

# **LOCAL GOVERNMENT IN SCOTLAND ACT 2003**

**Advisory Notes  
from the Best Value Task Force**

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## **Trading Advisory Note**

(Version 1/2004)

# TRADING UNDER BEST VALUE – AN ADVISORY NOTE

## PREFACE

This document is issued by the Best Value Task Force in response to requests to provide a more discursive advisory note on trading. It does not form part of the statutory guidance. It is intended to support local authority senior managers in their interpretation of the relevant chapter (Chapter Six – Competitiveness, trading and the discharge of authority functions) of the main Task Force guidance “Characteristics of Best Value Arrangements” to which a local authority should have regard by virtue of s2 of the Local Government in Scotland Act 2003 (LGISA2003).

This document sets the context for, and is consistent with, the Chartered Institute of Public Finance and Accountancy (CIPFA)/Local Authority (Scotland) Accounts Advisory Committee (LASAAC) “Guidance note on Trading Accounts”, but it has been designed for a different audience. The CIPFA/LASAAC guidance note is addressed to Directors of Finance and helps local authorities ensure that they comply with their statutory obligation (under s12 of the Act) to observe proper accounting practices in the maintenance and disclosure of accounts for trading operations.

In exploring the rationale behind the requirement to maintain and publish trading accounts, this document does not try to offer technical advice on how such accounts should be maintained, and for which particular activities. Hopefully it will enable local authorities to form a better understanding of the role of trading under the Local Government in Scotland Act 2003, and so assist them in framing policies and practices relevant to their own individual circumstances.

## **BACKGROUND**

Three provisions in LGISA2003 are directly relevant to the issue of trading by local authorities, whether such trading relates to internal or external agreements. They are:

- (a) the duty to secure Best Value (and associated repeal of Compulsory Competitive Tendering (CCT) legislation)
- (b) the duty of Community planning
- (c) the Power to advance well-being.

The three measures are inter-connected. Together they create a new legislative framework which gives Councils real flexibility to identify, organise and deliver the best services for their local communities.

In addition, section 8 of the LGISA2003 amends the Local Authorities (Goods and Services) Act 1970 (LAGSA1970) so that the external agreements to which it applies relate only to trading operations, and defines those trading operations as those for which, under proper accounting practice, the local authority must keep trading accounts.

As a result, authorities are now free to structure services under a range of possibilities that previously were not available to them. They can approach the formation of partnerships and trading relationships with confidence, whether they are with other local authorities, community planning partners, the voluntary sector and (to a more limited extent) with the private sector.

The policy intention of the LGISA2003 is to remove barriers to innovation, but within a legislative framework that secures Best Value, including accountability for the use of public assets and public funds and encourages local authorities to keep within the parameters set by competition law and the rules on state aids. For avoidance of doubt, the policy intention is not to allow local authorities unfettered opportunities to expand trading simply to increase turnover and employment: with the added flexibility and freedoms created by the LGISA2003 goes a commensurate duty of responsibility to account for trading in an open and transparent manner.

## RATIONALE

The rationale behind the requirement to maintain and publish accounts for activities which are deemed to be “trading operations” of significant scale is accountability: to demonstrate to all stakeholders that decisions made by the authority on the organisation and delivery of these services meet the requirements of Best Value.

Stakeholders in sectors which might normally expect to tender for contracts with a local authority, such as in the local business and voluntary sectors, will be looking particularly for evidence that the local authority is basing its decisions about the provisions of services on sound business practice. They are also expected to look for evidence that the authority is having regard to its obligation to discharge the duty of Best Value in a way which contributes to the achievement of sustainable development, since this is commonly defined as being development which secures a balance of social, economic and environmental well-being in the impact of activities and decisions. The publication of trading accounts will not provide that evidence of itself, but it is intended to contribute to it.

It should be noted that this rationale is quite different in origin and purpose to the trading account requirements under CCT, which were instruments to give effect to the requirement to tender certain kinds of work (the “defined activities” such as building cleaning, roads and grounds maintenance, etc.).

It is therefore appropriate that Councils consider the issue of trading under the amended LAGSA1970 and Best Value with a new mindset, free from the assumptions which underpinned CCT. For example, whereas trading accounts required to be published for building cleaning under CCT but not for payroll services, it could well be that under Best Value the opposite will apply. The provisions within the LGISA2003 are not prescriptive, and each Council will require to examine its own arrangements before deciding which need to be labelled as “trading operations”. This will be a more complex position than applied under CCT where tendering provided for a definite, fixed outcome for a set time period, and where a fairly mechanistic regime applied.

Under Best Value, and the scope it allows for a range of options to be considered, the future may be more complex. The range of options could include in-house provision or externalisation as before, but equally could embrace a spectrum of hybrid options working with other public, private and voluntary organisations to deliver improvements to services. Which option is selected will emerge from the review and option appraisal mechanisms under Best Value, and it is certain that no single pattern will suit every Council across Scotland.

It is therefore neither desirable, nor possible, to set down prescription with regard to trading activities. Choices will be made by individual Councils on the organisation and delivery of their services, and the Councils will have to examine their choices to determine which result in a requirement to maintain and publish trading accounts. The CIPFA/LASAAC Guidance will assist with this task.

It may well be that as Community planning develops, or Councils make decisions to use the Power to advance well-being, they will require to revisit their arrangements for trading accounts in the light of the changing market place in which they operate. Both the duty of Community planning and the Power to advance well-being offer scope for external trading, i.e. the provision of services to individuals or organisations outwith the Council itself. The next section discusses the topic of external trading.

## **EXTERNAL TRADING**

Councils will require to consider the nature and purposes of their various activities, whatever their history, to see which come within the definition of trading activities. It may be helpful for Councils to recognise that a major reason for Trading Accounts to be kept and published is to establish that Councils are not undertaking work of a significant scale for the general public or other bodies at taxpayers' risk and expense when this same work could be better provided by others, nor that they are seeking to profit in any significant way from their tax exempt status in passing surplus goods and services to private individuals.

Indeed, in reviewing their services under this guidance, Councils should consider the following issues:

### **(a) Aims**

External trading should not be undertaken simply for its own sake nor to perpetuate historical practice. Councils should have clear, explicit reasons for work of this nature, which justify the associated balance of risks and rewards.

Legitimate reasons for undertaking trading outside the Council could include the following:

- Reduced cost to the Council by sharing of overheads
- Makes use of surplus capacity
- Shared gains of joint working through the Community planning process
- Reduced costs to partners be they public, private or voluntary
- Limited local alternatives or market failure
- Contributes to the Council's corporate goals in a way which cannot be better provided by an alternative provider (key links to the Power to advance well-being)
- Creation of critical mass of business to allow desired standards of technology, etc. to be justified
- Provides contribution to local economy which contributes to sustainable development
- Provides a degree of local market regulation

### (b) Impact Assessment

Dependent upon the scale in question, Councils must be mindful to a degree of the impact that their trading could potentially have on businesses that contribute to local employment and the local economy. Clearly, the spirit of wider trading freedom within the LGISA2003 is to remove unhelpful restrictions on sensible partnership working and enhance joint initiatives, not to encourage a monopoly of provision. Such assessments must form a core part of any decision-making process with clear linkage to the aims identified previously. The result of this appraisal may be twofold: it may alter the selected option or indeed, help re-enforce its need and suitability.

### (c) Best Value

Best Value has comprehensive application and Councils are reminded that the principles and practices of Best Value apply equally to those activities that require trading accounts under the Best Value Accounting Code of Practice (BVACOP) and to those which do not.

## **PUBLISHED TRADING ACCOUNTS**

This advisory note, and associated statutory guidance, relate to the requirement under the Act to publish accounts for activities that are deemed to be significant trading activities.

It is worthy of mention that the principles of Best Value would suggest that many, indeed most, activities operated by Councils should be supported by robust, business-like accounting which detail income and expenditure in a manner which permits activity-based costing, cost and process benchmarking and other tools of Best Value to be applied.

The existence of such management information systems does not, of course, imply an automatic requirement to publish trading accounts, and to achieve a break-even position for each activity within each rolling three-year period. For many activities, the trading accounts will have internal use only.

The BVACOP will define those activities, which require published trading accounts. The Code describes six categories of operations for which trading accounts are required:

- 1. Trading services to the public or with other third parties. These include, among others, catering undertakings, markets, commercial refuse collection and industrial units.**
- 2. External trading organisations which have won contracts from other public bodies.**
- 3. Continuing CCT arrangements where contracts are still being provided within the original specifications and periods.**
- 4. Work carried out by internal trading organisations arising from voluntary competitive tendering exercises.**
- 5. Support services provided in a free internal market, for example to schools or other budget holders who have been given the freedom to buy from other sources if they so wish.**

6. **Support services provided in a limited internal market, for example where budget holders are free to decide the quantity and type of work they wish to be done on the basis of quoted prices, but not to buy externally.**

The CIPFA/LASAAC Guidance focuses on three tests of whether trading accounts are required:

1. The test of “significance” is passed (with regard to scale).
2. The service is provided in a “competitive environment”, i.e. the user could go elsewhere for the service.
3. The service is provided on a basis other than straightforward recharge of costs.

For the purposes of illustration, some examples follow. All assume that the scale of work is deemed to be significant in terms of the Guidance.

1. **Printing Services** Council A operates a full-colour printing service by taking in work from other public sector bodies including the health sector and various local voluntary groups. All work is charged on a tariff, and Council departments are free to compare this tariff (among other factors) with alternative external printers and place work where they judge it to be most economical. This service will require to operate Trading Accounts.
2. **Payroll Services** The Finance Department of Council B undertakes payroll services for a Housing Association under the terms of a Stock Transfer agreement. Trading Accounts will be required for this work, again with due allocation of shared costs between the Council and the external work.
3. **Street Cleansing Operations** Council C has a revised regime of street cleansing work, provided only to the Council itself, and based on an agreed lump sum annual payment or on the basis of a year-end recharge based on work done. Although a former CCT activity, this work no longer falls within the definition of a Trading activity.
4. **Refuse Collection Services** Council D has an integrated service, which collects from all households and from some business premises. The former is paid on the basis of a lump sum or formula relating to the number of households, whilst the latter derives income from competitive charges levied to those customers who choose the Council against other potential collectors, Trading accounts require be to be kept for the commercial waste service, and will need to demonstrate a fair and transparent allocation of all costs which are shared by both the household and commercial waste streams.
5. **Architectural Services** Council E operates an Architectural Practice which secures commissions on a competitive basis for the Council itself, for the local Health Sector and for local Housing Associations based on a scale of fees determined by the scope and nature of the work undertaken. Trading accounts are required for this activity.

6. **School Meals** Council F delivers a school meals service and also generates Meals on Wheels for its Social Services. The school meals and Meals on Wheels have customer prices set by the Council and the entire catering operation is subsidised on a lump-sum basis under an internal Service Level Agreement. This service does not require to maintain Trading Accounts.

For further information on Best Value and the Local Government in Scotland Act 2003 (LGISA2003) please visit the Scottish Executive Website  
<http://www.scotland.gov.uk/bestvalue>

or

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