)—

(a) In what securities would you invest the money?

(b) How would you deal with the interest on the investments?

(c) How would you deal with a profit on the realization of the investment?

(d) How would you deal with a loss on realization?

(e) How would you allocate the dividend payable by the corporation on the portion of stock raised in excess of requirements and invested?

40. If you were investing sinking fund moneys in stock of another authority, would you prefer to buy at par, at premium, or at a discount, assuming the interest yield to be equivalent in all cases?

41. Outline the operations relating to an issue of stock in the exercise of available borrowing powers.

42. What do you understand by Inscribed Stock?

43. If you were contemplating an issue of stock would you recommend its issue at a discount, at par, or at a premium?

44. Are there any circumstances in which borrowing may be effected without specific sanction of a Government department? If so, state them.

45. What security is given to loan holders in respect of borrowings by different methods?

46. State the limitation which is fixed by Section 235 of the Public Health Act, 1875, to the amount of a loan which a local authority may raise under that section, on the credit of land, works, or other property which they possess for purposes of sewage disposal.

47. What statutory provisions are there for ensuring that loans made by the Public Works Loan Commissioners to local authorities shall be applied to the purposes for which they are advanced.

48. You receive notice to repay a mortgage standing in joint names. On the expiration of the notice you find one of the persons named in the mortgage has died. What course would you take in paying off the mortgage to get a proper discharge ?

49. Discuss generally the advisability of a corporation investing in its own securities and mention the principal dangers to be guarded against.

50. What is meant by the term "Equation of Loans" ? Under what circumstances would it be advantageous for a local authority to equate its loans, and how should it be effected ?

51. Give an instance where it would be disadvantageous to raise capital moneys by short-term loans, as against the issue of redeemable stock.

52. A corporation obtains sanction to borrow £25,000 for the erection of an elementary school. Payments are made to the contractor as the work proceeds, the total amount of the sanction is borrowed, but when the final statement is made out it is found that the school has cost £24,500. How would you deal with the £500 over-borrowed ?

53. State in detail the chief method adopted by local authorities in dealing with the question of depreciation and sinking funds, and indicate which, in your opinion, is the soundest method.

54. What are the objections, if any, to raising loans under the provisions of the Local Loans Acts ?

55. Compare the advantages of an issue of stock by the following two methods : (a) by tender ; (b) at a fixed price.

56. What would influence you in your decision as to the advisability of borrowing by long-term mortgages or by short-term mortgages ?

57. What are the advantages, if any, in long-term mortgages over stock ?

58. Show by working which is the cheapest method, and by how much, of redeeming a loan of £10,000 in six years, interest at 3 per cent—

(a) By equal annual instalments of principal, with interest on outstanding balances paid yearly ;

(b) By the annuity method (£18459 will redeem principal and interest combined on £1 in six years).

(c) By the sinking fund system, setting aside an annual sum which accumulated at 3 per cent compound interest would pay off the debt at the expiration of six years (£15459 will provide for the redemption of £1 at the end of six years).

59. What are the important factors to be considered in fixing depreciation of assets from the accountancy standpoint, and what circumstances, if any, would justify you in subsequently altering the basis ?

60. Assuming the rate of interest to be the same in both cases is it more economical to borrow on the "instalment" than on the "annuity" plan ?

61. What are the principles which govern the distinction between capital and revenue expenditure ? Is all expenditure for which sanction to a loan cannot be obtained, necessarily a revenue charge ? Illustrate your answer by examples.

62. You are authorized to borrow £3,729 for street improvements. Actually you can raise only £3,700. How would you deal with the difference so as to pay off the loan out of sinking fund and make a clear transaction at the end of the period allowed for redemption ?

63. The waterworks undertaking of the Corporation of Drinkwater was purchased from a private company, part of the capital being paid in the form of annuities which are irredeemable. The corporation some years later desires to redeem the annuities on equitable terms. Give one or two illustrations showing how this could be done, and which of the courses proposed is the best in your opinion, with reasons for the same.

64. Explain the provisions as to borrowing, re-borrowing, and repayment of loans contained in the Public Health Act, 1875, and the Municipal Corporations Act, 1882.

65. Do you consider there is any material difference between the provisions of the Municipal Corporations Act, 1882,

and the Public Health Act, 1875, with regard to re-borrowing for the replacement of loans falling due before the loan period has expired? If so, what are your views?

66. What do you know of the restrictions (if any) as to the investment of sinking funds of local authorities?

67. What are the advantages or disadvantages of applying sinking fund accumulations as new capital?

68. How must and how may contributions to sinking funds be dealt with?

69. What is (a) a Sinking Fund, and (b) a Redemption Fund?

70. Which method of repayment of loans is the most economical? Does the period of the loan make any difference?

71. Why do the larger local authorities seldom borrow from the Public Works Loan Commissioners?

72. Describe the procedure when sinking funds are utilized as new capital, giving *pro forma* entries.

73. What is the effect of sinking funds on borrowing powers?

74. Explain a system of accounts whereby capital expenditure is readily compared with and set against the amounts sanctioned. Describe how the system you recommend would be made to work in with the ordinary financial books.

75. Explain the issue of stock, and compare it with two other methods of raising loans.

76. Discuss the question of raising loans for defraying expenditure by local authorities on permanent works. Deal only with matters of principle.

77. Prepare in tabular form a statement showing the maximum periods prescribed by the Acts mentioned (as amended) for repayment of loans by: County Councils; County Borough Councils; Non-County Borough Councils; Urban District Councils and Rural District Councils—as far as each class of authority may be affected by expenditure under the Public Health Act, 1875; Municipal Corporations Act, 1882; Local Government Act, 1888; Education Act, 1921; Housing Act, 1890, etc.; Tramways Act, 1870, and Electric Lighting Act, 1882.

78. Mention which authorities in the previous question may incur expenditure and borrow therefor (quoting statutory authority) in respect of: (a) Light railways; (b) streets and roads; (c) offices; (d) water supply; (e) police stations;

(*f*) lunatic asylums ; (*g*) allotments ; (*h*) depots ; (*i*) hospitals ; (*j*) electric lighting ; (*k*) mortuaries ; (*l*) public elementary schools ; (*m*) public libraries ; (*n*) private street improvements ; (*o*) lodging houses.

79. What Government returns are required to be made by local authorities in respect of loan debt ? Outline one of such returns.

80. What statistical statements do you consider should be prepared in reference to loans and borrowing powers ?

81. Outline a statement of borrowing powers, sinking funds and debt, explaining how you would proceed to compile such statement.

82. What are the main provisions of the Forged Transfers Acts so far as local authorities are concerned ?

83. Outline the provisions of the Local Authorities (Financial Provisions) Act, 1921.

84. A sinking fund is being accumulated to amount to £20,000 in 30 years from 1920. On 31st March, 1925, part of the land bought out of the loan of £20,000 in respect of which the fund is being accumulated, is sold for £1,000. Is an adjustment of the sinking fund necessary ? If so, how would you give effect to it ?

85. Your local authority has obtained a borrowing power of £5,000 for purposes of sewerage and has spent £5,400. How would you deal with the matter in the books assuming you had actually borrowed £5,400 and allocated it to this sanction before noticing the over-borrowing ?

86. In what ways, if any, may a local authority obtain money for working capital ?

87. Discuss the pros and cons of transferring annually from revenue account to sinking fund the contribution plus the amount of interest which the fund should earn, as compared with the theoretical method.

88. Show in journal form the entries necessary when—

- (*a*) Investing sinking funds ;
- (*b*) Receiving interest on sinking fund investments ;
- (*c*) Repaying a loan and re-borrowing to replace it ;
- (*d*) Paying interest to loan-holders.

89. Show in journal form entries in respect of—

- (*a*) Redeeming debt out of sinking fund ;
- (*b*) Redeeming debt out of revenue account direct ;
- (*c*) Capital expenditure defrayed out of revenue account.

90. How would you deal with the balance standing to the credit of sinking fund account after the debt for which the fund was accumulated has been wholly redeemed, and with the present value, if any, of the asset for which the debt was incurred?

91. The Corporation of Wellofftown has a reserve fund of £20,000 in respect of its tramways undertaking and a surplus of £15,000 on borough fund account and decides to use both these sums in redeeming equivalent amounts of mortgage debt on the respective accounts. Assuming the transaction is permissible, show in journal form the book entries necessary to effect this.

92. What do you consider to be the best method of stating capital expenditure in the accounts and balance sheet? Illustrate your answer.

93. The County Council of Stockshire raised £100,000 5 per cent stock redeemable at par in 30 years, repayable at the option of the Council after 20 years. The stamp duty on transfers was free. The purposes to which the stock was applied are—

	£	
Lunatic asylums	50,000	(25 years)
Elementary schools	30,000	(30 years)
Police stations	10,000	(25 years)
County bridges	8,000	(10 years)
Expenses of issue	2,000	(30 years)

Construct the necessary accounts from the following figures and prepare a balance sheet—

Stock raised and allocated . . . . .	£	100,000
Composition for stamp duty . . . . .		50
Rents of property (received) . . . . .		80
One year's contributions to dividends on stock . . . . .		5,000
Contribution for redemption of stock . . . . .		2,600
Insurance on house property . . . . .		4
Rates and taxes on houses . . . . .		8
Dividends paid on stock (less tax) . . . . .		3,875
Investment of Redemption Fund with another authority . . . . .		2,600
One year's interest thereon . . . . .		100

94. Assume that your local authority has been engaged in work of a capital nature on a large scale, and has now raised the necessary funds by issuing £1,250,000 5 per cent

Redeemable Stock at 95. From the particulars given below, compile all the necessary accounts together with a statement of assets and liabilities as at 31st March, 1921—

	£
5 per cent Redeemable Stock at 95 . . . . .	1,250,000
Sewage-works . . . . .	215,000
Gas-works . . . . .	187,250
Town Hall . . . . .	90,000
Electricity undertaking . . . . .	275,000
Tramways undertaking . . . . .	295,000
Housing . . . . .	75,000
Street improvements . . . . .	50,250
Dividends on stock . . . . .	62,500
Sinking Fund . . . . .	25,750
Paid for redemption of stock at 96 . . . . .	12,960
Fees charged on registration of stock . . . . .	17
Stamp duty and commission on purchase of stock . . . . .	135
Bank interest received . . . . .	227
Balance in banker's hands . . . . .	?

95. A county council issued £300,000 of 3 per cent Consolidated Stock at 98½, redeemable at their option after 20 years. The council transferred the sum of £506 11s. 3d. from General Capital Account to the Dividend Account of the Consolidated Loans Fund to provide for the payment of dividends on instalments paid in advance of the due dates. The expenses of the issue were as follows—Stamp duty £375, commission £362 6s. 9d., advertisements £59 15s. 0d., management of issue £750. Open necessary accounts recording the above transactions and offer any criticisms which occur to you.

96. The Newborough Corporation having obtained sanction to borrow the sum of £100,000 for the construction of a Waterworks reservoir, raised the same by the issue of a 3½ per cent stock at par, under the provision of the Public Health Acts Amendment Act, 1890. Upon completion of the work you find the total cost to be as follows—

	£
Purchase of land . . . . .	9,000
Material for construction . . . . .	34,000
Carting . . . . .	1,500
Wages of workmen . . . . .	39,000
Proportion of salaries of engineer and staff . . . . .	1,700
Stores used . . . . .	6,600

Show the entries in the books so far as loans transactions are concerned.



97. On balancing the accounts of your corporation you find you have the following amounts standing to the credit of the Sinking Fund Account, no portion of which is invested.

	£
Gas . . . . .	5,200
Water . . . . .	7,500
Borough Fund . . . . .	7,000
General District Fund . . . . .	8,000

The corporation has the following unexercised loan sanctions which it is desired to exercise immediately—

	£
Electricity Works extensions . . . . .	15,000
Waterworks extensions . . . . .	16,000

It is decided to apply the Sinking Fund moneys so far as they will go in exercise of the said borrowing powers. Show in journal form the entries necessary to give effect to this.

Separate banking accounts are kept for each fund, and for each trading undertaking, but not for capital and revenue.

98. Your local authority in the year 1880, floated a 3 per cent stock issue, redeemable in 50 years. You have at the present time £10,000 Stock Redemption Fund moneys uninvested. You require to raise £10,000 for street-making charges in connection with the assisted housing scheme. The period granted for repayment of the street-making charges is 20 years.

(1) Would you use the stock redemption moneys in exercise of the sanction ?

(2) Assuming the stock redemption fund is so applied, does any other question arise which should receive your consideration ?

99. A municipal corporation exercises borrowing powers for £100,000 by an issue of redeemable stock under the Stock Regulations of the Ministry of Health, at  $96\frac{1}{2}$  per cent, the cost of issue representing 3 per cent on the nominal value of stock issued.

(a) What sum will require to be issued ?

(b) Journalize the entries relating to the transaction of the issue and application of proceeds.

100. Draft forms to serve the purpose of

(a) A register of Investments, and

(b) A Sinking Fund register.

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