

## AMMENDMENT OF THE LOGALGOVERNMENT SORP

### CJC response

#### INTEREST CHARGES

- 01 We agree entirely with the view, reported at paragraph 8.19 of the Consultation Document, that omitting any charge for interest on capital from trading accounts would be unfair to private sector competitors; and would be widely seen to be unfair.
- 02 Paragraph 8.22 is in our experience nevertheless right to say that private sector measures of cost vary widely, and may often include no charge for interest on capital. This is however irrelevant to the present debate about trading accounts. Contractors undoubtedly have to allow for interest on capital in their tenders, whatever the form of their segmental accounts or their management accounting records. Local authorities' trading accounts would therefore be misleading if they were to reflect costs ascertained on some basis more favourable than their competitors have to provide for in their tenders.
- 03 This would count as giving interest-free loans and therefore as state aid for the purposes of article 87 of the Treaty of Rome.
- 04 Paragraph 8.23 notes that the definition of cost in BeVACOP, which includes interest charges, has been accepted by government, and that this has given BeVACOP greater legitimacy. We can confirm that we have not ourselves heard competitors or contractors' organisations express any reservations about BeVACOP's definition of cost.
- 05 We believe that it would also be realistic for interest charges to be included in cost for the purposes of charges for discretionary services, and presumably for other cost recoveries. Our general preference would therefore be for interest to be retained in 'cost' as used throughout service accounts, as well as in trading accounts.
- 06 If however the Institute is unable to agree to do this, we would need
- ¥ to recommend authorities to ascertain interest charges ad hoc, and add them back to the tenders of trading organisation in tender evaluation
  - ¥ to point out in our Standing Guide that interest charges can still be counted as cost for the purpose of charges for discretionary services, even though no longer part of cost in BeVACOP

#### LONG TERM CONTRACTS

- 07 We see no objection to the proposed wording in the proposed paragraph 3.84.
- 08 Work in progress can amount to significant amounts for long term contracts, which are almost always won in competition, so that SSAP 9 can have a major effect on trading accounts. The overall net effect of the SSAP is of course to include estimates of **future losses** in **current** trading accounts.
- 09 It may be worth reminding Institute members that the requirements of the SSAP as to anticipated losses have not changed significantly since before the introduction of CCT. The Institute on that occasion agreed with the predecessor body to the ASB, and with the Treasury (who were then taking a close interest in DLO revenue accounts and rates of return) how the necessary charges to DLOs for anticipated losses should be estimated.
- 10 The method then agreed was reproduced in the former Code of Practice for CCT and is still reproduced in the CJC Standing Guide. Occasions for making the charges (and occasionally the credits) called for by SSAP 9 have if anything increased, as a result of the growing practice of sculpting tenders for long term contracts. Failing to make the necessary charges and credits can then seriously distort the trading pattern shown by successive trading accounts.
- 11 The guidance now in the Standing Guide was designed to help practitioners to come to grips quickly with a complex and demanding process. We attach a copy. It would clearly be out of place in the SORP, but it may be constructive to draw it, in other documentation, to the attention to institute members.

**STANDING GUIDE TO THE COMMISSIONING OF WORK & SERVICES  
EXTRACT FROM PART E - COST**

**The cost of future losses**

- E.49** SSAP 9 (1004) was drafted primarily for the textile industry, but is expressed to apply to all manufacturing and trading organisations. In local government trading, it is in practice usually effected only for
- ¥ task-and-finish jobs
  - ¥ term contracts for which tenders are sculpted, as when tenderers voluntarily (and not merely in response to a requirement applying to all tenderers) tender prices which differ in real terms from year to year, usually lower in later years
- and**
- ¥ term contracts for which prices are not indexed
- for any of which **either**
- ¥ significant and unavoidable losses are expected on completion (1154)
  - or**
  - ¥ significant profits would be shown on 31 March but authorities believe they would not be maintained.
- E.50** The SSAP requires the gross estimated income and expenditure of work not yet done on 31 March on contracts **accepted before the balance sheet date** to be brought into account on 31 March. This is so that
- ¥ any estimated future losses to which trading organisations are already committed on the balance sheet date are brought into account in the current year
  - ¥ profits on work during the current year are not brought into account if it is estimated that they will be offset by subsequent losses.
- E.51** Gross figures of expenditure and income for work in progress (if defined in this way) are however often disproportionately large, and may exceed even those for work done during the year. They might then make trading accounts confusing to many users. The end result sought by the SSAP can however be secured without introducing such entries. This can be done by forecasting the net final profit or loss for each job. Forecasts need then to be compared with the net profit or loss for the job already shown in the accounts for the current and previous years. The terms of the SSAP require provision for the difference to be made if this comparison shows that
- ¥ the net loss now forecast for the job, on completion, exceeds the net amount of losses and profits included to date in the trading account
  - or**
  - ¥ a net profit is still forecast, on completion, but it is less than the net profit included in the trading account to date
  - or**
  - ¥ a loss is now forecast for the job, on completion, but a net profit has been included in the trading account to date.
- E.52** Any such provisions are conveniently effected by
- ¥ charging them to trading accounts on 31 March
  - ¥ crediting them to provisions accounts, and
  - ¥ reversing all these entries on 1 April.
- E.53** An example of a calculation of the provision needed for future losses is included in paragraphs E.56 & 57.
- E.54** Satisfactory estimates of future income and expenditure require the matching of the effect of both
- ¥ inflation and variation orders
- on both
- ¥ income and expenditure.
- E.55** Matching can usually be secured by taking account, on both sides, of
- ¥ all pay and price increases known on the date of the forecast (except that, for term contracts which are not indexed, cost forecasts also need to include estimates of the cost of inflation up to completion)

and  
 ¥ all variation orders then made.

### Example of calculation of provision for future losses

**E.56** Further losses after the end of the current year are expected on jobs **A** and **B**, which were then in progress. For job **C** it is expected that the profit shown at the end of the year will not be wholly maintained. For job **D** the eventual loss is expected to be less than the loss on work to the end of the current year.

	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>TOTAL</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
<b>totals to end of current year</b>					
cost	100,000	50,000	100,000	80,000	
valuations	80,000	40,000	120,000	60,000	
profit			20,000		
loss	20,000	10,000		20,000	
<b>final totals now estimated</b>					
cost	175,000	80,000	120,000	90,000	
valuations	120,000	60,000	130,000	80,000	
profit			10,000		
loss	55,000	20,000		10,000	
<b>provision now needed</b>	<b>35,000</b>	<b>10,000</b>	<b>10,000</b>	<b>nil</b>	<b>55,000</b>

**E.57** In this example, provision for losses and reduced profits of £55,000 thus needs to be charged to the trading account on 31 March, and written back on the following 1 April.

### CROSS REFS

**1004** SSAP 9 (Stocks & Long Term Contracts)

**1015** Code of Practice on Local Authority Accounting (BeVACOP)

**1082** The Local Government SORP

**1122** Whole of Government Accounts Programme (contained in detailed guidance for government departments and non-departmental government bodies)

**1152** CIPFA Guide Fair Shares 2003

**1153** Best Value Green Paper 1999

**1154** Financial Reporting Standard 12