Section 2: The Definition of Total Cost

The Purpose of Total Cost

2.1 The definition of total cost will provide the consistent basis for all statutory financial disclosures in relation to Best Value.

2.2 Specifically, financial information requirements for formal financial reports of performance, for performance indicators and for statistical returns will be harmonised around the definition of total cost. Total cost must also be used for reporting the cost of services in the Income and Expenditure (I+E) Account (in Northern Ireland, the District Fund Summary). Formal reports of performance that may include financial details include Best Value Performance Plans (BVPPs) in England, Improvement Plans in Wales and other similar reports.

2.3 The use of total cost for less formal purposes, such as unpublished local performance indicators, activity-based costing and cost benchmarking at lower levels of detail than required by Section 3, will also enhance the reliability and comparability of such information.

2.4 However, there are several areas where total cost may not be appropriate for management accounting and decision-making purposes. For example, there are strong arguments for reflecting the costs of early retirements in management accounts so that service managers can see the cost as well as the benefit of such decisions, and as a way of ensuring management discipline. Such costs are not within the total cost of individual services for consistency reasons, and so parallel accounting systems may be required, using total costs for external reporting and comparisons and other accounts for internal management purposes. Authorities will also need to decide whether a particular reporting purpose requires a cost of capital element to reflect the full cost of using fixed assets in the provision of a service. This issue is addressed in more detail in paragraphs B19 to B22 of Annex B.

2.5 In particular, local authorities will need to ensure when putting any service(s) out to competition that all their own relevant costs are taken into account, whether these are defined as being within total cost or not.

2.6 It is important also to distinguish between costs that are within total cost to support the aim for as much consistency as possible between authorities and those costs over which service managers exercise control. The latter depends on local management and delegation arrangements and there is no intention to restrict local authorities' discretion over such matters.

2.7 The total cost of a service or activity includes all costs, as defined below, which relate to the provision of the service (directly or bought in) or to the undertaking of the activity.

2.8 The total cost of a service or activity must reflect all the costs associated with that service/activity, wherever in the management structure they arise. It is acknowledged that the accounting structure, as defined by the service expenditure headings, is unlikely to match the management structure in any authority.

2.9 The accounting structure has been and will be further developed to allow flexibility in combining the elements within the Service Expenditure Analysis (SEA) to match management structures and review requirements.

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Gross and Net Total Cost

2.10 Total cost exists in both gross and net terms. No categories of income are considered to be abatements of expenditure, and movements to and from reserves must be excluded from total cost definitions. Relevant movements can easily be taken into account in local comparisons, if required.

Gross Total Cost

2.11 Gross total cost includes all expenditure attributable to the service/activity, including employee costs, expenditure relating to premises and transport, supplies and services, third party payments, transfer payments, support services and depreciation.

2.12 Specifically, it includes depreciation calculated in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom:* A *Statement of Recommended Practice* (the SORP) and with existing capital accounting guidance. Where relevant, depreciation charges will be matched by credits from the Government Grants Deferred Account to reflect the amortisation of grants and contributions given towards the funding of the relevant asset. The amortisation credit is treated as income rather than being offset against the depreciation charge. Further discussion of capital issues can be found at Annex B.

2.13 The SORP requires that "General Fund service revenue accounts, as defined by CIPFA's *Best Value Accounting Code of Practice*, central support services...should be charged with depreciation and where required, any related impairment loss (due to clear consumption of economic benefits) for all fixed assets in the provision of service". Total cost therefore also includes any related impairment loss. Any reduction in value due to a general fall in prices rather than impairment should be recognised in the Statement of Total Recognised Gains and Losses and therefore not in the total cost of a service, unless there is no accumulated gain attributable to the relevant asset in the Revaluation Reserve to absorb the loss. In exceptional cases, a revaluation gain might be credited to a service revenue account where it represents the reversal of a loss previously recognised. Additional information on the treatment of impairment loss can also be found at Annex B.

2.14 The 2008 SORP introduced the term "revenue expenditure funded from capital under statute" (paragraph 3.104). In England and Wales, this replaced the concept of deferred charges. Where legislation allows expenditure that does not result in a fixed asset being carried on the balance sheet to be counted as capital for funding purposes, the SORP now requires such expenditure to be charged to the Income and Expenditure Account in accordance with the general provisions of the SORP. Funding the expenditure from capital resources is achieved by adjusting the General Fund Balance and the Capital Adjustment Account. Except in exceptional circumstances, revenue expenditure funded from

Deleted: The SORP requires that "in England and Wales deferred charges should be amortised to revenue over an appropriate period consistent with the consumption of the economic benefits controlled by the local authority" and includes an explanatory paragraph (3.20).

Deleted: deferred charges

capital under statute will be included in the total cost calculation for individual (or a combination of) services in the year that they are incurred. An example of an exceptional circumstance would be where a direction has been given to capitalise redundancy cost for reorganisation and the services to which the redundancy cost relates no longer exist. Again, Annex B gives further information on revenue expenditure funded from capital under statute.

Deleted: the amortisation of deferred charges

2.15 Total cost also includes an appropriate share of all support services and other overheads. These should be charged, allocated or apportioned across users and other beneficiaries in accordance with the following seven general principles.

1. Complete Recharging of Overheads	All overheads not defined as Non Distributed Costs or Corporate and Democratic Core should be fully recharged to the service expenditure headings as defined by Section 3 of the *Best Value Accounting Code of Practice*. Note that Corporate and Democratic Core costs should receive an appropriate allocation of overheads.
2. Correct Recipients	The system used must correctly identify who should receive overhead charges.
3. Transparency	Recipients must be clear what each recharge covers and be provided with sufficient information to enable them to challenge the approach being followed.
4. Flexibility	The recharging arrangements must be sufficiently flexible to allow recharges to be made regularly enough and to the level of detail appropriate to meeting both users' and providers' needs.
5. Reality	Recharging arrangements should result in the distribution of actual costs which has the basis of fact. Even if the link cannot be direct, reality should be the main aim.
6. Predictability/Stability	Recharges should be as predictable as possible, although there will be practical limitations to this.
7. Materiality	It is unlikely that a simple system will be adequate to meet all other requirements noted above. However, due regard should be made to materiality to minimise the costs involved in running the system.

2.16 The physical nature of fixed assets means that depreciation (and associated credits for government grants deferred) can usually be identified as a direct cost for services. However, where there is shared use of the assets and depreciation needs to be apportioned to the service headings defined in Section 3 of BVACOP, the seven principles listed above will apply. For further details on the application of the seven principles to the apportionment of depreciation, see Section 4, Chapter 3. The seven principles of apportionment set out above are also applicable to the apportionment of current service (pensions) costs to service divisions (see paragraph 2.19 and Section 4, Chapter 6).

2.17 The reported total cost of a service and service division should reflect material adjustments applicable to prior periods arising from changes in accounting policies or the correction of fundamental errors. This should be accounted for by restating the comparative figures for the preceding period in the statement of accounts (where the adjustment relates to the preceding period).

2.18 The restating of comparative figures also applies to comparative financial information reported in formal reports of performance, including Best Value Performance Plans and Improvement Plans, and in cost-based performance indicators, whether local or national (this may require the adjustment of opening balances for cumulative effect).

2.19 The total cost of a service includes (for defined benefits schemes) its attributable current service (pensions) costs, defined in the SORP as the increase in the present value of a defined benefit scheme's liabilities expected to arise from employee service in the current period. As with all costs, current service (pensions) costs should be reported at the mandatory service division level defined in Section 3 of BVACOP. More detail on accounting for current service costs is included at Annex F – *The Creation of a Framework for Retirement Benefits Accounting and Best Value Reporting and the Treatment of Non Distributed Costs.*

2.20 The SORP states that provisions should be charged to the correct revenue account. In most cases, therefore, provisions will be included within the total cost calculation for individual services. However, if a provision is required for the items defined as Non Distributed Costs (see paragraph 2.45), then such provisions should be charged to this service division.

Net Total Cost Excluding Specific Grants

2.21 Net total cost excluding specific grants is defined as gross total cost (as above) less income other than specific grants.

Net Total Cost

2.22 Net total cost is defined as gross total cost (as above) less income, with income defined to include income from fees and charges and specific, special and supplementary grants which can be attributed to services (ie all grants except for general grants such as redistributed non-domestic rates, the block grants and other general grants, including all non-ring-fenced grants). Further discussion of the treatment of grants can be found at Annex A.

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Relationship to the Income and Expenditure Account

2.23 The sum of the net total cost of all services, the costs included within the definition of Non Distributed Costs and Corporate and Democratic Core (see paragraphs 2.42 to 2.46) and the cost of any discontinued operations and exceptional items disclosed on the face of the I+E Account (in Northern Ireland, the District Fund Summary) will equate to the sum of the 'Sub-total: Net cost of services'.

Analysing Costs on an Internal Cross Cutting Basis

2.24 Best Value and the modernisation agenda for local government are increasingly stimulating Best Value authorities to analyse their costs in the context of objectives and outcomes that require co-operation across the organisation on particular issues. CIPFA refers to such initiatives as internal cross cutting issues. It defines them as follows:

"An Internal Cross Cutting Issue is an outcome or output that benefits the local population as a whole or in part and relies upon the performance of an activity or a series of activities aimed at securing that outcome or output. Examples would include improving community safety, improving educational attainment or reducing poverty. To be Cross Cutting the activity or activities must be undertaken by two or more different parts within a Best Value Authority, as defined in CIPFA's Standard Service Expenditure Analysis, working in co-operation."

2.25 Where an authority has established internal cross-cutting initiatives, CIPFA provides guidance to calculate and report its costs in its formal financial reports of performance on an internal cross-cutting basis. The guidance note in Section 4 should be used as the basis for all regular reporting of costs on an internal cross-cutting basis.

Partnerships

2.26 The total cost of a service includes those costs attributable to an authority's proportion of a relevant partnership. Relevant partnerships are those governed by statute, agency arrangements, contractual relationships or understandings that are in substance dealt with as if there were a formal relationship. Costs attributable to partnerships are recognised for total cost purposes within the I+E Account (in Northern Ireland, the District Fund Summary) or the Housing Revenue Account of the authority to the same extent that expenditure, income or other contributions are recognised as relating to services' expenditure in those same accounts within the SORP.

2.27 Where the authority *in substance* exercises control over a relevant partnership, the gross total cost of the service(s) concerned includes all the authority's expenditure, whether by way of contribution or otherwise, which relates to that partnership. Contributions received from other parties will be included as income. Where such control does not exist, total cost includes the authority's contributions measured on an accruals basis to all organisations where statutory, contractual or informal partnerships exist. This is set out in more detail at Annex C.

2.28 For reporting within the I+E Account and the HRA, total cost will exclude any transactions actually entered into by another entity. Where these transactions are under the control of the authority because the authority has a controlling interest in the entity, where the authority has a dominant or significant influence over the entity, or where the authority is able to exercise control over an entity by acting jointly with another party, then the transactions will be brought together in the Group I+E Account prepared for the group financial reporting.

2.29 The requirements for preparing total cost figures for group accounting are set out in paragraphs 2.49 and 2.50.

Trading Accounts and Trading Operations

2.30 A trading account is a method of matching income and expenditure for a particular activity or group of activities. Trading accounts should be maintained where services are provided on a basis other than a straightforward recharge of cost or on a cash-limited vote basis. The configuration of service delivery will determine the scope of a trading account. In Scotland, Section 10 of the Local Government in Scotland Act 2003 requires that trading accounts should be maintained and disclosed for significant trading operations.

2.31 Trading operations are services provided to users on a basis other than a straightforward recharge of cost, such as a quoted price or a schedule of rates. Formal financial reports of performance may need to include summarised details of performance for significant trading operations providing services in a competitive environment. Annex D, paragraph D7, expands on the circumstances when this is necessary.

2.32 A competitive environment is one in which the user has discretion over whether to procure the service from the in-house provider either as part of a periodic tendering procedure or on a continuous basis. A service where the user may negotiate only over volume or quality, but has never had the opportunity to exercise choice on where to procure, is not provided in a competitive environment for Best Value performance reporting purposes. Trading operations in categories (a) to (d) in paragraph D1 are deemed to provide services in a competitive environment. Such operations should be considered for disclosure in formal financial reports of performance. In Scotland, trading accounts are required to be maintained and disclosed for significant trading operations. Specific guidance on the identification of competitive services and on a test of significance can be found in A *Best Value Approach to Trading Accounts – A Guidance Note for Local Authority Practitioners.*

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2.33 Some authorities may have established legally separate Trading Companies to carry out some trading activities. Charges made by (parent) authorities for providing such trading companies with services, supplies, work and facilities (e.g. accommodation) have to cover all the costs of doing so. Authorities should establish a robust methodology for determining the charges, and are free to decide which methodology to adopt. However, they may find it helpful to use the definition of total cost as defined elsewhere in BVACOP, and may also consider it appropriate to include a contribution to corporate and democratic core (CDC) costs and non distributed costs (NDC) in the charge. Trading companies are liable to income and corporation taxes on their profits. Full charges to trading companies by parent authorities for services, supplies, work and facilities will however tend to minimise taxable profits, while giving in-house users the benefits of any economies of scale.

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2.34 Where one part of a service is provided in a competitive environment and another part in a non-competitive environment, only that part provided in a competitive environment should be considered for disclosure. The decision to divide a trading account in this manner should be subject to consideration of the significance and materiality of the part that is provided in a competitive environment.

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2.35 Significant balances on trading accounts for support services or for other services provided internally on a trading basis may distort materially the total cost of recipient services, regardless of whether the results of the trading operation are disclosed in formal financial reports of performance. Where a trading account balance leads to the material misstatement of total cost at the division of service level or of a published performance indicator, regardless of whether the indicator is local or national, a reapportionment should be made. The amount of any such reapportionment should be disclosed in the summary disclosure note.

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2.36 In determining materiality, authorities should consider the significance of the surplus or deficit in terms of the overall income and expenditure of the trading operation, and the relevant assets and liabilities.

2.37 The summary disclosure should include:

(a) the nature of the trading operation, ie the service that is provided and the main customers

(b) turnover

(c) surplus/deficit

(d) any reapportionment of surplus/deficit

(e) any details putting financial performance in a context useful to the reader of a formal financial report of performance. In Scotland the requirement is for disclosure of significant trading operations. The identification of a trading operation in itself does not necessarily indicate that formal disclosure should be made.

The summary disclosure note should be compiled on the basis of proper accounting practice using the total cost approach in BVACOP.

2.38 Where a significant balance on a trading account relates to both internal and external bodies, only the element relating to internal bodies should be reapportioned. The element relating to external bodies should remain as a balance on the trading account.

Relationship with the Treatment in the Income and Expenditure Account (District Fund Summary in Northern Ireland) in the Annual Statement of Accounts

2.39 For the annual Statement of Accounts, the line in the I+E Account for "the surplus or deficit of trading undertakings (where not included above) or other operations including dividends from companies" should include the aggregate performance of all category (a) operations for which there is no division or subdivision of expenditure and the surplus/deficit on category (b), (c), (d) and (e) operations, subject to the requirements of paragraphs 2.35 and 2.36 above. For category (a) operations where there is a division or subdivision of service, that division or subdivision should be used to accumulate income and expenditure.

Further Guidance

2.40 Annex A gives further detail and explanation on the definitions of gross total cost and income, including specific grants. The treatment of capital items in reported total cost is discussed at Annex B. The impacts of partnerships and trading accounts are further discussed at Annex C and Annex D respectively. Good practice guidance on overhead and depreciation apportionment, accounting for internal cross-cutting issues, accounting for partnerships and a recommended subjective analysis has been included in Section 4.

Costs Excluded from Gross and Net Total Cost

2.41 An apportionment of all support service costs and some overheads are to be included within total cost. The exceptions are:

(a) Corporate and Democratic Core

(b) Non Distributed Costs.

Each of these is defined below and further details are given at Annex E and Annex F (paragraphs F15 to F30) respectively.

2.42 The Corporate and Democratic Core (CDC) is defined as comprising two divisions of service: Democratic Representation and Management (DRM) and Corporate Management (CM). If anything does not fall within the definitions given for either DRM or CM, then it cannot be within CDC.

2.43 DRM concerns corporate policy-making and all other member-based activities. CM concerns those activities and costs that relate to the general running of the authority. These provide the infrastructure that allows services to be provided, whether by the authority or not, and the information required for public accountability. Activities relating to the provision of services, even indirectly, are overheads on those services, not CM.

2.44 The composition of the CDC is illustrated in Table 1 at Annex E.

2.45 Other central costs not included within the total cost of individual services are those that are defined as Non Distributed Costs (NDC). For a full discussion, see Annex F. In summary, they comprise:

(a) past service costs relating to retirement benefits (if any) – for a defined benefit scheme these costs are defined by the SORP as scheme liabilities related to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits

(b) settlements relating to retirement benefits (if any) – these are defined by the SORP – the SORP definition of settlements is provided at Annex F

(c) curtailments relating to retirement benefits (if any) – these are defined by the SORP – the SORP definition of curtailments is provided at Annex F

(d) the costs associated with unused shares of IT facilities

(e) the costs of shares of other long-term unused but unrealisable assets

(f) impairment losses relating to assets under construction and surplus assets held for disposal and depreciation (and associated credits to income for government grants deferred) on the latter category of assets (but not costs associated with abortive capital projects, which should be charged to the relevant service revenue account)

(g) the revenue expenditure involved in holding surplus assets (eg security costs).

2.46 Although none of these costs (ie DRM, CM or NDC) is within the total cost of any service, there are arguments that accounts such as the Housing Revenue Account (HRA) and for administering authorities, the pension fund should be required to contribute towards their funding.

2.47 It should be noted that such contributions should only take place in order to comply with statutory requirements.

2.48 The basis on which such contributions are made must follow relevant legislation and should reflect the same principles as those governing the apportionment of overheads. Any contribution or change in the methodology used to derive such contributions must be clearly disclosed.

Definition of Total Cost for Group Accounts

2.49 Many authorities have interests in companies and other entities that will need to be encompassed in arrangements for financial reporting, particularly group accounts in the statement of accounts. In order to bring financial information from different entities together effectively, variations are required from the accounting policies that would normally be applied by local authorities. The principle of total cost remains applicable to group reporting, so that authorities should follow the principles set out in paragraphs 2.10 to 2.25 for the purposes of establishing total cost for the financial reporting of group activity, but with the following differences:

Where the activities of the subsidiary can be identified to service headings, gross total cost for services should include any amounts for amortised goodwill that arose on the acquisition of an interest in a subsidiary. Where this is not possible, amounts of amortised goodwill should be presented as a separate line in Net Cost of Services.

Where the activities of the subsidiary can be identified to service headings, the operating results of subsidiaries should be allocated or apportioned as income and expenditure to the total cost of the services in accordance with the other principles of this paragraph. Where this is not possible, a separate line or lines describing the activity should be included alongside the SEA services.

Transactions between the authority and its subsidiaries should be eliminated from the income and expenditure included in total cost.

Where transactions between the authority and its subsidiaries, associates and joint ventures have resulted in unrealised profits on the disposal of fixed assets, the unrealised profits should be eliminated from total cost.

Apart from any unrealised profits covered by the previous item, no adjustment should be made for associates and joint ventures to total cost figures for services. The authority's share of the operating profits of associates and joint ventures is shown as a separate line in the Net Cost of Services.

2.50 Guidance on the definition of total cost for group financial reporting is provided in Annex G.

Annex A

Expenditure and Income, Including Specific Grants

Expenditure

A1 The definition of gross total cost includes all direct and reasonably attributable costs of a service. Specifically, it includes an allocation of support service costs, overheads and appropriate depreciation.

Deleted: the amortisation of deferred charges

A2 The total cost of a service also includes, where applicable, any impairment losses, revenue expenditure funded from capital under statute and provisions.

A3 The definition of total cost includes:

exceptional or 'lumpy' costs, ie those costs exceptional by their size or incidence, such as the costs of internal audit investigations, legal expenses or charges for the impairment of fixed assets

expenditure that is dependent on matching income that is expected to net to zero, such as the cost of projects that would not take place without 100% grant funding and services provided on the basis of full reimbursement of costs

any contributions, either cash or in kind, towards the work of others (partnerships) – see paragraphs 2.26 and 2.27 of Section 2 of BVACOP.

A4 Exceptional expenditure is included within the definition of gross total cost. It is a real cost to the authority.

A5 The SORP requires that exceptional items should be included in the total cost of services to which they relate or on the face of the Income and Expenditure (I+E) Account (in Northern Ireland, the District Fund Summary) if that degree of prominence is necessary to give a fair representation of the accounts. Although exceptional service expenditure might be disclosed separately from the service outturn of the I+E Account, it should not be excluded from the total cost of the service for other external reporting requirements such as performance indicators.

A6 An adequate description of each exceptional item should be disclosed for all external reporting requirements, the Statement of Accounts, formal financial reports of performances or in any external report that includes the publication of related performance indicators. It would seem reasonable for the financial statement in a formal financial report of performance to note this exceptional spend as a part of comparative outturn information provided.

A7 Expenditure that is dependent on matching income is also included in the calculation of total cost. Although such expenditure will not normally impact on the tax payer, and may vary considerably between otherwise comparable authorities, it is considered that leaving it unreported would give rise to a number of potential problems, including:

If funding ceases for work done through the employment of a member of staff, it will usually not be possible to cease the expenditure at the same time. It is more informative for this to be shown as under-recovered income than as over-expenditure.

This expenditure may vary between authorities for management reasons and, in any event, the associated costs may not be distinguishable. For example, where meals are offered to staff in a client facility, the cost should properly include a share of the fixed costs as well as the variable costs involved. It is not practicable to identify and thus exclude this element of expenditure, which would mean that the contribution made would be the only indication of what expenditure should be excluded.

A8 Expenditure on work carried out by the authority under formal agency agreements, where the authority is not *in substance* accountable for the partnership arrangement (or any aspect of it), should not be included within the definition of total cost. Annex C provides additional guidance on this issue. Such expenditure is clearly definable and is excluded from the I+E Account, except by way of disclosure, in the notes to the accounts, within the terms of the SORP. Agency agreements are also subject to notice clauses that minimise the risk which, in other third party funding arrangements, might fall on the authority.

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Income

A9 The consequences of the above definition of expenditure for the purposes of calculating gross total cost are that the following are also defined as income, as opposed to 'abatements of expenditure':

(a) income in respect of incidentals, such as staff meals and private telephone calls

(b) revenue income from the sale of equipment, for scrap or otherwise

(c) reimbursements for non-agency work undertaken for, and fully funded by, third parties

(d) reimbursements for work done under partnership arrangements so that the net total cost of the service(s) concerned includes the appropriate proportion of partnership costs attributable to the authority

(e) receipts that arise as the result of successful insurance claims or similar process (eg fraud recovery).

A10 Some contracts with third party providers of services are net contracts, in that the authority will pay the provider a sum for the service that is net of income that the provider may collect from service users. For instance, a contract for leisure centre management may be tendered at a reduced fee if the provider is given the right to retain the takings that it generates from the operation of the catering facilities at the centres. If the authority has given up rights to the income, then the expected accounting practice would be to account for the fees that it will pay to the provider and not to seek to gross up the cost to recognise the value of the income foregone. In contrast, grossing up would be expected where the authority retains the right to income, engages the service provider to collect it, and nets the cash collected off any fees payable to the provider for services when payment falls due. In these circumstances the authority would account for the gross fee payable to the provider as expenditure and the income collected as income when preparing total cost.

Specific Grants: Principles

A11 The SORP defines the net cost of services as being "net of specific grants and income from fees and charges" and later, after "corporate" adjustments for the operating expenditure of the authority and relevant appropriations have been made, requires a credit for general government grants (paragraph 5.20). This is unambiguous in its intention that the net cost of services should be net of **all** grants that can be attributed to services, whether they are called specific, supplementary or special, and whether they are within aggregated external finance (AEF) or not.

A12 As detailed in paragraphs A15 to A21 below, government treatment of various specific grants differs across the United Kingdom and it is not consistent with UK Generally Accepted Accounting Practice (UK GAAP). It may also differ from year to year as new grants are introduced or have their status altered. In theory, it would have been possible to reflect the different status of various grants in the definition of the net cost of services, and thus of total cost. However, to do so would require a harmonisation of treatment between England and Wales on the one hand and Scotland and Northern Ireland on the other. More significantly, it would introduce a degree of instability and complication to the definition of total cost. Therefore the current SORP definition of total cost has been maintained.

A13 This definition means that the grants which should not be netted off to reach the net cost of services are redistributed non-domestic rates, the block grants (such as revenue support grant) and other general grants, including all non-ring-fenced grants such as Area Based Grant. With the move away from ring fencing, more grants will not be applicable to services and therefore fall within this category.

Net Total Cost Excluding Specific Grants

A14 Where a national indicator provides the definition of net cost to exclude specific grants, the definition must be adhered to. Paragraph 2.21, therefore, defines the concept of 'net total cost excluding specific grants' as gross total cost less income, but income excludes all specific grants. In this context, the distinction between specific grants and other forms of Government support for a service is relevant and authorities will need to consider the specific circumstances if there are situations where doubt arises. For example, the transitional funding for fire authorities in 2004/05 was not a specific grant for this purpose. In Scotland, Scottish Government Finance Settlement Circulars may provide an indication of what can be classified as a specific grant.

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Specific Grants: Requirements of the Local Government Finance System

A15 The information requirements of central government differ from those of the SORP and UK GAAP. The accounting information produced to reflect BVACOP needs to meet these additional requirements.

A16 In England, some confusion seems to have arisen, however, because of the different ways in which grants are classified in the DCLG's revenue summary form in order to meet the requirements of the local government finance system. Here, 'gross revenue expenditure' is net of fees and charges income but gross of specific (and special) grants. Then, 'revenue expenditure' is gross revenue expenditure less specific (and special) grants outside AEF. Finally, 'net revenue expenditure' is revenue expenditure less specific (and special) grants inside AEF. Even this, however, is gross of police grant, as in practice this serves as a block grant, though technically it is a specific grant.

A17 In Scotland, the provisional outturn budget estimate (POBE) return gathers only information on net expenditure for each service. In this context, net expenditure is defined as expenditure financed by revenue support grant, non-domestic rates, council taxes, specific grants within AEF and balances. Local financial returns gather information on gross expenditure and income, and support two published summaries of net expenditure: 'Net expenditure to be financed from grants, non-domestic rates, council taxes and balances', and 'Net expenditure to be financed from revenue support grant, non-domestic rates, council taxes and balances'.

A18 Net local authority expenditure to be financed from revenue support grant, non-domestic rates, council taxes and balances is defined as:

Total expenditure minus:

specific grants inside AEF

other central government grants (eg grants towards job creation schemes)

rents, fees and charges

sales

income to the service from other accounts and authorities

interest on lending

other income (eg grants from non-central government bodies, such as the EC, health boards and trusts).

A19 Net local authority expenditure to be financed from grants, non-domestic rates, council taxes and balances is defined as the above total plus specific grants inside AEF.

A20 It should also be noted that in Scotland, the POBE return requires expenditure for each service to be reported net of any specific grants outside AEF, but including any expenditure supported by specific grants within AEF. Expenditure supported by police specific grant is treated in the same way as all the other specific grants within AEF.

A21 In Northern Ireland, net expenditure is defined as expenditure financed by general exchequer grant, specific grants, district rates and balances.

Consolidation

A22 The definitions of gross expenditure and income given above apply at all levels at which total cost is calculated. However, there may be occasions when two or more total costs at a detailed level require consolidation into a summarised total cost and, in these circumstances, care must be taken to avoid double counting. For example, it may be that a total cost is calculated for each individual secondary school and also for a secondary school support unit at education HQ, from which secondary schools buy services. Simple addition of gross expenditure, income and net expenditure (each as defined above) to form the total cost of the secondary school service would result in double counting in both gross expenditure and income of the amounts involved in such transactions. In this situation, the double counting should be removed by extracting the internal transactions from both gross expenditure and income so that the gross total cost is not distorted.

The Relationship Between Net Total Cost and the Income and Expenditure Account

A23 The following is an illustrative extract from the I+E Account that demonstrates the relationship between net total cost and the I+E Account. BVACOP's main impact on the SORP is to provide the segmental analysis defined by Section 3, the SEA.

A24 The extract demonstrates the relationship between the total cost of all services using the segmental analysis in Section 3 of BVACOP and the 'net cost of services' in the I+E Account. Section 2, paragraph 2.23 notes that the sum of the net total cost of all services, the costs included within the definitions of Non Distributed Costs and Corporate and Democratic Core and the cost of any discontinued operations and exceptional items disclosed on the face of the I+E Account will equate to the sum of the 'sub-total: net cost of services'. See also the comments in Note 1 below.

A25 It also includes the area of the I+E Account which covers the corporate expenditure of the authority, ie the 'net operating expenditure'. These costs are not included within the definition of total cost.

Table 1: An Illustrative Extract from the Income and Expenditure Account of an English Authority [TO BE UPDATED]

Previous Year Net Expenditure £000s		Gross Expenditure £000s	Gross Income £000s	Net Expenditure £000s	Comments
718	Central Services – Local Tax Collection	2,982	(2,260)	722	Notes 1 & 2
1,075	Central Services – Other Central Services to the Public	4,473	(3,388)	1085	Note 1
3,851	Cultural, Environmental, Regulatory and Planning Services	20,436	(17,055)	3,381	Note 1
94,155	Children's and Education Services	125,889	(30,744)	95,145	Notes 1 & 3
23,999	Highways and Transport Services	35,982	(11,895)	24,087	Note 1
1,551	Housing Services	47,056	(46,137)	919	Notes 1 & 3
16,811	Adult Social Care	25,308	(8,277)	17,031	Note 1

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Previous Year Net Expenditure £000s		Gross Expenditure £000s	Gross Income £000s	Net Expenditure £000s	Comments
-	Exceptional costs of Highways and Transport legal settlements	3,036	-	3,036	Note 4
516	Corporate and Democratic Core	671	(98)	573	Notes 1 & 5
128	Non Distributed Costs	119	(20)	99	Notes 1 & 5
142,804	**Net cost of services**	**265,952**	**(119,874)**	**146,078**	
147	Parish council precept	158	-	158	
594	Surpluses/deficits on trading undertakings	274	(71)	203	Note 7
(16,181)	External interest payable	-	(17,061)	(17,061)	
(3,392)	Interest and investment income	-	(3,539)	(3,539)	
123,972	**Net operating expenditure**	**266,384**	**(140,545)**	**125,839**	Note 6

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Note 1: This section of the I+E Account provides an illustrative breakdown of the services defined by the SEA on the basis of gross and net total cost, in accordance with the SORP provisions on segmental reporting.

It is important that, where possible, authorities follow the service classification given in paragraph 3.10 of Section 3 of BVACOP England and Wales, paragraph 3.9 of Section 3 OF BVACOP Northern Ireland and paragraph 3.7 of Section 3 of BVACOP Scotland. However, the SORP does allow the analysis to be presented in a note to the accounts rather than on the face of the I+E Account. Authorities may also wish to use the flexibility afforded by the mandatory service divisions within the SEA to report services that are significant to the local authority on the face of the I+E Account. See the example provided by Note 2. It is important for comparison purposes that summary information at service level is easily identifiable.

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Note 2: The authority's annual consultation process has identified that the public in the area is particularly interested in the cost of council tax and non-domestic rate collection. The authority has decided that, in the interest of accountability, the cost of local tax collection will be clearly identified in all its financial reports.

Note 3: Total cost figures are also required for Housing outturns on the face of the I+E Account. Authorities may, if these amounts are material, need to make an adjustment for any contributions made to the CDC and NDC accounts.

Note 4: The authority has identified the exceptional cost of a legal settlement to a highways contractor. This has been excluded from the outturn information of gross and net total cost for the highways, roads and transportation service. NB: any published performance information would include this exceptional expenditure in total cost.

Note 5: The authority has decided that the outturn information for CDC and NDC is material and has therefore decided to report these amounts on the face of the I+E Account. Note the SORP also requires a note to the accounts where any overheads are not apportioned to services (together with the rationale for not apportioning the costs).

Note 6: The Central Services SEA provides the classification of the net operating expenditure of the authority. This area of the SEA is outside of the definition of total cost. The service classification for Net Operating Expenditure complies with the requirements of the SORP. This part of the I+E Account includes income and expenditure that relates to the authority as a whole and has not been recharged to the total cost of services.

Note 7: This denotes the total of the non-material balances (surpluses or deficits) of the trading operations of the authority (ie trading operations defined within categories (b) to (e) of the categories listed at Annex D) and/or the aggregate performance of any category (a) trading operations not already included in the total cost of the divisions of service. It may be useful to the reader of the Statement of Accounts if a summary disclosure note demonstrating how this amount was arrived at was provided in the Statement of Accounts.

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This should not be confused with the SORP requirement to provide a disclosure note on the nature, turnover and profits and losses of any significant trading operation. This should include income and expenditure attributed to service heads.

Impact of Prior Period Adjustments on Best Value Financial Reporting

A26 The SORP defines prior period adjustments as being:

"Those material adjustments applicable to prior years arising from changes in accounting policies or from the correction of fundamental errors. A fundamental error is one that is of such significance as to destroy the validity of the financial statements. They do not include normal recurring corrections or adjustments of accounting estimates made in prior years."

It should be noted that the SORP also indicates that the majority of prior period items arise from corrections and adjustments that are the natural result of estimates inherent in the accounting process. Such adjustments constitute normal transactions for the year in which they are identified, and should be accounted for accordingly.

A27 The definition of total cost requires that the reported total cost of a service and service divisions reflect such material adjustments for prior periods for changes in accounting policies or the correction of fundamental errors. All formal reports of total cost should reflect and disclose such prior period adjustments where relevant. Normally BVACOP defines a material item or error as one which if not corrected would otherwise distort reports of performance indicators or service divisions. Where formal reporting requires that reports of total cost be made at subdivisions of service, then the treatment of prior period adjustments should also be reflected in these subdivisions.

A28 Prior period adjustments are effected by excluding the income and/or expenditure representing the adjustment from the total cost of a service (division) for the current year and accounting for it in the year that the relevant transaction took place, as if it had been accounted for properly at that time. Consequently, if the adjustment relates to the immediately preceding period, then it should be made to the comparative figures for that period.

A29 This treatment should be reflected in the reported total cost of a service in formal financial statements of performance, such as Best Value Performance Plans and Improvement Plans. The main impact for Best Value reporting requirements of prior period adjustments will be on reports of total cost in the Statement of Accounts, in Financial Statements in formal financial statements of performance and in cost-based performance indicators (whether local or national).

A30 The amount of the adjustment and the reason for the error or the change in accounting policy should be disclosed in a note in the financial report on performance or in a note to cost-based performance indicator disclosures.

A31 The cumulative effect of any fundamental error or change in accounting policy should be reported in formal financial reports of performance. This should indicate the timescales and the dates of the fundamental error or change in accounting policy. The fundamental error may, for example, not have just taken place over one financial year.

Table 2: Extract from a Best Value Performance Plan – Reporting the Consequences of Prior Period Adjustments

Cost-based performance indicators	Actual 200V/0W	Forecast 200W/0X	Target 200X/0Y	Target 200Y/0Z
BV51	Costs of services for children looked after by the authority (gross weekly	£444*	£440	£435

	expenditure per looked-after child in foster care or in a children's home).			
* The 200W Best Value Performance Plan reported the forecast unit cost for this performance indicator in 200W/0X to be £425. After the plan was published, the council identified an omission of a regular contract payment from the accounts. This meant that an additional £565k was charged to the children looked after service after the calculation of last year's (200W) forecast, which did not allow for this increase in cost. The impact of this error has been corrected in the actual reported cost for 200W/0X and the forecast for 200X/0Y and 200Y/0Z.				

Annex B

The Revenue Impact of Capital Items on the Definition of Total Cost

Charges Relating to Capital Expenditure

B1 The *Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice* (the SORP) requires that service revenue accounts, support services and trading accounts be charged with depreciation and, where required, any related impairment loss (due to a clear consumption of economic benefits), for all fixed assets used in the provision of the service, This means that for the published accounts, no charges that are additional to depreciation and impairment (such as a cost of capital or loan charges) may be made.

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Determination of Depreciation

B2 The consistent treatment of depreciation within the reported total costs of services involves:

following the definition of capital expenditure as laid down in the SORP

following the requirements and principles laid down in the SORP for the valuation and revaluation of assets

using the principles and requirements prescribed by the SORP for the depreciation of fixed assets. The detail of local asset management policies will determine local policies on depreciation and asset lives

allowing the impact of any resulting differences in depreciation to reflect the effectiveness of such policies.

B3 Applying the above principles will assist depreciation, and thus total cost, in being consistent and comparable between authorities by specifying a basis of calculation that is consistent enough to eliminate technical differences, such as whether otherwise identical accommodation occupied is rented or was bought on the open market, but which leaves real differences as requiring explanation and/or investigation.

B4 Consistency and comparability of depreciation will be dependent on local authorities' treatment of the following:

the definition of what is capital expenditure

the balance sheet valuation and any subsequent revaluation of assets

the translation of the balance sheet value into depreciation (as defined by the SORP, see paragraph B1 above), and thus into the total cost calculation. Again, in the interests of ensuring consistent treatment between authorities, the requirements of the SORP must be adhered to.

B5 The SORP provides the requirements for the recognition and measurement of fixed assets. The incorporation of FRS 15 *Tangible Fixed Assets* into the SORP ensures that tangible fixed assets are accounted for on a consistent basis and where revaluations are required that these are kept up to date. This FRS sets out the principles of accounting for the recognition, initial measurement, valuation and depreciation of fixed assets. Application of the requirements of FRS 15 should also ensure consistency and comparability in relation to the inclusion of depreciation in the definition of total cost. Additional guidance on the accounting treatment of tangible fixed assets and the calculation of depreciation is contained in the CIPFA publication *Code of Practice on Local Authority Accounting: A Statement of Recommended Practice – Guidance Notes for Practitioners*.

B6 There are, however, management issues arising from the specification of depreciation as the charging basis for the use of fixed assets; for example, using asset rents within budget holders' controllable budgets as an incentive to make the most effective use of property. Such arrangements are an acknowledged exercise of management discretion. They cannot, and should not, be standardised or otherwise constrained by financial accounting regulations and it is possible, therefore, that authorities may adopt an internal management treatment that differs from the external accounting treatment.

B7 It is considered that comparability is best served by adhering to the principles and requirements contained in the SORP and CIPFA guidance on capital accounting when calculating asset lives and choosing depreciation policies, rather than by having standardised asset lives and depreciation policies. This gives an opportunity for authorities to be rewarded or penalised for their asset management policies. Since such policies can affect the real costs incurred, it is sensible for their impact on total cost to be shown through, for example, an extended (or shortened) useful life. In other words, consistency requires clear principles to be set out. Detailed policies should be determined locally, to allow real differences to be manifest, but in accordance with the principles and requirements laid down in the

SORP.

B8 The SORP explicitly recognises that local authorities may have intangible fixed assets, particularly in relation to computer software. Balances of intangible assets will be subject to a comparable treatment to tangible assets as regards charges to service revenue accounts based on impairment (if any) and amortisation.

Impairment

B9 Paragraph B1 references the SORP requirement that service revenue accounts be charged with any impairment loss clearly attributable to the consumption of economic benefits. Therefore, calculation of total cost should, where appropriate, include any related impairment loss.

B10 The SORP provides the following examples of events and changes in circumstances that indicate that a reduction in value may have incurred:

evidence of obsolescence or physical damage to the fixed asset

a significant adverse change in the statutory or other regulatory environment in which the authority operates

a commitment by the authority to undertake a significant reorganisation.

Other impairments reflecting a general fall in prices should be recognised in the Revaluation Reserve and not in total cost, unless there are insufficient accumulated gains in the Reserve for the relevant assets to absorb the loss. In the latter case, the excess of the impairment loss over the accumulated gains will also be chargeable as part of total cost. Where a revaluation gain reverses a loss that has already been recognised as part of total cost in a prior period (and does not merely compensate for earlier losses), this gain may exceptionally be taken to the service revenue account. Impairment losses relating to assets under construction and surplus assets held for disposal, and any revaluation gains that reversed a loss in a prior period in relation to those assets, should be taken to Non Distributed Costs. Costs associated with abortive capital schemes are not classed as impairment of assets under construction; these costs are a proper charge to the Income and Expenditure Account and should be charged to the relevant service revenue account(s). Where an abortive scheme was to be funded by grant, and that grant is available to fund the expenditure even if the scheme does not proceed, the grant should be recognised as a revenue grant. Additional guidance on the accounting treatment of impairment loss can also be found in CIPFA's publication *Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice – Guidance Notes for Practitioners*.

Revenue Expenditure Funded from Capital under Statute

B11 The SORP defines revenue expenditure funded from capital under statute as expenditure that legislation allows to be "classified as capital for funding purposes when it does not result in the expenditure being carried on the Balance Sheet as a fixed asset". The SORP requires revenue expenditure funded from capital under statute to be charged to the Income and Expenditure Account. Such items (previously known as deferred charges) will generally be those that qualify as capital expenditure under the statutory controls framework but do not result in a tangible fixed asset for the authority. The relevant paragraph in the SORP (3.104 in the 2008 SORP) explains the treatment in

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more detail.

B12 In order to achieve a degree of consistency in the treatment of accounting for both tangible assets and assets that are not in a tangible form, the following approach should be adopted:

Amounts included in the balance sheet should be based on the continuing value of expenditure to an authority at the balance sheet dates, not on its need to finance that expenditure. Revenue expenditure funded from capital under statute will therefore not be included in the balance sheet.

Revenue expenditure funded from capital under statute should be charged to service revenue accounts as defined by the service expenditure headings in Section 3 of BVACOP. Only in very exceptional circumstances will it be likely that the expenditure is not for the benefit of any particular service or combination of services. In such exceptional cases, it should be charged corporately after net cost of services. Section 2 of BVACOP provides an example of an exceptional circumstance, ie where a direction has been given to capitalise redundancy costs for reorganisation and the services to which the redundancy costs relate no longer exist.

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B13 If revenue expenditure funded from capital under statute materially distorts the total cost of a division of service or a published performance indicator, then this should be clearly disclosed.

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B14 The effects of financing revenue expenditure funded from capital under statute should be accounted for corporately after net operating expenditure has been disclosed.

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To Which Accounts Should Depreciation, Impairment Loss, Revenue Expenditure Funded from Capital under Statute and the Amortisation of Intangible Assets be Charged?

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B15 The general principle is that depreciation and impairment loss should be made to the service making use of the asset concerned (or charged to Non Distributed Costs if the assets are non-operational).

B16 The level of detail to which depreciation, impairment loss, revenue expenditure funded from capital under statute and the amortisation of intangible assets should be made is determined by the level of detail at which total cost is to be reported, as specified in Section 3.

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B17 Where assets are shared between services, an apportionment question will arise, especially if one (or more) service is occupying property of greater value than it requires, simply to prevent the space remaining unused. The full value and associated depreciation charges do, however, need to be apportioned to the services using the accommodation on the basis of the SEA in Section 3 of BVACOP. The ‘actual’ cost of the accommodation should be charged to the service. The management decision to allocate services to ‘prestige’ accommodation is a separate consideration to how the costs should be accounted for. (See also the arguments contained in Section 4, Chapter 3 on apportionment of depreciation.)

B18 If an external contractor is making use of an asset at no charge to them, then the amount the authority is paying for their services will be less than would otherwise have been the case. There is, therefore, no justification for not charging depreciation to the client service to which the contractor’s work is charged.

The Role of Charges for the Cost of Capital

B19 Up until 2006 BVACOP, service revenue accounts were required to be debited with a capital financing charge (notional interest) based on the value of fixed assets employed in the provision of the service. The charge reflected the cost to the authority of having resources tied up in fixed assets that could otherwise have been invested or applied to the provision of another service. As such, notional interest is a fundamental part of the full cost of service provision and is a concept widely applied across the public services.

B20 However, since 2007 BVACOP, total cost has been defined in Section 2 to include depreciation and impairment losses but to exclude notional interest.

B21 Following the removal of notional interest from total cost in the 2006 BVACOP, there remain a number of circumstances where it may or will not be an appropriate definition of ‘cost’. Authorities will need to have alternative accounting arrangements for the following transactions and activities:

Statutory reporting – reporting in the form of plans, PIs, etc, is under the control of the Government, which has the ability to specify the basis on which calculations are to be carried out. It is recommended that in order to maximise consistency with the Statement of Account, authorities apply total cost principles to other forms of statutory reporting and only include notional interest where this has been specifically required by the relevant government department, the Welsh Assembly Government or the Scottish Government.

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Fees and charges – in determining amounts to be recovered from users of the authority’s services, there should be an awareness of the full cost of providing the service. Even if the authority is not proposing to recover full cost, an accurate costing will demonstrate the level of subsidy being applied to the service. It would be appropriate to include notional interest charges where:

the supply of goods and services is on a trading basis

legislation, including consideration of fair competition, requires charges to be set at a level that recovers the full cost of supplying the service

the goods or services supplied are ones where the authority has powers to recover full cost and chosen to do so. Typical examples would be cost recoveries from debtors such as principals under agency agreements, leaseholders and recipients of discretionary services.

HRA and pension fund – the broad objective of the statutory ring-fencing of the HRA is that there is no cross-subsidisation of the HRA by the General Fund or the General Fund by the HRA. Charges to the HRA are required to be made in accordance with relevant statutory provisions. In some cases the amounts debited and credited to the HRA are closely specified by regulation; in other cases reliance is placed on non-statutory proper practices. The support services used by the HRA require assets in order to operate and therefore providing these services to the HRA increases the overall financing costs borne by the authority. In recharging support services to the HRA, authorities should consider the ability to pass on a charge for notional interest along with any depreciation that has been absorbed into administration costs. Similarly, in recharging support services to the Pension Fund, administering authorities should consider the ability to pass on a charge for notional interest along with any depreciation that has been absorbed into administration costs.

Pricing for competitive tender – in order to make fair cost comparisons with the private sector, any internal bid for work should feature notional interest so that fixed assets are not treated as a free asset. Authorities will need to be aware that it would be a distortion of competition to price without a cost of capital element.

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Cost comparisons and efficiency assessments – notional interest is an integral part of the Gershon efficiency agenda. In addition, it is essential for fair comparison between local government and the private sector and for decisions about whether to buy, lease or rent property.

Trading accounts – as trading account information is usually provided within the Statement of Accounts, then it can be expected that trading accounts will be prepared in accordance with the SORP, subject to any overriding statutory provisions, and will exclude notional interest. However, if work has been tendered for taking account of notional interest (see 'Pricing for competitive tender' bullet, above), then the income credited to the account will be overstated compared with the related expenditure, moving the account away from break-even. Authorities should consider whether they need to explain in a note to the trading account that the effective financial target for such accounts is not break-even but to make a surplus at least equal to the notional interest that would otherwise have been debited to the account.

Asset management – in order to make fair cost comparisons between assets that are financed through different means (eg lease and direct purchase), notional interest should be taken into account where appropriate. For example, where assets are acquired through leasing, an interest element will be included in the lease, whether the lease is a finance or operating lease. Where the cost of this asset is compared with that of a purchased asset, the cost of the purchased asset should include notional interest, as not to do so could lead to asset management decisions being made on the basis of invalid comparisons.

Annex C

Partnership and Joint Working Arrangements:

Accounting Arrangements for Single Entity Financial Statements – the Income and Expenditure Account

Introduction

C1 From 2005 BVACOP, total cost has been defined for both the single entity statements of an authority and the group accounts. Paragraphs 2.28–2.29 and 2.49–2.50 set out the changes to the definition of total cost with respect to the group financial statements. Annex G to section 2 and Chapter 4 of Section 4 set out guidance on the definition of total cost for group financial reporting.

C2 The detailed guidance set out below, and some of the specific guidance in Section 4, Chapter 4 of BVACOP, applies to the recognition of partnership activity in the single entity accounts.

Single Entity Accounts

C3 The guidance for single entity accounts remains unchanged from previous years. The principle of accounting for total cost is that cost must be inclusive, and this means that the costs attributable to partnership working need to be identified and aggregated within those costs incurred by the body itself, ie those transactions that it is in substance accountable for. Additional guidance on accounting for detailed transactions of partnership arrangements and accounting for partnerships in a Best Value context is contained in Section 4, Chapter 4 of BVACOP.

C4 It is important to distinguish between cases where the 'partnership' is a separate entity conducting its own business with the partners jointly exercising control over its operating and financial policies and those where it is simply a mechanism for each of the partners to carry out its own business better by securing more effective co-operation between the partners. Partnerships that are entities will usually be 'joint venture' as defined by the applicable accounting standard FRS 9 *Associates and Joint Ventures* and will be included in the authority's group accounts but not in the authority's Net Service Costs in the I+E Account. In the single entity statements, they are excluded from the total cost of the service(s) concerned.

C5 This contrasts with partnerships that are not joint ventures, where the income and expenditure of the partnership attributable to the local authority is accounted for in its I+E Account and therefore the amounts included in the Net Service Cost will be included in the total cost of the service(s). The question in these cases is therefore how to identify "the income and expenditure of the partnership attributable to the local authority". The answer will depend on whether the authority *in substance* controls the partnership or whether it does not.

C6 The total cost of a service should include those transactions that an authority is in substance accountable for as an entity. Therefore, where the authority does control the partnership, all the partners' expenditure that relates to the partnership, whether by way of contribution or otherwise is included in the gross total cost of the service(s), with contributions received from other parties included as income. This will be the case only where the local authority has control of and gains economic benefit from the partnership arrangement and, practically speaking, the authority is responsible for the commitments that arise from the transactions. There is a possibility that such situations can arise when an authority is a formal accountable body for a partnership. Further guidance on the treatment of partnership transactions of accountable bodies can be found in Section 4, Chapter 4 of BVACOP.

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C7 Where the authority does not control the partnership it accounts for its attributable share of income and expenditure to the extent that expenditure, income or other contributions are recognised as related to services' expenditure. Total cost thus includes contributions measured on an accruals basis to all organisations where statutory, contractual or informal partnerships exist.

C8 The definition of total cost currently excludes:

Dividends payable or receivable from entities in which the authority has an interest. This includes dividends from companies limited by shares or costs being reimbursed by other corporate entities.

Proportions of expenditure or income of an informal partnership, to the extent that they relate to another authority's or entity's share of the costs. This exclusion should be rebutted if the local authority is likely to pick up the costs as a consequence of the partner's lack of financial resources or where such costs are effectively paid for by the authority by way of a grant.

Expenditure and income of or attributable to (separate entity) joint boards, companies in which the body has an interest, industrial and provident societies and charitable trusts, other than any contribution to revenue expenditure.

Expenditure that has by statute to be delivered through a separate corporate entity, and where equivalent services are not performed by the authority; for example, bus undertakings, airports, and, in England and Wales, the operation of waste disposal facilities.

Where the authority is acting under a formal agency agreement (see also Annex A, paragraph A8).

Income and expenditure in relation to subsidiary or associated companies and other corporate bodies. Where the local authority, acting as a principal, does not make the accounting transactions, income and expenditure will be excluded from total cost. Where it acts as an agent for, say, an economic development company, the amounts should be excluded from total cost.

C9 Except where the amounts are immaterial, total cost should also include an authority's assessment of non-cash contributions to a relevant partnership. Guidance on the treatment and the quantification of an authority's non-cash contribution to a partnership is given in paragraphs 4.4.12-16 of Chapter 4, Section 4 of BVACOP.

C10 To determine total cost where informal partnership arrangements exist, costs should be split on the basis of financial obligations. For example, depreciation relating to assets provided to the informal partnership should be charged to the arrangement on the basis of a proportional share of assets employed.

Other Issues

C11 There are four other issues that will need to be considered when accounting for partnerships for the single entity financial statements, where the transactions are those for which the authority itself is in substance accountable as a part of a partnership arrangement:

(i) Fixed Asset Accounting

If the partnership uses assets in the delivery of its activities and no depreciation is shown in the authority's proportion of costs, an adjustment will need to be made to the cost for depreciation on the proportion of the asset for which the authority controls access to the underlying economic benefits.

(ii) Accounting Policies

The partnership reflected in the authority accounts should use the same accounting policies as the local authority. If this is not the case, other than when the effect will be immaterial, adjustment will be needed to reflect the financial consequence of the differences. The principle must be to standardise the local authority's accounting practices.

(iii) Accounting Periods

The partnership's accounting period should be the same as that of the authority. Where this is not the case, efforts should be made to adjust the financial information so that it does reflect the same accounting period. This is normally carried out by taking the audited results of the partnership organisation and adjusting them, based upon the management accounting information both at the start and at the end of the financial year. Authorities will appreciate that this approach should only be adopted where they are satisfied that management accounting records are of an adequate standard. In the case of comparatively small partnerships, information from different accounting periods can be used, but only if the previously mentioned approaches are impracticable. Where there are inconsistencies in accounting year-ends, the following options should be examined (in order of preference):

(1) the authority should look to organise its affairs so that year-ends are the same

(2) it should use a combination of financial and management accounts

(3) if it is not a major entity, it can use the most readily available audited accounting information.

(iv) Correlation of Accounting

Inaccuracies in reporting partnership results can occur if the transactions between the parties are not agreed at the time that the numbers for total cost are compiled. Authorities should adopt practical steps to agree the balances at the date of consolidation or aggregation provided that this is not more than three months old.

Annex D

Trading Accounts

Definition

D1 There are five main types of trading operation that may be run by authorities:

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(a) Trading services or undertakings with the public or with other third parties. These include, inter alia, catering undertakings, markets, trade refuse collection and industrial units.

(b) External trading organisations (ExTOs) which have won contracts from other public bodies, for example under the Local Authorities (Goods & Services) Act 1970.

Deleted: (c)Continuing compulsory competitive tendering (CCT) arrangements. These are contracts for work previously won by direct service organisations (DSOs), to which CCT no longer applies, but which are still being performed within the original specifications and period. ¶

(c) Work carried out by internal trading organisations (InTOs) arising from voluntary competitive

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tendering (VCT) exercises.

(d) Support services provided in a free internal market, ie to schools or to other budget holders who have been given freedom to buy externally if they wish.

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(e) Support services provided in a limited internal market, eg where budget holders are free to decide the quantity and type of the work to be done on the basis of the prices quoted to them, but not to buy externally.

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D2 In Scotland, trading accounts require to be maintained and disclosed for significant trading operations. Specific guidance on the identification of competitive services and on a test of significance can be found in *A Best Value Approach to Trading Accounts – A Guidance Note for Local Authority Practitioners*.

D3 Trading accounts for trading operations are kept for a variety of purposes for different stakeholders, including:

showing managers, auditors and the public the trading results

enabling managers, auditors and unsuccessful tenderers to see whether ExTO and InTO tenders have covered costs in total

ensuring that any overspendings revealed by budget-cost comparisons are attributed to the budget holders responsible, eg so that overspendings on highways payroll as a direct result of inefficiency in the payroll provider are attributed to payroll, not highways

ensuring that budget holders are not charged more than they agreed when they chose to have the support service

relieving budget holders from having to accept arbitrary apportionments

enabling budget holders to predict the cost to themselves of the support services they order.

D4 Appendix A to this Annex provides an example of a trading account compiled using the existing subjective analysis and the formal financial report of performance disclosure which might arise. Further examples are found in Chapters 5 and 8 of Section 4 of BVACOP. This is not a mandatory form of account or disclosure.

Disclosure of the Performance of Trading Operations in Formal Financial Reports of Performance

D5 For England and Wales, there is no requirement to publish information about trading accounts in Best Value Performance Plans and Improvement Plans. For Scottish local authorities, where trading accounts are required to be prepared and disclosed in order to comply with proper accounting practice, the Local Government in Scotland Act 2003 requires them to at least break even every three years (see also paragraph D24 below).

D6 It is recognised that in the early days of the development of Best Value there was an emphasis on the disclosure of trading operations in Plans. There remains a requirement in the SORP to disclose significant trading operations in the Statement of Accounts. However, as Best Value has evolved, the emphasis on trading operation disclosure requirements in formal financial reports of performance has changed and local authorities will need to weigh trading account disclosures against the need to include financial information in such reports in a way which effectively demonstrates financial performance and the authority's ability to manage and direct resources.

D7 Trading operations in categories (a) to (d) in paragraph D1 are deemed to provide services in a competitive environment. Such operations should be considered for disclosure in formal financial reports of performance. In Scotland the requirement is for disclosure of significant trading operations. The identification of a trading operation in itself does not necessarily indicate that formal disclosure should be made.

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D8 It is possible that a service will be partially provided in a competitive environment and partially in a non-competitive environment. In such cases, the summary disclosure only applies to the portion of the service provided in a competitive environment. Authorities are likely to need to know this information for internal decision-making purposes, ie to ascertain whether the competitive element is subsidising the non-competitive element, or vice versa.

D9 BVACOP does not dictate the services for which trading accounts should be maintained and disclosures made. It is up to authorities to determine which services are to be provided on a trading basis. In coming to such decisions, authorities will be aware of the need to demonstrate competitiveness and make comparisons. Authorities therefore need to consider the arrangements for financial administration conducive to these objectives. They will probably need to consider prevailing industry norms and standards. Authorities will also need to make decisions on the grouping of trading operations.

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D10 Disclosures only apply to significant trading operations. There is no precise measure of materiality in relation to trading operations. Information is likely to be useful to the readers of formal financial reports of performance if it enhances their understanding of the way in which services have been provided and the way in which resources have been deployed in the provision of those services.

D11 Consequently, disclosures should not be so limited that they fail to give readers insights into the financial performance of major trading operations. Conversely, immaterial information impairs understandability. Disclosures should not therefore be so voluminous that they divert attention from key areas. In Scotland, *A Best Value Approach to Trading Accounts – A Guidance Note for Local Authority Practitioners* provides guidance on the content of disclosures. In particular, performance against the three-year prescribed financial objective should be demonstrable to the reader.

D12 Disclosure should be made on a probable outturn price base if actual figures are not available at the date of publication of plans. Comparatives should be provided where relevant.

D13 Where a trading operation has sustained a deficit disclosed in a formal financial report of performance, details should be included of remedial action and the results of such action.

Treatment of Surpluses and/or Deficits from Trading Operations

D14 Significant surpluses or deficits for trading operations with internal users can distort spending comparisons or unit cost-based performance indicators. This applies to trading operations in categories (c) to (e) in the definitions in paragraph D1. Whilst category (e) trading operations do not meet the definition of being provided in a competitive environment, surpluses or deficits can distort the costs to the recipient and so should be treated in a similar way. This is more likely to occur where a trading operation with a small number of internal clients generates a large surplus or sustains a large deficit.

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D15 A reapportionment of trading account balances must be carried out for total cost reporting purposes if a failure to do so would result in a material misstatement at the division of service level as defined in Section 3 or in a published performance indicator, regardless of whether it is national or local. Such a reapportionment should be disclosed in formal financial reports of performance.

D16 BVACOP does not advocate the routine reapportionment of surpluses and deficits generated/sustained by trading operations unless a failure to action a reapportionment is likely to lead to a material distortion. This is because:

Routine reapportionment undermines the ethos for maintaining trading accounts in the first place.

Reapportionment potentially undermines budget monitoring disciplines for both the suppliers and recipients of services because both know that reported figures will be modified at year-end.

Depending on the charging mechanism, accurate reapportionments are likely to be technically complex and time consuming. This particularly applies to activities with multiple users and differential profit margins for different items of work, ie work carried out on a schedule-of-rates basis. This means that crude reapportionments with little relation to reality are likely to be made.

D17 Trading activity will necessarily result from capital works and should not be reflected in revenue accounts. In this instance therefore, particular care will require to be taken when reapportioning surpluses.

Disclosure Requirements in the Local Authority SORP

D18 This section should be read in conjunction with the relevant SORP and paragraph D1 of this guidance.

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D19 Information on local authority trading operations is provided in a number of disclosures, both on the face of the I+E Account and in notes to the core financial statements.

D20 There is currently a one-line item between the Sub-Total: Net Cost of Services and the Sub-Total: Net Operating Expenditure in the I+E Account. This is the surplus or deficit of trading undertakings (where not included above) or other operations, including dividends from companies.

D21 There are also three notes to the core financial statements:

the nature, turnover and profits/losses of any significant trading operation and for Scottish local authorities the cumulative surplus or deficits for the current year and two preceding financial years in accordance with the requirements of the Local Government in Scotland Act 2003

the nature, turnover and profits/losses of the building control account required by the Building Act 1984 and specifically the Local Authority Building Control Charge Regulations (S1 1998/3129)

(England and Wales only)

income from bodies under the Local Authorities (Goods and Services) Act 1970 and the related expenditure.

D22 For the annual statement of accounts, the line disclosure on "the surplus or deficit of trading undertakings (where not included above) or other operations including dividends from companies" should include the aggregate performance of all category (a) operations for which there is no subdivision of expenditure and the surplus/deficit on category (b), (c), (d) and (e) operations. For category (a) operations where there is a subdivision of service, that subdivision should be used to accumulate income and expenditure.

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D23 The note on "the nature, turnover and profits/losses of any significant trading operation and for Scottish local authorities the cumulative surplus or deficit for the current year and two preceding financial years in accordance with the requirements of the Local Government in Scotland Act 2003" should be used to give details of an operation in categories (a) to (e) deemed significant and, for Scottish local authorities, to comply with the provisions of the 2003 Act.

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D24 The second note in paragraph D21 should be used only to provide summary details of the statutory building control account.

D25 The third note in paragraph D21 should detail the income and expenditure from contracts with other public bodies under the Local Authorities (Goods & Services) Act 1970. For Best Value performance reporting purposes, these are categorised as type (b) operations in paragraph D1 of this guidance.

Appendix A: Example of Trading Account for a Building Maintenance Internal Trading Organisation (type (c) or (d)) and Resultant Summary of Disclosure in a Best Value Performance Plan

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Trading Account

Previous Year Actual £		Current Year Forecast £
Income		
2,280,700	Charges to internal users	2,598,700
70,000	Charges to public bodies	88,100
1,600	Miscellaneous income	2,100
2,352,300		**2,688,900**

Expenditure		
657,400	Labour	723,100
247,700	Direct purchases	292,900
195,100	Materials	230,500
197,800	Sub-contractors	227,500
252,800	Transport and plant	283,100
685,500	Overheads	810,800
2,236,300		**2,567,900**
116,000	**Surplus for year**	**121,000**

This might be reported as:

Summary Disclosure in a Best Value Performance Plan

The authority operates a building maintenance trading unit that carried out routine and programmed/planned maintenance on the authority's property portfolio, including schools, residential homes and the civic centre. Similar work was also carried out by a number of private sector contractors. The projected financial outturn for the current year is:

Previous Year Forecast £000	Previous Year Actual £000		Current Year Forecast £000
2,300	2,352	**Turnover**	2,689
110	116	**Surplus**	121

(This example assumes that there is no reapportionment of the surplus necessary.)

Local authorities in Scotland should refer to Section 12 of *A Best Value Approach to Trading Accounts – A Guidance Note for Local Authority Practitioners*, which provides guidance on disclosure.

Annex E

Corporate and Democratic Core

Introduction

E1 Corporate and Democratic Core (CDC) is defined as the two service divisions Democratic Representation and Management (DRM) and Corporate Management (CM).

E2 DRM is defined to accommodate the wide range of governance structures adopted by local authorities.

E3 It is anticipated that many authorities will continue to use the phrase 'corporate management' to cover a range of activities which suits their own culture and method of operating. It must not be assumed that any such definition of corporate management equates to the accounting definition that follows. The accounting definition must be consistently applied for total cost calculations or, through the consequential effect on support services, the comparability of all total costs will be undermined.

E4 It should also be noted that there may be situations in which statutory requirements have to take precedence over the accounting guidance given below. For example, national parks authorities have a definition of 'corporate management and administration' laid down in their financial grant memorandum. This includes DRM but it also includes activities that are service management and administration and which, in the absence of such overriding guidance, would be treated as an overhead across the service.

E5 It is important to note that activities are not within CDC because:

They are provided centrally. This may be cost effective, but that in itself does not affect the nature of the activity.

They are provided on the insistence of someone other than the manager of the service to which the costs of the activity will be charged. Managerial responsibility for decisions regarding the nature and scale of such activities, and therefore their costs, is a separate consideration to how the costs should be accounted for.

E6 As Best Value and the modernisation agenda has developed, local authorities are increasingly subjecting their corporate governance arrangements to reviews. It is important, therefore, that each of

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the two elements comprises a coherent set of activities, regardless of who undertakes them, to which outcomes can be directly attributed. So, for example, it would be artificial and unhelpful to split the member-related costs of a council meeting from those relating to officer support of that meeting. All such costs, detailed in E8 and E9 below, therefore fall within DRM.

Democratic Representation and Management

E7 This includes all aspects of members' activities in that capacity, including corporate, programme and service policy making and more general activities relating to governance and the representation of local interests. To give authorities maximum flexibility in reflecting their own constitutional arrangements, there are no recommended subdivisions of service.

E8 Activities covered include all meetings that involve members acting on behalf of the authority. This includes meetings of the council, of all policy and service committees, of joint officer/member working groups and of cabinets or similar executive groups. DRM also covers activities that members undertake as local representatives or to represent local interests. This includes:

- preparing, making, defending and opposing proposals for local government reorganisation, changes of function, boundary changes, local legislation and attending Government committees on behalf of the authority or the local area
- making appointments to other public bodies and responding to their requests for information and advice
- advising voluntary bodies
- following up particular issues raised by their constituents
- attending conferences and meetings organised by local authority associations and similar organisations
- civic ceremonials, including mayor making, the granting of freedom, town twinning, civic regalia and jubilee celebrations.

E9 DRM costs also include the costs associated with officer advice and support to members. This covers a range of activities, including:

- Office support services, including typing, mail handling, library and IT support.
- Professional advice and support, for example in challenging proposals that would adversely affect the council.
- The functions of monitoring officers designated under section 114 of the Local Government Finance Act 1988 and section 5 of the Local Government and Housing Act 1989, when acting in that capacity (ie the duty to consider whether proposals, actions or omissions would give rise to breaches of the law or maladministration and to report on them).
- Other procedural and legal advice relating to the conduct of meetings.
- The preparation of agendas and minutes.
- Attendance at meetings involving members, as defined in paragraph E8 above.
- The production of specific papers for members and/or for meetings involving members. Papers produced for management reasons which then go to members as background or for information are not DRM. The level of member involvement in the management of services will therefore affect DRM costs but not the costs borne by the service.

Following up queries or answering questions raised by members.

E10 Costs properly chargeable to DRM therefore include:

all members' allowances and expenses, including telephone calls, postage, equipment costs, hospitality, accommodation costs, training and conference fees

the costs associated with officer time spent on appropriate advice and support activities, as described in E8 above

subscriptions to local authority associations and provincial councils.

E11 CIPFA has received a number of requests for further clarification of this statement, particularly for member involvement in planning applications and similar functions.

E12 BVACOP states that the level of member involvement should affect the cost of DRM at an authority and not affect the cost of services. This should be interpreted as follows:

All officer time preparing papers and attending meetings as a specific consequence of the existence of members at a local authority should be charged to DRM.

All officer time that would have been incurred in the management of the service, if it were assumed that there were no members at the local authority, should not be included in DRM, regardless of whether members are or are not actually involved. The cost of such time is a management cost and should therefore be charged to the appropriate service.

E13 For example, for the cost of processing a planning application, all routine site visits and other associated costs are to be defined as service management costs, as they have been incurred as a result of the function of the local authority as part of their responsibility for local planning services. The cost of obtaining member approval for planning applications is an additional cost of the local democratic process and should, therefore, be included in DRM. As such, DRM may include the preparation of reports specifically written for members, additional site visits undertaken for the benefit of members and officer attendance at member meetings.

E14 In summary, therefore, officer support of members can be included in DRM if, and only if, the cost incurred was specifically due to the existence of elected members, and is over and above the cost incurred in the management of the service or function. Any cost that would have been incurred if members did not exist should be charged to the relevant service.

Corporate Management

E15 Corporate management concerns those activities and costs that provide the infrastructure that allows services to be provided, whether by the authority or not, and the information that is required for public accountability. Activities that relate to the provision of services, even indirectly, are overheads on those services. There are no subdivisions recommended for CM.

E16 Specifically, the following activities and functions are defined as within CM:

the functions of the individual designated the head of the paid service (frequently the chief executive), except those concerned with the direct management of services or the provision of advice and support to members

maintaining statutory registers, eg of politically sensitive posts, unused land, payments to members and members' interests – except when those statutory registers are defined specifically as a function of the services included in the SEA

providing information required by members of the public in exercise of statutory rights (other than about specific services)

completing, submitting and/or publishing all service staffing returns, statements of accounts, annual reports, public performance reports and local performance plans

estimating, negotiating, accounting for and allocating corporate-level resources such as capital grants, supported borrowing and other sources of capital finance, precepts, block grants and taxes.

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E17 CM also includes the following cost items:

treasury management and bank charges

external audit

external inspections.

Each of these is discussed below.

Treasury Management and Bank Charges

E18 The definition of CM includes the costs of treasury management and bank charges other than those relating to accounts operated on a decentralised basis.

E19 Treasury management and bank charges fit within the context of the definition of CM, which says that it concerns those activities and costs that provide the infrastructure that allows services to be provided. The nature of treasury management is also inherently corporate, since one of its functions is to manage the net cash flow needs of services across the whole authority. As one of the outcomes of the treasury management activity, those bank charges which relate to main council accounts should also be accounted for as CM. Charges for any accounts operated on a decentralised basis, eg those held by schools, should be a charge against the account holder.

E20 Following the adoption of FRS 26 *Financial Instruments: Measurement* in the 2007 SORP, service revenue accounts should feature two potential transactions that are now identified separately from financing costs but would previously have been accounted for as part of interest receivable or payable:

Debits reflecting the effective loss incurred when an authority makes soft loans (ie loans at less than a market rate and which therefore contain an element of financial assistance granted by the authority).

Credits for the effective gain made when an authority is advanced a loan at less than the market rate (and which therefore contains an element of financial assistance granted to the authority) – this will either be a credit at the time the loan is advanced to the service or services benefiting from the financial assistance or by amortisation on a government grants deferred basis where the loan is to support identifiable items of capital investment. If very rarely the service(s) benefiting from the element of financial assistance contained in the loan cannot be identified, the gain should be included after net operating expenditure with Government Grants (not attributable to specific services).

Debits and credits relating to the recognition and subsequent measurement of financial guarantees should also be included in the total cost of the service(s) whose objectives are furthered by the giving of the guarantee.

E21 The CIPFA publication *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the TM Code), which was fully revised for local government in 2006, contains a definition of treasury management. The adoption of the recommendations of the TM Code by an individual local authority in England and Wales gives it the status of 'proper practice' under the 1989 Act within that authority. Although no such statutory backing exists in Scotland, all unitary authorities were recommended to adopt the TM Code.

The definition of treasury management in the TM Code is:

"The management of the organisation's cash flows, its banking, money market and capital transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

E22 It is recommended that, for consistency with the existing approved TM Code, BVACOP adopts the definition of treasury management used within the TM Code, and that this definition is updated for any revisions to the approved TM Code in future years.

E23 With reference to the definition of treasury management given above, these costs are generally at a higher level than the costs of bank reconciliation. This normally includes the routine checking that the authority's internal records agree with transactions recorded by the bank and are outside the definition of 'treasury management'. However, activities such as checking that the timings of in-payments to the bank are optimal should be included as CM.

E24 In Scotland, bank charges and treasury management costs should be charged to the consolidated loans fund, where appropriate.

External Audit

E25 The costs of statutory external audit including value for money (VFM) work are included in the definition of CM. This is on the basis that, as a large amount of the external audit fee relates to the annual audit of the financial statements and reviews of corporate governance arrangements, the costs involved should be viewed as corporate.

E26 This includes VFM work, where it is recognised that while VFM reviews could very reasonably be associated with specific services, to avoid year-on-year distortions these costs are included as a part of CM. This does not include work done by external auditors which would otherwise be done within the authority or by separate contractors, eg consultancy work. Also excluded is work done by the external auditor in relation to the auditing of grant claims. Such costs must be charged to services, including CDC, if the grant claim is of a corporate nature. Where such work includes a reimbursement, it should be treated as income. Other activities that may or may not be done by the external auditor should be accounted for according to the nature of the activity concerned.

E27 The advantage of including external audit within CM is that it reflects the above argument and relieves authorities of what is inevitably an artificial allocation exercise. It also accounts for a key aspect of public accountability alongside related activities, such as the preparation of the accounts and the annual report. The disadvantage could be that it excludes from total cost something which is a legitimate charge both on single purpose authorities and on much of the private sector. Private companies, however, would not necessarily allocate annual audit costs to operational units.

External Inspections

E28 Under Best Value, local authorities and other authorities in England and Wales are subject to external inspections. Authorities are required to bear the costs associated with these where they are undertaken by the Audit Commission Directorate of Inspection, rather than by the specialist inspectorates. Inspections are likely to concentrate on particular functions or groups of functions and the associated costs will vary significantly from year to year. The inclusion of such costs within service total costs could have a significant distorting effect and should, therefore, be accounted for as a corporate management cost.

Costs Excluded from the Definition of Corporate Management

E29 CIPFA receives regular enquiries about whether or not the following activities should be included in the costs of CM.

Cross Service/Community Initiatives

E30 Most local authorities are currently participating in initiatives that cross services, such as economic regeneration, sustainability and youth training or other initiatives that are being developed as a part of an authority’s community strategy under the Local Government Act 2000. Many authorities have questioned whether or not some or all of these costs, including start-up costs, should be included as CM. Such corporate initiatives are usually for the benefit of one or more of the services of an authority and therefore should be allocated to the relevant service divisions. The Community Development service division has been included in the Environmental Services SEA to accommodate the costs of many types of community initiative.

Cost of Chief Officers

E31 Chief officers other than the chief executive are appointed primarily to be responsible for particular services provided by an authority. Whilst they may engage in activity which has cross-authority significance, BVACOP takes the line that, given the increasing nature of such activity, centralisation of such costs would increasingly distort the costs of service delivery. Therefore, costs of chief officers are to be charged to services. Where a chief executive also acts as a chief officer for part of his or her time, eg chief executive and director of finance (excluding those functions of the director of finance that may be classified as DRM), costs should be allocated between CM and the service. It should be noted that where chief officers or other officers are specifically responsibly for the activities defined as CM, then such costs should be allocated to that service division.

The Costs of Producing the Budget

E32 Most of the work entailed in producing the budget is a management requirement, chargeable to services, not CDC. (The preparation of budget strategy options or covering papers to the budget setting out options and requiring decisions would, however, be DRM and, thus, CDC.) In this case, the detailed service budgets can be seen as background information against which members are being asked to make decisions. The reference under CM to estimating, negotiating, etc, corporate resources specifically concerns the allocation of capital grants, precepts, etc, which fund the budget of the authority.

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Table 1: What to Include in Corporate and Democratic Core

Service	Division of Service	What does it include?
Corporate and Democratic Core	Democratic Representation and Management	(a) All members' allowances and expenses, including telephone calls, postage, equipment costs, hospitality, accommodation costs, training, conference fees etc, incurred when undertaking activities on behalf of the authority, as local representatives or to represent local interests. These are listed in paragraph E8. (b) The costs associated with officer time spent on appropriate advice and support activities, as described in paragraph E9. (c) Subscriptions to local authority associations and provincial councils.
	Corporate Management	(a) The functions of the individual designated the head of the paid service (frequently the chief executive), except those concerned with the direct management of services or the provision of advice and support to members. (b) Maintaining statutory registers, eg of politically sensitive posts, unused land, payments to members and members' interests. (This excludes the costs of maintaining statutory service specific registers.) (c) Providing information required by members of the public in exercise of statutory rights (other than about specific services). (d) Completing, submitting and/or publishing all service staffing returns, statements of accounts, annual reports, public performance reports and formal financial reports of performance. (e) Estimating, negotiating, accounting for and allocating corporate-level resources such as capital grants, supported borrowing and other sources of capital finance, precepts, block grants and taxes. (f) The costs of statutory external audit. (g) The costs of external inspections. (h) The costs of treasury management. (i) Bank charges other than those which relate to accounts operated on a decentralised basis.

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Relationship with the Annual Statement of Accounts

E33 Where overheads are not charged or apportioned, the SORP requires disclosure. Authorities will need to recognise that CDC has not been charged to services in a note to the statement of accounts. Where material, it would seem reasonable to disclose CDC on the face of the I+E Account. CDC is included in the Central Services SEA.

Annex F

The Framework for Retirement Benefits Accounting and Best Value Reporting and the Treatment of Non Distributed Costs

Impact of FRS 17 on the Income and Expenditure Account and the Areas on which BVACOP Focuses

F1 Best Value reporting focuses on the cost components above the net cost of services line in the I+E Account. These include:

current service costs

past service costs

settlements

curtailments.

The main impact on Best Value reporting is the inclusion of current service (pensions) costs as defined by FRS 17 in the total cost of services: the other three elements of cost are now defined as Non Distributed Costs (NDC). The following diagram summarises the treatment of FRS 17 costs in the I+E Account and identifies which elements Best Value reporting covers.

Figure 1: Summary of the Impact of FRS 17 *Retirement Benefits* on the *Best Value Accounting Code of Practice*

The Benefits of FRS 17 and the Impact on Reports of Financial Performance Relating to Best Value Reporting

F2 The approach to retirement benefits changed in the 2003 BVACOP. Before that it was based on cash accounting. Authorities recognised the 'cash' cost of retirement benefits when they made payments of contributions into a pension fund or made the payments to pensioners that they are directly responsible for. This basis was straightforward but was not guaranteed to do an effective job of recognising costs in the financial year that an authority took on responsibility for them, especially where pensions are unfunded.

F3 The previous treatment of pensions costs by local authorities allowed the impact of pension decisions to be reflected over a number of years, as contributions were made to pensions funds. Potentially this could have deferred cost over very long periods. FRS 17 takes a different approach. The standard requires that the cost of a decision (to the extent it is vested) be accounted for in the year it is taken rather than the year it results in payments to a pension fund or pensioner. Pension costs are now recognised in the year in which they are incurred, with the (pensions) contributions being treated as a cash flow item as they are made.

F4 FRS 17 is a complex accounting standard, but it is based on a simple principle – that an organisation should account for retirement benefits when it becomes committed to give them, even if the actual payment of benefits will be many years in the future. FRS 17 therefore requires that pensions costs be accounted for as employees work the years of service that give them a right to a pension when they retire and that this entitlement should be as much a part of the cost of employment as the salary that they are paid.

F5 This principle of reflecting the full costs of employing people during the period that they are employed is wholly consistent with the concept of total cost. Authorities should be reporting on the full cost consequences of the decisions they take in providing services to the public, and FRS 17 ensures that this is done on a fair and consistent basis for retirement benefits, irrespective of the method of funding.

Retirement Benefits Accounting and the Definition of Total Cost

Current Service Costs

F6 One of the objectives of FRS 17 (as it applies to Best Value reporting requirements) is that the operating cost of providing retirement benefits to employees is recognised in the accounting period(s) in which the benefits are earned by the employees.

F7 The FRS 17 definition of current service (pensions) cost represents the benefits earned by and awarded to employees during the year to reflect the true costs of service. FRS 17-defined pension costs are actually no different to any other cost of employment. These costs are attributable to the individually defined services of local authorities (these services gain benefit and make decisions about the employment of each individual) and therefore the current service (pensions) cost as defined by FRS 17 is included in the definition of total cost.

F8 Paragraph 2.19 of Section 2 includes within the total cost of a service the current service (pensions) cost as defined by the SORP. The SORP defines current service (pensions) costs as the increase in the present value of the defined benefit scheme's liabilities expected to arise from employee service in the current period.

F9 Current service (pensions) cost should be reported at service division level. Cost-based performance indicators should be reported on the same cost base as provided in the Statement of Accounts. Therefore any cost-based performance indicators should be based on the total cost definition in BVACOP.

F10 Current service (pensions) cost applies to all defined benefits schemes (see SORP requirements). Any contributions receivable by an authority from employees should be offset against the current service cost.

F11 Current service (pensions) cost applies equally to police and fire fighters' defined benefit schemes.

F12 The current service (pensions) cost represents the actuarially calculated present value of the pensions benefits earned by current employees and is an estimate of the true economic cost of employing people in a financial year, earning years of service that will eventually entitle them to the receipt of a lump sum and pension when they retire. It measures the full liability estimated to have been generated in the year (at today's prices) and is thus unaffected by whether any fund established to meet liabilities is in surplus or deficit.

F13 The SORP assumes that the current service (pensions) cost will be based on an actuarial valuation, even where there is no statutory requirement for one (ie for unfunded schemes). Where there is a valuation, the SORP requires it to be updated to reflect economic conditions at 1 April of the year of account, not 31 March.

F14 Current service (pensions) costs are to be stated net of employees' contributions, reflecting the part of the total pensions liabilities that is not to be funded by the authority. Thus, if employees have earned estimated benefits in the year worth £12m and paid in contributions to the pension fund of £3m, the current service (pensions) cost would be £9m.

Non Distributed Costs

F15 In summary the definition of Non Distributed Costs comprises the following elements of cost excluded from the definition of total cost of a service:

(a) past service costs (if any)

(b) settlements (if any)

(c) curtailments (if any)

(d) the costs associated with unused shares of IT facilities

(e) the costs of shares of other long-term unused but unrealisable assets

(f) impairment losses relating to assets under construction and surplus assets held for disposal and depreciation (and associated credits to income for government grants deferred) on the latter category of assets (but not costs associated with abortive capital projects, which should be charged to the relevant service revenue account)

(g) the revenue expenditure involved in holding surplus assets (eg security costs).

(It is notable that the definition of Non Distributed Costs is strictly limited to the above seven elements.)

F16 The definition of past service costs, settlements and curtailments in FRS 17 is different from that included in the previously defined Unapportionable Central Overheads (UCO). UCO included past service pension contributions to fund a deficit, however arising, and charges for added years and early retirement – these were cash payments or contributions to the pension fund. Under the new arrangements, these will not be current year revenue items, but provided for in prior periods or treated as actuarial gains or losses in the statement of total recognised gains and losses in the financial statements.

F17 FRS 17 definitions of past service costs, settlements and curtailments relate to decisions in the current year whose effects are influenced by employees' service earned in preceding financial years. Thus FRS 17-defined past service costs (and settlements and curtailments) are not costs which relate to the current service provision or the current service of the employee and therefore should not be included in the definition of total cost. This treatment follows the principle of the treatment of pensions costs in previous editions of BVACOP.

Past Service Costs (if any)

F18 Past service costs (for a defined benefit scheme) are defined by the SORP as being liabilities related to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits.

F19 Past service costs arise when an employer makes a commitment to provide a higher level of benefit than previously promised. Past service costs would also include benefit improvements awarded as a result of a surplus arising in the scheme, where this might be permitted by statute.

F20 Past service costs are a non-periodic cost – they arise from decisions taken in the current year, but whose financial effect is derived from years of service earned in earlier years. For instance, if scheme regulations were amended to increase the multiplier derived from years of service applied to final salaries in calculating pensions, total liabilities would rise but the majority of this rise would not relate to employee activity in the current year. It is therefore presented separately from the current service cost.

F21 The SORP requires that unfunded discretionary benefits should be accounted for on a defined benefit basis. Discretionary benefits include added years liabilities. These should be treated in accordance with other past service costs and be recognised when the benefits vest. The Best Value Steering Group and the Local Authority Accounting Panel consider that, in the interests of consistency with previous editions of BVACOP and because it is often difficult to differentiate between those costs which are a cost of service decisions and those which are corporate decisions, all added years liabilities should be excluded from the definition of the total cost of the service. However, local authorities may wish to ensure service accountability for these decisions by including added years liabilities within service budgets.

F22 Unfunded discretionary benefits arrangements – unfunded defined benefit schemes for teachers and local authority employees where the costs fall directly on the employer – should be accounted for on a defined benefit basis and included in Non Distributed Costs.

F23 Vesting of past service costs refers to the process of an entitlement to benefits becoming unconditional, not to when payment falls due. In most cases vesting will be immediate, but there might be instances where increased benefits are phased in over more than one year, whereupon a straight-line allocation across the years will be necessary.

F24 It is important that past service costs are not confused with past service contributions – the element of employer's contributions payable to make good any deficit on the pension fund – previously an element of Unapportionable Central Overheads. This is no longer a current revenue item but is included as a part of the payments to the pension fund (in accordance with pension scheme regulations) and is treated as a cash flow item which reduces the pensions liability.

Curtailment (if any)

F25 The SORP defines a curtailment for a defined benefit scheme as:

"...an event that reduces the expected years of future service of present employees or reduces for a number of employees the accrual of the defined benefit for some or all of their future service. Curtailments include:

(a) Termination of employees' services earlier than expected, for example as a result of … discontinuing a segment of business.

(b) Termination of or amendment to the terms of a defined benefit scheme so that some or all future service by current employees will no longer qualify for benefits or will only qualify for reduced benefits."

Settlement (if any)

F26 The SORP defines a settlement as:

"...an irrevocable action that relieves the employer (or defined benefit scheme) of the primary responsibility for the pension obligation and eliminates risks relating to the obligation and the assets used to effect the settlement. Settlements include:

(a) A lump-sum cash payment to scheme members in exchange for their rights to receive specified pension benefits;

(b) The purchase of an irrevocable annuity contract sufficient to cover vested benefits; and

(c) The transfer of scheme assets and liabilities relating to a group of employees leaving the scheme."

Non Distributed Costs – the Costs of Unused Shares of IT Facilities and Other Assets

F27 These headings cover the cost of portions of computer mainframes and integrated systems that are unused as a result of loss of work caused by outsourcing or the loss of a function or area, and an appropriate share of the cost of other long-term unused but unrealisable assets.

F28 Their inclusion within Non Distributed Costs reflects the reality that there is no service to charge costs on to because those costs relate to unused capacity (IT or otherwise). Where services are using the capacity, whether by choice or otherwise, they should be bearing their fair share of the cost. Similarly, if previous decisions about, for example, the choice of IT system, have resulted in a cost which might be higher than the services concerned would wish, they still have to bear the full cost.

F29 These two subdivisions should only be used in the narrowly defined way described; they are not a general mechanism to insulate services from the cost impact of past decisions. Whilst some may consider that their identification in this way may reduce the incentive to plan for their demise, an alternative view is that their separate identification makes the additional costs more conspicuous than if they were obscured within an overhead allocation.

Charge Relating to Assets Under Construction and Surplus Assets Held for Disposal

F30 Impairment losses on assets under construction and surplus assets held for disposal, plus depreciation (and associated government grant deferred credits) for the latter class of assets, and the revenue costs of holding surplus assets (eg security costs), are added to the list of Non Distributed Costs for the first time in 2006 BVACOP. They were previously debited to the Asset Management Revenue Account, but this was abolished in the 2006 SORP. The charges have therefore been relocated to Non Distributed Costs. Costs associated with abortive capital projects should be charged to the relevant service revenue account.

Relationship of Non Distributed Costs with the Annual Statement of Accounts

F31 Where overheads are not charged or apportioned, the SORP requires disclosure of this fact. Authorities will need to recognise this in a note to the statement of accounts. Where material, Non Distributed Costs should be disclosed on the face of the I+E Account. Non Distributed Costs are included in the Central Services SEA.

Annex G

Group Accounts

Application of BVACOP to Group Accounts

G1 Group accounts must comply with the requirements set out in paragraphs 2.49 and 2.50 of Section 2 of BVACOP.

Significance of BVACOP for Group Accounts

G2 There are two particular references in the SORP that require authorities to consider the provisions of BVACOP:

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Paragraph 6.17 of the 2008 SORP states generally that "FRS 2 and FRS 9 require that the accounting polices of the subsidiaries, associates and joint ventures are aligned with the policies of the reporting entity, as adjusted to comply with UK GAAP for the purposes of group accounts".

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Paragraph 6.28 of the 2008 SORP requires that "The operating income and expenditure of [a] subsidiary should be included within the appropriate service line before net cost of services. … Where it is not possible to combine the income and expenditure with a service heading used by the authority, a separate line should be inserted …".

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G3 The effect of these references is that, where an authority has subsidiaries that are required to be consolidated on a line-by-line basis, the operating results of the subsidiary will need to be adjusted to align with total cost principles and the SEA. However, variations are required to the total cost definition generally used in BVACOP, because of the adjustments to the authority's accounting policies that are required by the SORP for group accounts.

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The Definition of Total Cost for Group Accounts

G4 Paragraph 2.49 of BVACOP sets out the mandatory requirements for the preparation of total cost figures in external financial reports for the local authority group. These are based on a requirement to adjust the income and expenditure of the authority so that they are more closely aligned with UK GAAP and to consolidate the transactions and balances of subsidiaries, associates and joint ventures in accordance with UK GAAP. The required adjustments are discussed below. More detailed guidance on the requirements is provided in *Group Accounts in Local Authorities – A Practitioners' Workbook*, published by CIPFA, which is referred to below as the *Group Accounts Practitioners' Workbook*.

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Goodwill

G5 Where an interest in a subsidiary, associate or joint venture is acquired and the consideration given for the interest is more or less than the fair value of the share of the assets and liabilities of the entity acquired by the authority, the difference is accounted for in group accounts as goodwill. This can be either positive (the consideration exceeds fair value) or negative (the consideration is less than fair value). Over time, as the difference in these values narrows, the goodwill is written off to the Group I+E Account. The circumstances in which goodwill might arise, its calculation and the requirements for amortisation are discussed in paragraphs 8.8 to 8.22 of the *Group Accounts Practitioners' Workbook*.

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G6 Paragraph 6.24 of the 2008 SORP requires that amortisation charged in respect of goodwill should be included in the gross expenditure of the relevant service in the Group I+E Account. Goodwill will therefore need to be analysed across the activities of the entity that has been acquired by the authority and allocated to divisions of service as part of total cost.

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G7 Where the activities of the entity include elements that are not included in the SEA, the charge should be made to a separate heading in the Net Cost of Services (see paragraphs G8 and G10).

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Consolidation of Subsidiaries

G8 Paragraph 6.28 of the 2008 SORP contains the following provisions in relation to the consolidation of subsidiaries in the Group I+E Account:

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"FRS 2 requires income and expenditure … to be consolidated on a line-by-line basis. The operating income and expenditure of the subsidiary should be included within the appropriate service line before Net Cost of Services. … Where it is not possible to combine the income and expenditure with a service heading used by the authority, a separate line should be inserted."

G9 The effect of these provisions is that for group financial reporting, the operating results of subsidiaries (before interest and taxation) should be aligned with the accounting treatments specified in the preceding paragraphs and then allocated across the divisions of service in the SEA.

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G10 There may be two instances where allocation is not possible:

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The subsidiary carries out activities that are not covered by the SEA – in this case, the authority will create appropriate new divisions of service.

The subsidiary has corporate expenses that cannot be allocated or apportioned to particular services – this will rarely be the case but subsidiaries might on occasion have expenses that do not contribute to any particular service, in which case the relevant expenses might be posted to Corporate and Democratic Core or to Non Distributed Costs in the SEA, provided that these costs meet the definitions provided in Section 2 and Annexes E and F (respectively) of BVACOP.

G11 Authorities should also ensure that the allocations of subsidiary expenditure across the SEA headings comply in all material respects with the seven general principles of overhead recharging.

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G12 Transactions should be consolidated in their entirety, even if the authority has less than a 100% interest in the subsidiary, as this should show the full value of transactions controlled by the authority. However, below Net Cost of Services the operating profit/loss attributable to minority interests should be reversed out before Net Expenditure before Movements on Reserves. Comprehensive guidance on accounting for subsidiaries is contained in Chapter 8 of the *Group Accounts Practitioners' Workbook*.

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Intra-group Transactions

G13 As group financial reporting presents the authority and its subsidiaries as if they were a single reporting entity, transactions between the authority and its subsidiaries (and between subsidiaries) should be excluded from the income and expenditure included in total cost.

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G14 For example, where a subsidiary provides housing management services to the authority from premises rented from the authority, total cost will exclude the payments made by the authority for services rendered by the subsidiary and the rent charged and paid on the office accommodation. The process for eliminating intra-group transactions is set out in paragraphs 8.23 to 8.25 of the *Group Accounts Practitioners' Workbook*.

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Unrealised Profits on Fixed Assets

G15 In special circumstances, elimination of intra-group transactions might not remove all the effects of intra-group activity for income and expenditure purposes. This will be the case where group entities have been providing each other with fixed assets and charging more or less than actual cost. Where the acquirer has recorded the acquisition at cost and the provider has accounted for a profit or loss on the transaction, the profit/loss is unrealised as far as the group is concerned. Total cost will need to be adjusted to exclude any such profits/losses. Adjustments will also be needed to the depreciation charged by the acquirer to make sure that it is based on the cost of the asset to the group rather than the price that was paid between the group entities.

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G16 The above special circumstances will seldom arise but they are more likely to arise where an entity is carrying out capital works for the authority. Further guidance on the situations where such accounting adjustments might be needed is contained in paragraphs 8.29 and 8.30 of the *Group Accounts Practitioners' Workbook*.

Treatment of Associates and Joint Ventures

G17 Associates and joint ventures are brought into group accounts using the 'equity' methodology. This means that the transactions of such entities are not consolidated on a line-by-line basis, but the authority's attributable share of their income and expenditure is recognised by new summary lines before each subheading. Thus, in any disclosure of the Net Cost of Service, the transactions of associates and joint ventures will not be included in total cost figures for services but brought together in lines for the Share of the Operating Results of Associates and for the Share of the Operating Results of Joint Ventures.

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G18 Transactions between the authority and associates and joint ventures are not eliminated under equity methods. However, some adjustment might be needed to the authority's results if there are unrealised profits on fixed asset transactions between the authority and its associates/joint ventures (see paragraphs G15 and G16). Comprehensive guidance on accounting for associates and joint ventures is contained in Chapter 9 of the *Group Accounts Practitioners' Workbook*.

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Format of the Group Income and Expenditure Account

G19 In comparison to the illustrative extract from the I+E Account shown in paragraph A25 of Annex A, the following format would apply to a Group I+E Account for an authority with interests in subsidiaries, associates and joint ventures:

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Table A: An Illustrative Extract from the Group Income and Expenditure Account of an English Authority

Previous Year Net Expenditure		Notes	Gross Expenditure	Gross Income	Net Expenditure
£000s			£000s	£000s	£000s
1,195	Central services to the public	1	4,970	(3,765)	1,205

Previous Year Net Expenditure £000s		Notes	Gross Expenditure £000s	Gross Income £000s	Net Expenditure £000s
2,567	Cultural, environmental, regulatory and planning services	1	13,624	(11,370)	2,254
62,270	Children's and education services	1	83,401	(20,496)	62,905
15,999	Highways and transport services	1	23,988	(7,930)	16,058
1,034	Housing services	1	30,037	(30,758)	(721)
11,207	Adult social care	1	16,872	(5,518)	11,354
–	Exceptional costs of adult social care legal settlements	1	2,024	–	2,024
(400)	Education management consultancy (example of an activity potentially carried out by subsidiary that is not featured in the SEA)	1, 2	2,041	(2,594)	(553)
344	Corporate and democratic core	1	447	(65)	382
585	Non Distributed Costs	1	604	–	604
(1,787)	Share of operating results of associates	3	2,007	(4,486)	(2,479)
(239)	Share of operating results of joint ventures	3	2,013	(1,998)	15
(633)	Profits/losses on disposal of fixed assets		145	(1,297)	(1,152)
92,142	Net Cost of Services		182,173	(90,277)	91,896
98	Parish council precepts		105	–	105

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Previous Year Net Expenditure £000s		Notes	Gross Expenditure £000s	Gross Income £000s	Net Expenditure £000s
396	(Surpluses)/deficits on trading undertakings not included in Net Cost of Services		463	(78)	385
10,787	Interest payable		13,347	-	13,347
456	Share of interest payable by associates	3	478	-	478
856	Share of interest payable by joint ventures	3	872	-	872
–	Contribution of housing capital receipts to government pool		1,973	-	1,973
–	Losses on the repurchase of borrowing		2,230	–	2,230
1,332	Investment losses		–	–	–
(2,417)	Interest and investment income		–	(2,359)	(2,359)
(82)	Share of investment income of associates	3	-	(70)	(70)
(440)	Share of investment income of joint ventures	3	-	(531)	(531)
156	Pensions interest cost and expected return on pensions assets		223	-	223
242	Share of pensions interest cost and expected return on pensions assets of associates	3	281	-	281

Previous Year Net Expenditure £000s		Notes	Gross Expenditure £000s	Gross Income £000s	Net Expenditure £000s
(149)	Share of pensions interest cost and expected return on pensions assets of joint ventures	3	-	(154)	(154)
2,030	Corporation tax		2,049	-	2,049
830	Share of corporation tax of associates		963	-	963
127	Share of corporation tax of joint ventures	3	170	-	170
453	Minority interest share of profits of subsidiary		561	-	561
106,817	Net Expenditure		205,888	(93,469)	112,419

Note 1: The SORP allows the SEA to be presented in the notes to the Group I+E Account rather than detailed on the face of the Account.

Note 2: Where a subsidiary carries on a single activity that is outside the SEA, then this line will describe that particular activity. Where more than one additional activity is carried out, authorities will consider whether more lines need to be added for each substantial activity, or whether an 'Other' line can be justified.

Note 3: Disclosures are required against each subheading in the Group I+E Account for the attributable share of the transactions of associates and joint ventures. The SORP does not strictly provide for these entries to be consolidated on the face of the Account and detailed in a note.