

A Best Value Approach to Trading Accounts

A Guidance Note for
Local Authority Practitioners

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Foreword

David Sawers
Chair, CIPFA Directors of Finance Section

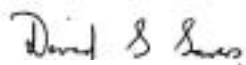
Nick Bennett
Chair, LASAAC

We have great pleasure in introducing this Guidance for Practitioners on the use of Trading Accounts in Scottish local government following the repeal of CCT legislation. Both the CIPFA Directors of Finance Section and LASAAC identified the need for early production of guidance for practitioners to coincide with the publication of the Local Government in Scotland Act 2003 introducing the statutory duty of Best Value. We are delighted that the work has been done jointly with the support and assistance of CIPFA in Scotland.

The Guidance has been subject to consultation through the use of a 'Sounding Board' comprising members of the Best Value Working Group of the Directors of Finance Section and members of LASAAC and includes all constructive views expressed by the Sounding Board, and also the results of a broader and very successful consultation exercise undertaken on our behalf by CIPFA in Scotland. The guidance is intended for finance practitioners and is based on the contents of the Local Government in Scotland Act 2003. The Act effectively ends the system of compulsory competitive tendering which has existed since 1980 and replaces it with a framework for monitoring and reporting on the financial performance of 'significant trading operations' with effect from April 2003. Alongside this, the Act introduces a statutory duty to adopt proper accounting practice, and it is anticipated that this guidance will be incorporated within CIPFA's Best Value Accounting Code of Practice (BVACOP) for use by Scottish authorities.

We would like to conclude by thanking the Sounding Board for their contributions to the preparation of this document, and in particular Don Peebles and Sandra Black who were responsible for its drafting:

- Helen Black, South Lanarkshire Council
- Sandra Black, Renfrewshire Council
- Russell Frith, Audit Scotland
- Yvonne Hunter, South Ayrshire Council
- Gordon Lawson, Dumfries & Galloway Council
- Andrew Leck, IPF
- Peter Marsh, Glasgow City Council
- Colin McMahon, Angus Council
- Keith O'Donnell, Fife Council
- Don Peebles, CIPFA in Scotland



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Nick Bennett
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Section One
Executive Summary

A Best Value Approach to Trading Accounts Executive Summary

1. Introduction

- 1.1 In response to the requirements contained in the Local Government in Scotland Act 2003 on maintenance of statutory trading accounts and reporting on trading performance in a Best Value environment, the CIPFA Scottish Directors of Finance and LASAAC agreed to set up a 'Sounding Board' to provide guidance and support to Councils in relation to the new requirements for Scottish local authorities, which came into effect in April 2003.
- 1.2 This Executive Summary provides an 'at a glance' summary of the main points contained in the guidance and is targeted mainly at senior staff. It is recommended that those staff responsible for the implementation of the guidance should read both this full guidance note and the relevant sections in the Act.

2. Previous CCT Requirements

- 2.1 The legislation governing CCT has been repealed, effectively ending the prescriptive competition regime which had been in place since 1980, and which led to the creation of Direct Labour Organisations (DLOs) and Direct Service Organisations (DSOs).
- 2.2 DLOs and DSOs had a statutory annual financial target of break even, which meant that separate trading accounts had to be maintained and that authorities had to include a summary DLO/DSO statement in their accounts. The legislation also required authorities to publish separate annual reports for DLOs and DSOs. Now that CCT has been repealed, these requirements are no longer relevant, but are replaced with new requirements contained in the Act. These extend beyond the narrow range of services affected by CCT to a consideration of all services provided by the authority.

3 Requirements of the Local Government in Scotland Act 2003

- 3.1 Part 1 of the Act sets out the statutory duty of Best Value, and provides a strong link between the duty of best value, the delivery of services and the reporting of financial performance.
- 3.2 Section 10 of the Act sets out the requirement for statutory trading accounts to be maintained for 'significant trading operations' and that they should break even over a three year rolling period.

- 3.3 Section 12 of the Act sets out, for the first time, a requirement under primary legislation for authorities to adopt proper accounting practice, which effectively elevates the importance of the Accounting Code of Practice and is a key issue for finance practitioners.
- 3.4 Section 13 of the Act sets out the statutory duty to publish performance reports, and includes provision for the publication of trading accounts.
- 3.5 The CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice ('the SORP') has been amended to reflect the new legislation and the current requirement to disclose the results of significant trading operations in the statement of accounts will continue.

4 What is a 'Trading Operation?'

4.1 The test of what is a trading operation will be a matter for individual authorities and should be based on a careful consideration of a wide range of services, and not simply on their past status as CCT or non CCT activities. The test is likely to be based on whether a service meets **both** the following criteria:

- (i) the service is provided in a 'competitive environment' - i.e. the user has discretion to use alternative providers; and
- (ii) the service is provided on a basis other than straightforward recharge of cost – i.e. users take the service on the basis of quoted lump sums, fixed periodical charges, or rates, or a combination of these.

4.2 Trading operations may therefore include:

- services to the public or client groups which are subject to charging; or
- work for other Council services where the Council has decided to subject it to a test of competition as part of a Best Value review; or
- services where users are free to buy services from outside the Council.

4.3 There is no compulsion to maintain trading accounts where the Council believes Best Value can be demonstrated without market testing or tendering, and where users are not allowed to buy services externally. The Council would, however, have to be able to clearly demonstrate that Best Value is being achieved in the absence of the use of any form of competition for services which have active external markets.

5 What is a Significant Trading Operation?

5.1 The test of significance is important as it determines which trading operations require to maintain a statutory trading account, (other non statutory trading accounts can be kept for internal purposes) must comply with the statutory requirement to break even over a three year period, and must disclose trading performance in the public performance report. Each authority should set its own parameters for significance, not only to ensure that it complies with legislation, but also to ensure that the disclosures are not too voluminous. Significance criteria should be set corporately, and applied consistently across trading operations. Paragraph 8.2 of the guidance sets out some suggested criteria which Councils may use.

6 Disclosure of Trading Performance

6.1 Summary disclosure of the financial performance of significant trading operations in the statement of accounts will continue. Whilst further regulations over the form, content and frequency of public performance reports may become available, the Act clearly identifies that significant trading operations performance, or a summary, is to be included.

6.2 Having judged which trading operations are 'significant', Councils are free to choose how best to present the trading information, but are likely to be expected to report with the spirit of the overall aims of Best Value in mind. Disclosure of the surplus/deficit for the year should be regarded as a minimum. The overall financial position of the trading operation in relation to its three year target would be more helpful, along with commentary to put the financial performance in a context useful to the readers. An example disclosure is provided at paragraph 12.8 of the guidance.

**Section Two
Guidance**

1. Background and Overview

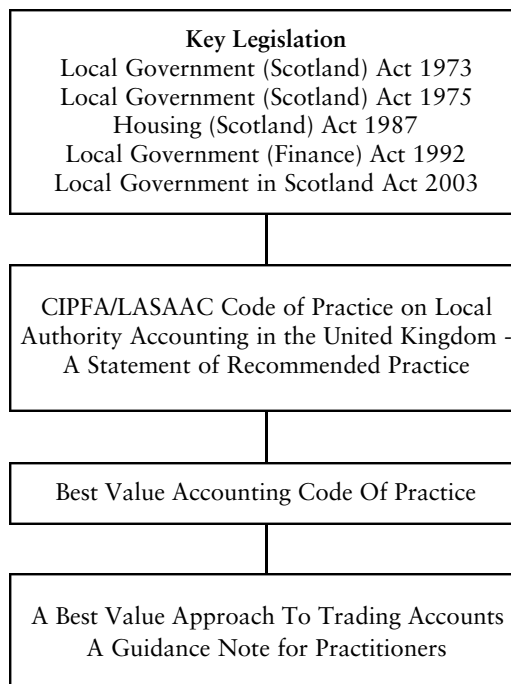
- 1.1 This document provides guidance to finance practitioners on the statutory financial targets and disclosure requirements for significant trading operations required by The Local Government in Scotland Act 2003. These requirements are effective from April 2003. Consequently, financial year 2003/4 will be the first year in which trading accounts require to be maintained and disclosed under the new legislation. The new requirements to maintain and disclose information on significant trading operations, like Best Value itself, apply to all services and are not restricted to services previously governed by CCT.
- 1.2 The Local Government in Scotland Act 2003 introduced a statutory duty of Best Value on local authorities in Scotland with effect from April 2003. The stated overall aim of the Act was the provision of a framework which enabled the delivery of better and more responsive public services in Scotland. This guidance is intended to provide practitioners with a flexible framework within which Councils can operate, and one of its key objectives is to avoid creating artificial barriers to the implementation of Best Value by being over-prescriptive. It will be through consistent application of this guidance that Best Value will be demonstrated and it is hoped it will provide members and officers with a means to measure whether or not a Best Value approach is being pursued
- 1.3 As part of the package of reforms within the Act, the legislation governing compulsory competitive tendering (CCT) was repealed. This effectively ended a prescriptive system of competition which had been in place since the early 1980's, and applied to a narrow set of activities defined by the legislation. The CCT legislation led to the introduction of direct labour organisations (DLOs) and direct service organisations (DSOs) in local authorities and also led to a separation of the duties in these services between client and contractor, an inflexible regime which did not allow for service reconfiguration or rationalisation.
- 1.4 In addition to the competition requirements, DLOs and DSOs were also required by CCT legislation to achieve a prescribed annual financial objective which was that expenditure should equal income i.e. break-even, which again provided little or no scope for medium term service planning.

- 1.5 The repeal of CCT legislation removes the requirement to achieve a prescribed annual financial objective for defined local authority services. However, the Act provides for an alternative framework for monitoring and reporting on significant trading performance.

- 1.6 The consequence for local authorities is that as the performance reporting duties under compulsory competitive tendering are repealed they are simultaneously replaced with the requirement to identify and report the results of 'significant trading operations'. The definition of 'trading operation' is explored later in the guidance, but by its nature, moves beyond the boundaries of CCT defined activities.

- 1.7 The introduction of new reporting requirements and the statutory duty of adoption of proper accounting practice requires the early identification of recommended best practice and its codification for the benefit of local authorities. Consequently, this guidance sets out a framework for local authorities to enable both accounting and disclosure requirements to be met for significant trading operations.

- 1.8 The governing legislative and accounting framework is considered in detail in the following paragraphs. As an introduction, the hierarchical relationship between statutes, the present accounting codes and this guidance is graphically demonstrated below which clarifies the primacy of legislation:



2. The Local Government in Scotland Act 2003

2.1 Part I of The Local Government in Scotland Act 2003 is entitled Best Value and Accountability. This part of the Act sets out the statutory duty of Best Value on local authorities. The statutory duty which effectively replaces compulsory competitive tendering requires that the results of significant trading operations should be disclosed in statutory trading accounts in accordance with proper accounting practice. (This does not prevent authorities maintaining other non statutory trading accounts for internal purposes, but these are not subject to the requirements of the Act).

2.2 There is now therefore a clear link between the duty of Best Value, the delivery of direct services and the reporting of financial performance by local authorities. Before considering trading operations in detail the specific duty of Best Value is considered. An extract from Part I, Section 1 of the Act is set out below:

- (1) It is the duty of a local authority to make arrangements which secure best value.*
- (2) Best value is continuous improvement in the performance of the authority's functions*
- (3) In securing best value, the local authority shall maintain an appropriate balance among*
 - (a) the quality of its performance of its functions;*
 - (b) the cost to the authority of that performance;*
 - and*
 - (c) the cost to persons of any service provided by it for them on a wholly or partly rechargeable basis*
- (4) In maintaining that balance, the local authority shall have regard to*
 - (a) efficiency*
 - (b) effectiveness*
 - (c) economy: and*
 - (d) the need to meet equal opportunity requirements*

2.3 The duty of Best Value empowers local authorities to critically review the present methods of service delivery. Under this legislation, it is likely that the future provision of 'direct' services by local authorities will continue to move away from the traditional structures of DLO's and DSO's. The Act does not specifically define services which must be regarded as trading operations but it does formally introduce the concept of 'significant trading operations'.

2.4 Accountability is a key theme within the Act, and again, whilst the Act does not prescribe the arrangements that a local authority should make for service delivery, the importance of accountability is demonstrable in that:

- a statutory framework for proper accounting practice is set out;
- significant trading operations are expected to achieve break even over a rolling three year period; and
- there is a requirement that local authorities produce annual reports on financial and service performance including trading accounts for significant trading operations.

2.5 The link between trading operations and the specific reporting requirements are included within Section 10 of the Act. **Section 10 sets out the statutory requirements which, in summary, are that:**

- trading accounts should be maintained and disclosed for significant trading operations; and
- significant trading operations must achieve ‘break even’ in financial terms over a three year rolling period.

2.6 An extract from Section 10 is set out below:

(1) It is the duty of a local authority to conduct each of its significant trading operations so that, as respects that operation-

(a) in relation to every three year period; and

(b) taking every year with the two previous years,

revenue is not less than expenditure

(2) In subsection (1) above, the references to a local authority’s significant trading operations are references to those of its trading operations for which it must, in accordance with proper accounting practices, disclose trading accounts and, in this subsection, “proper accounting practices” is to be construed in accordance with section 12(2) below.”

2.7 Section 12 of the Act sets out, for the first time, **the statutory requirement that local authorities now require to adhere to proper accounting practice.** The CIPFA/LASAAC Code of Practice on Local Authority Accounting – A Statement of Recommended Practice and the Best Value Accounting Code of Practice, taken together with other relevant guidance is recognised for this purpose. An extract from Section 12 is set out below:

- (1) It is the duty of a local authority to observe proper accounting practices*
- (2) In subsection (1) above and in paragraph (b) of Section 99... of the 1973 Act, the references to proper accounting practices are references to accounting practices which fall within one or more of the following-*
- (a) those which the local authority is required to observe by virtue of any enactment;*
 - (b) those which have been specified in guidance for the purposes of this section and that section by the Scottish Ministers;*
 - (c) those which, whether by reference to any generally recognised, published code or otherwise, are regarded as proper accounting practices to be observed in the preparation and publication of accounts of local authorities.*

2.8 Section 13 of the Act addresses the publication by local authorities of information on finance and performance. **A statutory duty to publish performance reports is now placed upon local authorities.** The Act makes it clear that the form, content and timing of reports are a matter for the local authority to determine. Provision is made however, for regulations to provide for the publication of trading accounts. An extract from Section 13 is set out below:

- (1) It is the duty of a local authority to make arrangements for the reporting to the public of the outcome of the performance of its functions.*
- (6) Such regulations may include provision-*
- (b) for the local authority's trading accounts or a summary thereof to be included in that which is to be reported under subsection (1) above*

3. **The CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice (‘the SORP’)**
- 3.1 The CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom - A Statement of Recommended Practice (‘the SORP’) is based on approved accounting standards. The SORP sets out proper accounting practice for statements of account.
- 3.2 As indicated at Section 1, the 2002 SORP required disclosure of the statutory information required as a result of the Local Government Planning and Land Act 1980 and the Local Government Act 1988.
- 3.3 Paragraph 4.23(f) of the SORP requires disclosure of the nature, turnover and surplus/deficit of significant trading operations of a local authority. In addition the cumulative surplus or deficit for the current year and two preceding financial years require to be disclosed.

- 4. **The Best Value Accounting Code of Practice (BVACOP)**
- 4.1 The Best Value Accounting Code of Practice (BVACOP) sets out proper accounting practice below the level of the statement of accounts.
- 4.2 The Institute Council of CIPFA has determined that the principles and detailed proposals set out in BVACOP should be adopted by all local authorities in Great Britain. BVACOP addresses the specific issue of trading accounts at Annex D of Section 2 of the Code.
- 4.3 It is anticipated that this guidance will be incorporated within future editions of BVACOP and will as a consequence become proper accounting practice for local authorities in Scotland.

5. Summary of Responsibilities for Local Authorities in Scotland

5.1 In summary, the requirements on local authorities in Scotland under the Local Government in Scotland Act 2003 are that:

- there is a statutory duty to achieve Best Value;
- there is a requirement to maintain statutory trading accounts for significant trading operations;
- summary results of significant trading operations will require to be disclosed as part of a local authority's public performance report;
- significant trading operations require to achieve break even over a three year period; and
- statutory trading accounts will be disclosed as part of the local authority's statement of accounts.

5.2 There is now a clear legislative link between service delivery, accountability and proper accounting practice.

6. Scope of the Guidance

6.1 This document is intended to provide practical guidance to local authority finance practitioners in Scotland which enables the accounting treatment and subsequent required disclosure in respect of significant trading operations to be set out which comply with:

- legislation; and
- proper accounting practice.

6.2 The guidance also contains practical advice on the identification of what determines a 'significant' trading operation. Clearly however, there may be issues which are specific to individual local authorities and, in such instances, the expectation is that the guidance will be applied as a broad principle rather than be considered to be prescriptive. The guidance will be reviewed on a regular basis to ensure it continues to be relevant.

6.3 It should be noted that this guidance concentrates on the specific requirements for reporting on significant trading operations and does not extend to a consideration of the following inclusions in the Act:

- relaxation of exclusion of non-commercial considerations in the letting of local authority contracts; or
- relaxation of restrictions in the Local Authorities (Goods and Services) Act 1970 on the supply of goods and services by local authorities;

6.4 This guidance is considered to represent proper accounting practice for compliance with the requirements of The Local Government in Scotland Act 2003. Consequently, CIPFA, LASAAC and the CIPFA Scottish Directors of Finance Section commend this document to local authorities in Scotland.

7. What Constitutes a Trading Operation?

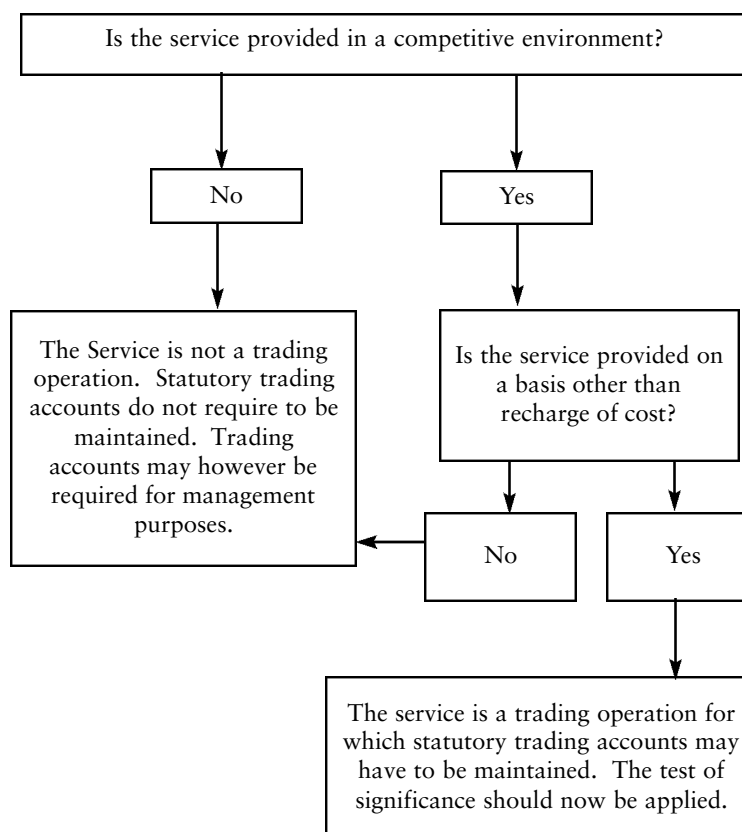
7.1 The papers circulated by the Scottish Executive as part of their consultation exercise on the Local Government in Scotland Act, titled 'Outline of Proposals' contained a specific section on the intended requirements in relation to Commercial and Trading Operations. This outline highlighted that it was the Executive's intention that where 'authorities undertake activities for which there is genuine commercial competition for the supply of the work or service' that trading accounts should be maintained.

7.2 At face value, this could cover a large proportion of the services provided by a local authority, and will in practice extend consideration beyond those services previously governed by CCT legislation. It is likely that the test of whether trading accounts are required will be whether the service meets both of the following criteria, in addition to passing the test of 'significance' (see section 8 below):

- the service is provided in a 'competitive environment' - i.e. the user has discretion to use an alternative provider, and
- the service is charged for on a basis other than a straightforward recharge of cost – ie users take the service on the basis of quoted lump sums, fixed periodical charges or rates, or a combination of these.

This can be represented graphically as follows:

The Trading Operations Criteria Test



7.3 Each authority will want to examine their own local service delivery arrangements to identify their own list of potential trading operations. In doing so, a clear understanding of what constitutes a 'competitive environment' under a best value regime is essential. A 'competitive environment' is deemed to exist where users have discretion to procure services from an in-house provider, or externally. Where users can only exercise discretion over the volume and/or quality of service but not the source, the service is not operating in a competitive environment. 'Users' may encompass either the general public (e.g. car parking), the Council as a corporate body, or its service departments (e.g. printing).

7.4 Trading operations may include work done for other council services where the Council has decided to subject the service to a competitive tendering or market testing exercise as part of a Best Value review; or support services which are provided in a free internal market where service departments have freedom to procure these services outside the Council; or subsidised services which compete with external service providers where

the Council chooses to support a level of service provision as part of its Corporate objectives (eg affordable leisure provision or supported employment).

7.5 However, where the Council believes that Best Value can be demonstrated without formal market testing or tendering and where users are not permitted to purchase services externally it is not a trading operation and therefore trading accounts are not compulsory under the requirements of the Act. In this case authorities will have to be able to clearly demonstrate that Best Value is being achieved in the absence of the use of any of these tools of competition.

7.6 The test of whether a service is provided in a competitive environment is likely to be the most subjective of the two tests of a trading operation. The following table is provided to assist in this assessment:

Table 1: Trading Operations Disclosure Requirements			
	Probably Required	Possibly Required	Unlikely to be Required
Service continues to be provided under existing CCT contract	✓		
Service subject to competitive tender	✓		
Service competes in the open/external market	✓		
Service subject to market testing		✓	
Service subject to benchmarking		✓	
Service provided in partnership		✓	
Service is part of the democratic process			✓
Service not subject to any of the above*		✓	

* Where the service does not fall into any of the above criteria, the Authority will need to consider how it can demonstrate that the service is being delivered in terms of Best Value.

- 7.7 In four out of the eight categories listed each authority will have to decide whether or not trading accounts are required. Each authority will be required to develop their own decision-making framework to assist in this process.
- 7.8 Authorities will want to avoid unnecessary use of internal market processes for the purpose of maintaining trading accounts if it serves no real purpose in practice, and adds no value to the work of the Council. In addition, there may be significant costs involved in the preparation and publication of trading accounts, and these should be considered, particularly where the Council chooses to maintain large numbers of non-statutory accounts.
- 7.9 Service areas which were previously subject to CCT legislation may still require statutory trading accounts to be maintained, but only if they pass the trading accounts and significance tests; or where they have not moved away from existing CCT contracts. Should they be judged to continue to require statutory trading accounts, authorities will no longer be restricted by the statutory definitions of activities imposed by CCT, and the trading account would be maintained for any new or revised service configuration as determined by each authority. In addition, some authorities may choose to consolidate services for which trading accounts in the past have had to be maintained separately - e.g. grounds maintenance and street cleaning to take advantage of improved working arrangements. Under the new arrangements, it is anticipated that one trading account covering both elements of service only would be required.
- 7.10 Services which may now have to be considered by authorities could include the following:
- Letting of Industrial Estates and Other Investment Properties
 - Provision of Car Parking Facilities
 - Printing Services
 - Market Undertakings and Manufacturing facilities (eg double glazing, furniture etc)
 - Professional and Support Services
 - Crematoria
 - Ports
 - Civic Halls
 - Theatres and Museums
 - Care Services/Residential Care
 - Housing Management

8. What is a Significant Trading Operation?

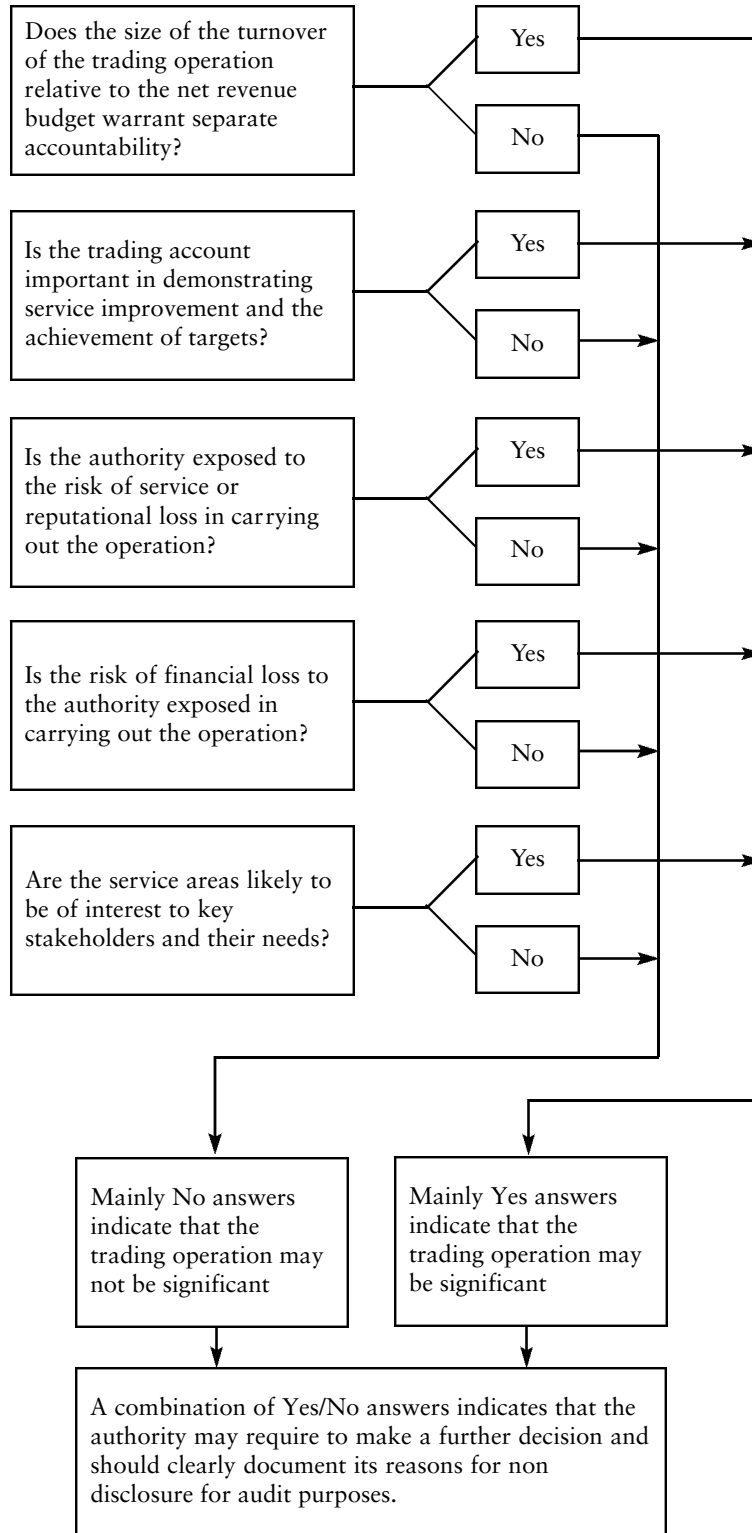
8.1 The test of significance is important as it determines which trading operations are subject to the new legislative requirement to break even over a three year period, and for which authorities must maintain statutory trading accounts in accordance with proper accounting practice, and disclose their trading results. Clearly, this does not prevent authorities maintaining further trading accounts for management information and control purposes but these would not be subject to the provisions of the Act, unless they became 'significant' at any point in the future.

8.2 Each authority will look to set parameters for 'significance', to ensure not only that the disclosure requirements of the legislation are satisfied but also to ensure that disclosures are not voluminous. It is anticipated these parameters will be set corporately and applied consistently across different trading operations. The criteria should not be regarded as fixed and final as they will have to adapt to the changing circumstances of the Council. It is emphasised that the each criterion should not be considered in isolation but viewed in totality against criteria overall. Criteria which the authority may wish to consider in setting parameters could include the following:

Table 2: TEST OF SIGNIFICANCE CRITERIA	
Financial Criteria	Non Financial Criteria
The size of the turnover of the trading operation, relative to the Council's net revenue budget.	The importance of a trading account to demonstrating service improvement and achievement of targets.
The risk of financial loss to the authority is exposed in carrying out the operation.	The authority is exposed to the risk of service or reputational loss in carrying out the operation.
	The service areas likely to be of interest to its key stakeholders and their needs.

The decision process can be represented graphically as follows:

Test of Significance Decision Criteria



9. **What are the new Financial Targets?**

9.1 Section 10 of the Act requires a 'break even' position for each operation over a three year period. The precise wording of the Section is as follows:

(1) It is the duty of a local authority to conduct each of its significant trading operations so that, as respects that operation -

(a) in relation to every three year period; and
(b) taking every year with the two previous years,

revenue is not less than expenditure

9.2 In practice, this will be operated as a rolling three year period, subject to annual assessment - i.e. Years 1, 2 and 3, followed by Years 2,3, and 4. The intention of the departure from annual break even financial targets is to enable the trading operation to move to a medium term business planning cycle, whereby deficits are permitted in certain years, providing over the three year cycle it covers its expenditure commitments. This will allow managers to take service decisions, for example, to invest in Years 1 and 2 and gain from efficiency savings as a result in Year 3. Clearly, any such plans would require approval as part of the Council's budgeting and planning process and the Director of Finance would have to be satisfied that the business plan assumptions underpinning the return to a break even position over a three year period were robust, and monitored on a regular basis.

9.3 An authority, as part of its Best Value strategy and for operational reasons, may take action which results in costs being incurred and thereby prevents a statutory trading account breaking even within a three year period. In these circumstances individual authorities may wish to inform the auditor at an early stage. The likely outcome from any such course of action regarding the statement of accounts is outlined at paragraph 13.4.

9.4 An example of 3 year break-even over three cycles of measurement is provided overleaf.

Table 3 DEMONSTRATION OF MEASUREMENT OF PRESCRIBED FINANCIAL OBJECTIVE			
	Statutory Cycle		
Period	Cycle One Financial Results	Cycle Two Financial Results	Cycle Three Financial Results
Year 1	£10K surplus	£10K surplus	£10K surplus
Year 2	£10K surplus	£10K surplus	£10K surplus
Year 3	£19K deficit	£19K deficit	£19K deficit
Year 4		£8K surplus	£8K surplus
Year 5			£11K surplus
Measurement Against Statutory Target	£1K Surplus	£1K Deficit	£0
	Statutory Target met	Statutory Target <u>not</u> met	Statutory Target met
	Note 1	Note 2	Note 3

Note 1 The results for years 1 to 3 are added to give a net surplus of £1K.

Note 2 The results for years 2 to 4 are added to give a net deficit of £1K.

Note 3 The results for years 3 to 5 are added and the net surplus is 0.

- 9.5 The methodology, based on statutory requirements against which the performance of a trading operation is measured, is straightforward and clearly requires a simple arithmetic calculation of final results for three years. Note that there are only two possible outcomes, either the prescribed financial objective has been met or it has not. Where income equals or exceeds expenditure over the relevant 3 year period then the prescribed financial objective has been met. Where income is less than expenditure over the relevant 3 year period then the prescribed financial objective has not been met.
- 9.6 Financial year 2003/4 will be the first year for which the disclosure requirements apply and will be 'year 1' from the above example. It follows that local authorities can plan for and can incur deficits in years 1 and 2 provided that the result from year 3 mean that, over the 3 year period income is not less than expenditure. It is not anticipated that the financial results for years prior to 2003/04 of any trading operation previously governed by CCT legislation will be taken into account in the assessment of the new statutory financial target. It is further anticipated that any DLO/DSO reserves held at 31 March 2003 will be returned to Councils' general reserves on 1 April 2003, and will not continue be ring fenced specifically for funding future trading deficits.

10. Maintenance of Trading Accounts

- 10.1 No form of trading account is described in the Act, but there is a requirement for trading accounts to be kept 'in accordance with proper accounting practices'. Proper accounting practices includes the requirements of the BVACOP to reflect 'total cost'.
- 10.2 Trading accounts should therefore be properly charged with costs of carrying out the significant trading operation, including:
- (i) all direct costs
 - (ii) work done for the trading operation by external contractors or sub-contractors
 - (iii) the cost of service management and all support services
 - (iv) capital charges, relevant impairment losses, deferred charges written off etc
- 10.3 Costs relating to corporate and democratic core and non distributed costs, as defined in BVACOP should not be charged to the trading account.
- 10.4 The costs of redundancy should be charged to the trading account but not the redundancy costs as a consequence of contracts not being renewed or service reconfiguration at a corporate level. The trading account will also adhere to the requirements of FRS 17 as required and defined by the SORP.
- 10.5 Similarly, trading accounts should be credited with the charges made for the work done for the full financial year, including work completed and not yet billed (work in progress).
- 10.6 It is anticipated that adjustments for the requirements of SSAP 9 (in respect of anticipated deficits or reductions in surpluses in individual contracts which require to be brought into account) will continue to be made only where a significant deficit has been identified.

11. Treatment of Surpluses And Deficits

- 11.1 Material surpluses or deficits on significant trading operations provided internally to Council services can distort the spending profile of the user service. BVACOP requires that material surpluses or deficits are returned, or reapportioned, to the internal client. Local authorities should however avoid widespread reapportionments as a matter of course. It is recommended that any reapportionments can be disclosed as a footnote to the report on trading performance. It is important to note however that the return or reapportionment of material surpluses and deficits should be accounted for after the annual financial performance has been measured under the new legislation.
- 11.2 The statutory power to hold reserves is contained within Schedule 3 of the Local Government (Scotland) Act 1975. There is no express statutory power for a significant trading operation to maintain a reserve.

12. Disclosure

12.1 As noted at paragraph 3.3, summary disclosure of the performance of trading operations in the statement of accounts will continue in line with the requirements of the SORP. In addition, however, authorities will want to consider how they wish to meet the disclosure requirements of the Act and further regulations may become available over the form, content and frequency of public performance reporting. Section 13 of the Act however clearly identifies that trading accounts performance or a summary is to be included in the performance report.

12.2 The general freedom from prescription which the Act provides, brings with it a responsibility for authorities to report on their trading activities in accordance with the overall aims of Best Value. Authorities are left to regulate themselves and decide what trading operations should be reported on, the details to be provided and the format for presentation, but this will be done so as to:

- facilitate consultation with stakeholders about the carrying out of trading operations;
- enable the comparison of performance year on year;
- promote challenge to what the authority does and how it does it; and
- help to demonstrate that the authority has a competitive approach to service delivery.

12.3 Authorities have to make two main decisions when planning what trading information to disclose:

- What operations should be reported on; and
- How their performance information can best be presented.

12.4 A practical methodology for determining what operations should be reported would have the following steps:

- identify the trading operations that are provided in a 'competitive environment';
- set up and maintain trading accounts for each;
- set parameters for 'significance' and test each trading operation against these parameters;
- Assess need for public disclosure; and
- Determine format of disclosure.

- 12.5 Having determined the operations to be reported on, authorities will determine the information to be disclosed. This should include the following:
- The nature of the trading operation – readers should be able to understand what the authority is doing and what it is seeking to achieve, rather than just be presented with a simple heading such as ‘Building Cleaning’ or ‘West Ayrshire Trading’. Relevant information might include:
 - › A description of the activities carried out;
 - › The main customers;
 - › The basis on which work is commissioned;
 - › The policy objectives the authority is seeking to achieve through the operation;
 - › The extent to which the operation is carried out on a commercial basis, and any risks involved; and
 - › Details of turnover – where there are substantial amounts of external and internal income, these might usefully be separated.
- 12.6 Disclosure of the surplus/deficit for the year should be the minimum disclosure for information on financial performance. The target for the year should also be disclosed, along with the targets for the rolling three-year period to provide reassurance that the statutory financial target is being achieved. Information on any internal reappportionment of surpluses/deficits should also be disclosed.
- 12.7 Commentary to put the financial performance in a context useful to the reader is also recommended, including an explanation where previous years’ outturn is significantly different from this year’s, information on future prospects and any action being taken by the Council to achieve the statutory financial targets or service plan objectives.
- 12.8 The following table contains a model disclosure for a trading operation which is judged to be significant and whose results will generate public interest. This should not be taken as a model for all trading results and discretion should be exercised to apply those elements that communicate most effectively financial performance.

Table 4: MODEL DISCLOSURE

West Ayrshire Council Refuse Collection Trading Account Year Ended 200X						
Previous Year Target £'000	Previous Year Actual £'000		Current Year Actual £'000	Current Year Target £'000	3 Year Target £'000	3 Year Actual Performance £'000
		Turnover				
		Expenditure				
		Surplus/ Deficit				
<p><i>The Council has discretion to include a narrative commentary to accompany the trading operation. The disclosure could contain the following explanatory narrative:</i></p> <p>The main operation for the council's refuse collection trading operation is the collection of some 83,000 tonnes of household waste annually, the average cost of collection of which is £46.54 per household. The average cost has been reduced by some £5 per household over the year due to a successful re-routing exercise during the year. The service continues its drive for efficiency and service improvements over the next three years by reviewing its vehicle fleet and extending the use of its recycling initiative to three further neighbourhoods.</p> <p>The actual financial performance for the current year of £X compared favourably with financial target for the financial year which was £Y.</p> <p>The statutory financial target for the 3 year period is to break even although the council has set a target of £Z which is in excess of that required. The information available to the council would indicate that the trading operation will achieve that target.</p>						

- 12.9 There is scope for authorities to group trading operations into a consolidated disclosure, or to group to reflect the way the service is organised, or managed, by the local authority (e.g. Roads Maintenance with Roads Management or Vehicle Maintenance with Vehicle Fleet Management). However, care should be taken if grouping is to be used to ensure that it reflects operational service delivery decisions, and cannot be interpreted as being used to mask trading difficulties in a particular service.

13. Role of External Audit

- 13.1 Under the previous legislation, the SORP required summary disclosure of the results of DLO/DSO revenue accounts to be included in the statement of accounts. In addition, there was a specific statutory requirement to produce a separate annual report covering each DSO/DLO. Auditors were required to give an opinion as to whether each DSO/DLO had met its prescribed financial objective in a report separate from the audit certificate provided on the local authority's statements of account
- 13.2 These requirements no longer apply. The financial results from significant trading operations will however be the likely subject of audit scrutiny although there is no requirement for a separate audit certificate.
- 13.3 The audit approach will be a matter for Audit Scotland and for the external auditors it appoints to each local authority. It is likely however that the point of commencement for appointed auditors will be an assessment of the arrangements that local authorities have in place to identify its trading operations and to consider whether it is significant or not. Local authorities should therefore properly document the decision making process to provide evidence to support the judgement as to whether each trading operation is significant or not.
- 13.4 The statutory trading accounts which the SORP requires to be disclosed within the statement of accounts will form part of the audit of the financial statements undertaken by the external auditor. This will include a consideration as to whether or not each statutory account has met the prescribed financial objective. Local authorities should therefore be prepared to demonstrate this. If the trading operation has not met the statutory break even requirement then the appointed auditor will add an explanatory paragraph to their certificate on the authority's statement of accounts stating that fact but without qualifying their opinion on the accounts of the authority.
- 13.5 The auditor will not be required consider the statutory break-even position until year 3 in the first cycle (refer to table 3). In practical terms the first financial year in which the auditor will be required to consider the statutory breakeven position will be 2005/6. Thereafter, the auditor will assess the achievement, or otherwise, of the prescribed financial objective of each 3 yearly cycle on an annual basis.

Glossary of Terms

The Local Government in Scotland Act 2003	Legislation introduced in April 2003 which introduced the statutory duty of Best Value upon local authorities. Also included within the Act was a statutory duty of community planning, the introduction of a power to advance well being and the requirement to adhere to proper accounting practice.
The SORP	The CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom - A Statement of Recommended Practice. The SORP sets out proper accounting practice for the statements of account. It requires the disclosure of the nature, turnover and surplus/deficit of significant trading operations and the cumulative surplus or deficit for the two preceding financial years.
BVACOP	The Best Value Accounting Code of Practice (BVACOP) which sets out proper accounting practice below the level of statements of account.
Trading Operation	Service delivery provided in a competitive environment and where the service recipient could receive that service from another source on a basis other than recharge of cost.
Significant	Where a trading operation is considered significant, trading accounts require to be disclosed and break even achieved. It can be determined by setting parameters and could include size of turnover, risk and stakeholder interest.
CCT	Compulsory competitive tendering. The statutory regime in place prior to the Local Government in Scotland Act 2003 which defined specific services which had to be delivered after market testing and which had to be accounted for separately.
Break even	The financial position at the end of the prescribed 3-year period whereby income is not less than expenditure

Trading Accounts	The revenue account which measures revenue income and revenue expenditure for a trading operation and which requires to be disclosed in accordance with proper accounting practice.
Best Value	The statutory requirement which requires that local authorities demonstrate continuous improvement in service delivery.
LASAAC	The Local Authority (Scotland) Accounts Advisory Committee. The body, which in Scotland makes recommendations to local authorities on the form of accounts and accounting practice.
Competitive Environment	Where users have discretion to use alternative providers. Discretion over the volume and/or quality of service but not the source does not count as 'competitive'.
Turnover	The total income of the trading operation, including any subsidies.