

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 formal external financial reporting and statutory financial disclosures.
- 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 Comprehensive Income and Expenditure Statement (in Northern Ireland, the District Fund Summary).
- 2.3 The use of total cost for less formal purposes, such as unpublished local performance indicators and cost benchmarking at lower levels of detail than required by Section 3, will also enhance the reliability and comparability of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, total cost may not be appropriate for management accounting and decision-making purposes. Costing for decision-making purposes will often require the use of different techniques; it will also require that all relevant costs, and only relevant costs, are taken into account, whether they form part of total cost or not. For example, there are strong arguments for reflecting the costs of early retirement 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 cost for external reporting and comparisons and other accounts for internal management purposes. Authorities will also need to decide whether a cost of capital element (to reflect the full cost of using fixed assets in the provision of a service) should be included in any costing for decision-making purposes.
 - 2.4.1 Notional interest is a fundamental part of the full cost of service provision and is a concept widely applied across the public services. However, notional

interest does not form part of total cost, and is not reported in the Comprehensive Income and Expenditure Statement.

- 2.4.2 There remain a number of circumstances where it may be appropriate to include notional interest in the definition of 'cost':

statutory reporting where the basis on which the calculation is to be performed is specified to include notional interest

fees and charges

recharges to the Housing Revenue Account and Pension Fund

pricing for competitive tender

cost comparisons and efficiency assessments

trading accounts

asset management.

- 2.4.3 In considering whether it is appropriate to include notional interest in the definition of 'cost', local authorities will need to ensure that they are using costing techniques that are appropriate to the circumstances. This may require the use of different techniques rather than simply incorporating notional interest into the BVACOP definition of total cost.

- 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 depend 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.

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.

Expenditure in Total Cost

- 2.11.1** 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 2.27 and 2.28 of Section 2 of BVACOP.

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

- 2.11.3** The *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) requires exceptional items to be included in the total cost of services to which they relate or on the face of the Comprehensive Income and Expenditure Statement (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 in the Comprehensive Income and Expenditure Statement, it should not be excluded from the total cost of the service for other external reporting requirements such as performance indicators.

- 2.11.4** 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.

- 2.11.5 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.

- 2.11.6 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. Such expenditure is clearly definable and is excluded from the Comprehensive Income and Expenditure Statement, except by way of disclosure, in the notes to the accounts, within the terms of the Code. Agency agreements are also subject to notice clauses that minimise the risk which, in other third party funding arrangements, might fall on the authority.

- 2.11.7 The move to the IFRS-based Code means that employee costs included in total cost will need to comply with IAS 19 *Employee Benefits*. For example, any accruals of holiday pay should be included in total cost.

- 2.12 Specifically, it includes depreciation calculated in accordance with the Code and with existing capital accounting guidance.

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

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Following the definition of capital expenditure as laid down in the Code.

Following the requirements and principles laid down in the Code for the valuation and revaluation of assets.

Using the principles and requirements prescribed by the Code for the depreciation of 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.

- 2.12.2 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.
- 2.12.3 The Code provides the requirements for the recognition and measurement of tangible assets. The incorporation of IAS 16 *Property, Plant and Equipment* into the Code ensures that assets are accounted for on a consistent basis and where revaluations are required that these are kept up to date. 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 in the United Kingdom – Guidance Notes for Practitioners*.
- 2.12.4 There are, however, management issues arising from the specification of depreciation as the charging basis for the use of 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.
- 2.12.5 It is considered that comparability is best served by adhering to the principles and requirements contained in the Code 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 Code.

- 2.12.6** The Code explicitly recognises that local authorities may have intangible 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.
- 2.13** Total cost also includes any related impairment loss or revaluation loss that is charged to Surplus or Deficit on the Provision of Services. Impairment losses or revaluation losses should be recognised in Other Comprehensive Income and Expenditure 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 losses. A revaluation gain should be credited to a service revenue account where it represents the reversal of a loss previously recognised. An impairment loss that has previously been charged to a service revenue account may only be reversed where there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. Impairment of an asset under construction should be charged to Non Distributed Costs. Where the asset under construction is an investment property, the impairment (or any movement in fair value in relation to an investment property under construction that is carried at fair value) will be shown in the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement, and will therefore not form part of total cost.
- 2.13.1** Assets held at fair value are revalued periodically. In addition, assets are assessed for impairment when there are indications that impairment may have occurred.
- 2.13.2** The Code provides the following examples of events and changes in circumstances that indicate that impairment may have occurred:
- a significant decline (ie more than expected as a result of the passage of time or normal use) in an asset's market value during the period (a smaller decline will be a revaluation loss)
 - evidence of obsolescence or physical damage of an asset
 - a commitment by the authority to undertake a significant reorganisation
 - a significant adverse change in the statutory or other regulatory environment in which the authority operates.

- 2.13.3 All impairments and revaluation losses 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 losses. In the latter case, the excess of the impairment or revaluation loss over the accumulated gains will also be chargeable as part of total cost, either in the service revenue account or, for assets under construction, in Non Distributed Costs. The process for reversing losses previously charged to a service revenue account depends on whether the loss was an impairment or a revaluation loss. Where a gain reverses a previous impairment loss that was recognised as part of total cost in a prior period, this gain may exceptionally be taken to the service revenue account (Non Distributed Costs for assets under construction) if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. However, any revaluation gain that reverses a revaluation loss previously recognised as part of total cost in a prior period may be taken to the service revenue account (Non Distributed Costs for assets under construction).
- 2.13.4 Costs associated with abortive capital schemes are not classed as impairment of assets under construction; these costs are a proper charge to the Surplus or Deficit on the Provision of Services and should be charged to the relevant service revenue account(s). Where a decision as to which service would have used the asset had not been taken (for example, where additional office accommodation was being provided but no decision as to the occupying service(s) had been taken), the costs should be apportioned between the possible users of the asset. Exceptionally, if the asset was to have been an investment property and therefore not related to the delivery of any service, the costs should be charged to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement. Costs should be included in the relevant subjective group. For example, staff costs relating to architectural plans would be included in Group 1 – Employees, but payments to external consultants for those plans would be included in Group 4 – Supplies and Services. Where an abortive scheme was to be funded by a capital grant or contribution, and the terms of the grant or contribution permit its use to fund the expenditure even if the scheme does not proceed, that part of the grant or contribution that relates to the abortive scheme should be recognised as a revenue grant or contribution. Where the terms of the grant or contribution do not permit its use to fund the expenditure if the scheme does not proceed, the costs of the abortive scheme will need to be met out of revenue resources (unless a direction allowing the expenditure to be capitalised has been given under section 16 of the Local

Government Act 2003 (England and Wales) or permission to borrow has been given by the Scottish Government).

2.13.5 Additional guidance on the accounting treatment of impairment and revaluation losses can also be found in CIPFA's publication *Code of Practice on Local Authority Accounting in the United Kingdom – Guidance Notes for Practitioners*.

2.14 Where legislation allows expenditure that does not result in an asset being carried on the Balance Sheet to be counted as capital for funding purposes, the Code requires such expenditure to be charged to Surplus or Deficit on the Provision of Services in accordance with the general provisions of the Code. 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 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.

2.14.1 The Code 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 Code requires revenue expenditure funded from capital under statute to be charged to the Comprehensive Income and Expenditure Statement. Such items will generally be those that qualify as capital expenditure under the statutory controls framework but do not result in an asset for the authority. Section 4.6 of the Code explains the treatment in more detail.

2.14.2 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. Paragraph 2.14 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.

- 2.14.3 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.

Accounts to be Charged for Capital Items

- 2.14.4 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).
- 2.14.5 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.
- 2.14.6 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.
- 2.14.7 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.

- 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 BVACOP. Note that Corporate and Democratic Core costs should receive an appropriate allocation of overheads.
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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.

Accounting for Overheads

- 2.15.1** The guidance on accounting for overheads is intended to consolidate and supersede a range of previous CIPFA guidance, including aspects of *The Management of Overheads in Local Authorities* and *Accounting for Central Services*. Further guidance on detailed overhead apportionment techniques entitled *Fair Shares?* was published by CIPFA in August 2003.
- 2.15.2** Users of support services expect to know what overheads they carry, how they are calculated and whether they can have any control over the amount charged.
- 2.15.3** While it is important that total cost includes an appropriate share of all overheads, there are other circumstances where the inclusion of the full range of overheads may not be appropriate. For example, management accounts may exclude from budget holders' reports any overheads for which they are not responsible. There may even be situations where an authority wishes to perform some cost benchmarking exercises, for management purposes, using a definition of cost which excludes specified overheads. Authorities clearly have discretion to do this, but care should be taken that, whatever alternative definition of cost is chosen, it can be consistently applied.

2.15.4 Guidance on Non Distributed Costs (NDC) can be found in paragraph 2.45 of BVACOP. Costs which fall within the Corporate and Democratic Core (CDC), including both Corporate Management (CM) and Democratic Representation and Management (DRM), are not overheads for this purpose; rather they are represented by their own SEA heading in Section 3.

Principles

2.15.5 Administrative overheads arise in service departments as well as in central departments. Service management costs also arise in all departments and these, like all overheads, require apportionment across the range of divisions of service affected. Both the general principles and this guidance apply equally to such service department overheads.

2.15.6 This guidance does not cover direct services, such as local tax collection, which in some authorities are managed centrally. Section 3 of BVACOP identifies all such direct services. A defining feature of overheads is that, for total cost purposes, they end up charged, allocated or apportioned to direct services, as defined in Section 3, rather than having a final service expenditure heading of their own. Accounting for them therefore requires the use of holding accounts.

2.15.7 There may be other holding accounts in use; for example, within Adult Social Care, a holding account may record the total costs of the home care service before they are apportioned across client groups. These are not overhead costs and are not covered by this guidance.

2.15.8 Nor does this guidance cover depreciation and impairment losses (see the guidance in paragraphs 2.12 and 2.13 of BVACOP) or direct costs such as for utilities, which are often paid for centrally and then recharged to users.

2.15.9 This guidance concentrates on the apportionment of overheads. Allocation, which is a matter of fact, does not give rise to the types of issue addressed in this section. For example, the allocation to operational units of the total costs of outgoing telephone calls can be based on the cost of calls made on the handsets used by each such unit, information on which will be available from the telephone bill.

2.15.10 Charging, the third method of recharging available, is based on an agreement between the user and the provider but is otherwise similar, in the bases that can be used and the issues that arise, to apportionment. The general principles that should apply to a charging regime and to the apportionment of overheads are the same.

Complete recharging of overheads

- 2.15.11 The general principle is that all overheads, support service and service management costs should be fully recharged to the service expenditure headings defined in Section 3 of BVACOP. Also, the costs of CDC and NDC should be allocated to separate objective heads and not allocated to any other head.
- 2.15.12 In this context, CDC costs are not overheads; rather, CM and DRM are service expenditure headings in their own right, to which many overheads will need to be apportioned.
- 2.15.13 Various types of cost may extend across more than one service expenditure heading and require apportionment; not all such costs are overheads. For example, the cost of meals on wheels is a direct service cost but it may require apportioning across different client groups, and thus different service expenditure headings.
- 2.15.14 Two features define apportionable overheads. One is that they end up charged, allocated or apportioned to direct services, as defined in Section 3, rather than having a final service expenditure heading of their own. The second is that they are 'overhead' in nature. In other words, they include service management, support services and certain other costs, such as insurance premiums, but they do not include costs such as grounds maintenance or other direct costs which, for convenience, are initially accounted for within a holding or trading account.
- 2.15.15 Some overhead costs are service specific, eg force command within the Police Service; others are of a more general, administrative nature, eg finance or legal. These latter can arise either in service departments or in central departments.
- 2.15.16 In some authorities, there may be a support activity which relates only to one SEA. For example, committee administration may support only DRM. However, this is still an overhead, albeit 100% allocated to DRM. In other authorities, the committee administration section may support officer-only groups and a more complex apportionment process may be required.

Correct recipients

- 2.15.17 The general principle is that apportionments should be made to each of the services benefiting from the support (or overhead). In Section 3, BVACOP has deemed that the level of detail for final apportionments must be at division of service level, or lower if required by specific performance indicators. However,

because authorities may wish to calculate total cost at lower levels of detail for their own purposes, it may be that apportionments to subdivisions of service, or even to individual cost centres, are required.

- 2.15.18** It is likely to be the case that, as more detailed calculations of total cost are required, more issues will arise concerning precisely who is benefiting from a support service or other overhead. However, even at service level, there may be some areas where apportionments are particularly difficult, for example between General Fund housing and the Housing Revenue Account (HRA). Here, it is important to balance fairly the interests of council tax payers and tenants.
- 2.15.19** Getting the recipients correct can also have a significant impact on trading accounts. For example, if personnel are working for a transport section, they need to be aware of the significance of distinguishing carefully between work involving minibuses (whose costs are met from the General Fund, eg Children's and Education Services or Adult Social Care) and work involving mechanics, whose costs and overheads are charged to a trading operation.
- 2.15.20** Another issue arises as a result of the increasing mismatch between the accounting structure as represented by the SEA and individual authorities' management structures. Support service providers will immediately be clear which part of the management structure is commissioning work, but it may not be so apparent which SEA the cost should be charged to. In this situation, the onus must be on the person commissioning to make it clear to the provider which SEA is to pay. Where work is provider led, the extent of any problem will depend on the apportionment basis used but, in any event, care should be taken to identify the correct division of service to receive the recharge.
- 2.15.21** A specific issue may arise when an external contractor is using a support service at no charge. On the basis that the amount the authority is paying for their services should be less than would otherwise have been the case, the apportionment should be made to the clients of the contractor's service, because it is they who are indirectly benefiting.

Transparency

- 2.15.22** Recipients must be clear what each recharge covers and be provided with sufficient information to enable them to challenge the approach being followed. This requires a number of features to be present in the apportionment system.
- 2.15.23** The first is that information about the bases of apportionments is given in a

sufficient level of detail. A lump-sum recharge covering the whole range of financial services is unlikely to be acceptable to users and, from a provider's perspective, more detail than this will be required to calculate apportionments in any event. However, there are levels of detail below which it may not be sensible to go. For example, there are some extremely complex calculation bases for IT services, using a dozen or more sub-headings, including, for example, a specific charge for relocating a computer terminal. It is not good practice to spend undue time or other resources in getting unnecessarily precise figures.

- 2.15.24 Also, although this level of detail may be considered necessary for the initial calculation of apportionments and for the monitoring of costs thereafter, it may be counter-productive to make the actual recharge to users at that same level of detail. On the other hand, any specific recharges where users can influence the amount by their actions will need to be identified separately so that they can see this occur. It is important not only that users are aware of the extent to which they can influence the level of the recharge, but also that they can see this responsiveness in action.
- 2.15.25 The actual level of detail used for the calculation of recharges should be agreed between the user and the provider in each case. However, as a minimum, all elements of the recharge that respond to specific user action should be identified. It will probably also be necessary to identify separately the elements that relate to different outputs (eg training separate from industrial relations work).
- 2.15.26 Users will also need to receive regular information on recharges, since even where they do not control these elements of cost, they will still feature within their total cost and therefore be of concern. Where users have no control over the level of recharges they receive, ie when they are all done by apportionments, they should receive information at least twice a year – once at the year-end as part of the formal total cost reporting and once at an earlier stage to enable the approach, if not actually the figures, to be challenged.
- 2.15.27 For some authorities, who fix apportionments at budget time and then revisit them only in exceptional cases, this earlier reporting would be part of the budget; for others it may be later in the year, most likely at the revised estimate stage.

Flexibility

- 2.15.28 The recharging arrangements must be sufficiently flexible to allow recharges

to be made regularly enough and to a level of detail appropriate to meeting both users' and providers' needs. In other words, as well as routine, regular apportionments, it should be possible to meet the ad hoc requirements of either party.

- 2.15.29 In terms of timing, the main requirement of the apportionment system will be to support the calculation of total costs at least at the end of each financial year for the production of the annual accounts, statistical returns, etc since full apportionments will be required at this time. Calculations will also be required of budgeted and estimated outturn figures to fit in with the timetable for the production of performance indicators and reports.
- 2.15.30 For other purposes, for example a cost benchmarking or activity-based costing exercise, separate total cost calculations will be required. This would entail making apportionments as and when such an exercise requires them to be made. The system should be flexible enough to deliver such apportionments whenever needed.
- 2.15.31 There may also be cases where more detailed apportionments than to division of service level may be required on a regular basis for management reasons, even though they are not required by BVACOP. For example, where there is any sort of client/contractor or purchaser/provider split in place within a division of service, however informal, it may be that the total costs of each activity is required. A specific example might be within the Adult Social Care client group divisions of service, where the total cost of assessment and care management, on the one hand, and service provision, on the other, may be required. To provide service managers with flexibility, the apportionment system should be capable of meeting this requirement, even if it is identified after the system is established.
- 2.15.32 Clearly, once overheads have been apportioned to any cost centre at or below division of service level, the accounting system will aggregate them automatically to the required level. When regular detailed apportionments are required, therefore, they should be calculated on the same rigorous, top-down basis as is required for the Statement of Accounts, performance indicators, etc and implemented using the main accounting system.
- 2.15.33 However, a distinction should be acknowledged between formal, regular apportionments of this sort and the calculation of total costs for ad hoc management reasons. The former need to be as accurate as possible to comply with BVACOP, and the comprehensive, top-down, ledger-based approach will help to deliver that accuracy.
- 2.15.34 For the more ad hoc calculations of total cost for management purposes, such

as benchmarking or activity-based costing, which are likely to relate to smaller elements of service, a different approach may be considered acceptable. The intention should still be to bring in the total cost of whatever activity or element of service is being considered, but this could be done on a bottom-up basis, identifying and costing the appropriate overheads only so far as they relate to that activity or element of service. A less than comprehensive approach, which does not apportion overhead costs down across the full range of services, runs the risk of being less accurate, but management discretion should be applied to the balance between the accuracy achieved and the effort required to achieve it.

2.15.35 This judgement also needs to take account of the risk of disagreements between figures calculated top-down (eg by Finance) and those calculated bottom-up (eg by service managers). If both calculations are done, they are almost inevitably going to reach different answers and a time-consuming reconciliation exercise may be required. To avoid this, the general guidance is therefore that total cost calculations should be based on a top-down approach wherever possible. This ensures that all costs are included once and only once, since there is a control total to work to. It should also improve the reliability of the results since all users can challenge their own, and other people's, apportionments.

Reality

2.15.36 Recharging arrangements should result in a distribution of actual costs that has a basis in fact. For apportionments, such a link clearly cannot be direct, or the apportionment would actually be an allocation. However, since the purpose of total cost is to reflect real cost levels, a main aim of the apportionment process must be to support that.

2.15.37 This has a number of consequences. The first is that there should be a link between the cost to a user and the benefit they receive. This link is clearest in an apportionment system that is based on the outputs of the support service and, for that reason, output-based approaches are generally to be preferred. It is acknowledged, however, that this may not be practical in all areas, at least in the short term.

2.15.38 A second consequence relates to cross-subsidisation between users. In the past, this has been viewed as unsatisfactory, largely for equity reasons. The concept of total cost precludes any cross-subsidisation between users. This means that, as a matter of principle, the same apportionment basis should be applied for all users (including trading accounts). Where a charging regime is in place, there may be some scope for differential charging, but differential

apportionment is not good practice and should be avoided.

- 2.15.39** A particular issue arises if some users are charged for a particular service using a service level agreement (SLA) and others receive their recharge by way of apportionment. In this case, the key requirement is that the two arrangements generally equate; in other words, that there is no advantage to users as a consequence of their being in one regime rather than the other.
- 2.15.40** This common approach to apportionments should apply at least down to division of service level. If apportionments are made below that level, then the same principles should apply, especially that all users should receive a 'fair share' of the apportionment. However, it may be considered appropriate to leave the detail of how such lower-level apportionments are made to the appropriate service manager.
- 2.15.41** A related issue concerns what could be regarded as cross-subsidy over time and the extent to which the concept of total cost allows the 'lumpiness' of certain costs, ie costs which, for an individual user, can vary a lot from year to year, to be 'smoothed out'. It is clear that such variability in the costs of, for example, internal audit, is not a reason for regarding such costs as 'corporate'.
- 2.15.42** Other areas of support service cost which are potentially 'lumpy' from the perspective of individual users are supporting service departments in reviews, IT developments and the costs of industrial tribunals or legal cases. To a lesser extent, costs such as staff development can vary from year to year in any one department, even if overall, across the authority, they are similar. Variations such as these can arise because of users' demands, eg for systems development, because of corporate or providers' requirements, eg audit investigations or reviews, or as a result of external events, eg insurable risks or legal cases.
- 2.15.43** The principle of 'reality' does not allow for the 'smoothing' of variations such as these. Overhead apportionments should be based on actual costs and reflect actual support levels to each user in the year in question. This means that not only should all overhead costs be written off in the year in which they are incurred, leading to potential fluctuations in the total apportioned, but also that each user's share of the total could, in some circumstances, vary significantly between years.
- 2.15.44** It is acknowledged that any such variations in total costs from year to year may be reflected in performance indicators. However, such variations will be explicable as part of the investigation of differences, whether between years or between authorities. To allow variations to be masked would undermine the credibility of the figures more than would be the case if fluctuations were

evident.

- 2.15.45 Also relevant to this issue is the guidance in paragraph 2.11 of BVACOP as regards exceptional expenditure. This is clear that such expenditure should form part of the relevant total cost even though, by definition, it is 'lumpy'.
- 2.15.46 A related issue concerns the pooling of costs across users. This has most frequently been done in the context of office accommodation where, often for historical reasons, some services are located in offices that cost more than others, even though the quality of the accommodation is similar, and they have no choice about this. Often, property allocation is treated as a corporate issue.
- 2.15.47 It is argued that, in this situation, services occupying more expensive property should not be penalised for this and that costs should be pooled and then apportioned on an equal basis (usually £n per square metre). It is clear that, where users do have choice as to which property they occupy, pooling should not apply, since pooling would obscure the consequences of them exercising this choice. However, it is also the case under the total costing regime that no pooling of property costs should be allowed.
- 2.15.48 Where property differs in quality or where different maintenance standards apply, then under the principle of 'reality', the apportionment system should reflect this. For example, a charge for property maintenance per square metre could be set at three levels: high for rooms that are required to be expensively decorated (eg members' and public rooms), medium for most normal space and low for 'scruffy' accommodation, such as depots.
- 2.15.49 There are other examples of where an apportionment system should reflect differences in the quality of the support service received. For example, although it will be normal practice to charge all accountants of a similar grade at the same rate, there may be a situation where a user wishes to pay extra for the services of a specified accountant with particularly relevant experience.

Predictability/stability

- 2.15.50 Recharges should be as predictable as possible, although there will be practical limitations to this, not least users' requirement for some flexibility in the amount of a support service they use and therefore pay for. This can have knock-on effects on other users and the apportionment system needs to strike an appropriate balance between providing each user with the flexibility they want to vary their cost by varying their demand, and the requirement of other users not to suffer unpredictable adverse effects as a consequence.

Predictability is of particular importance to users who themselves aim to recover their costs.

- 2.15.51 Minimising these adverse consequences is an issue that support service providers need to address by managing their volume of activity because, although there is scope within the definition of Non Distributed Costs for spare IT capacity to be held centrally if no one is using it and it cannot be disposed of, this is not the case for support services.
- 2.15.52 Central support staff will not be left sitting idle. Either support staff numbers will be reduced or they will spend the time freed up by reduced demands from one user working on behalf of other users. This latter course will increase the apportionments made to these other users, without them necessarily being aware of this in advance, to compensate for the reduction in apportionment achieved by the user whose demands reduced.
- 2.15.53 Even without a formal SLA, the solution to issues such as this lies in communication between providers and users. The provider needs to establish whether the other users actually require more service, in which case they should not object to the apportionment increasing. If they do not, then the solution is to manage down the total volume of service provided as soon as is achievable, with all users, including the one (or more) who initiated the decline, carrying a higher cost than they would wish in the interim.
- 2.15.54 In addition to the predictability of the actual recharge, there should also be stability in the method of calculation and apportionment of overheads. Therefore, it is desirable that there is stability in the method of accounting for recharges, with any change in apportionment methods being justified and undertaken in consultation with users.

Materiality

- 2.15.55 It is unlikely that a simple system will be adequate to meet all the other requirements noted in this chapter. However, due regard should be given to materiality to minimise the effort involved in running the system so that the quest for 'accurate' apportionments does not turn the process into a bureaucracy whose costs outweigh the benefits achieved.
- 2.15.56 There are many areas where the issue of materiality is important. For example, in the context of apportionments based on time recording systems, it is often tempting to offer people a large number of different activity codes to collect quite detailed information in case it is required at a later date for some reason. A long list of codes may be important to catch the occasional quarter of an hour spent on a particular activity, but it can also be very

daunting and put people off accurate completion of their time record, thus defeating the object, as well as causing resentment about the time it takes to complete.

- 2.15.57 Another would be where support services provide services to each other. If the extent of this is not material, in order to prevent complicated tail-chasing, the recharges between them can be left out of apportionment calculations.
- 2.15.58 Other examples might be where a service manager spends a very small amount of time on corporate or democratic management but, for reasons of materiality, this is not taken into account and they are deemed to be 100% service management. A similar situation may arise if a staff member moves temporarily to another area of work, for example to cover for someone off sick. If this is for a very short period then it may not be considered material enough for any adjustments to be made.
- 2.15.59 There are also materiality issues about how often it is necessary to recalculate the base data used to calculate apportionments, for example proportions of time spent on various activities or floor space occupied. These should be recalculated whenever there is reason to suppose that they may have changed by a material amount, and at least annually.

Impact on Charging Systems

- 2.15.60 Charging systems are a way of spreading the costs of support services between users which, whilst they may use the same bases as equivalent apportionment systems, are founded on an agreement, often called a service level agreement, between the provider and the various users. In principle, charging systems could also apply to other overheads such as office accommodation.
- 2.15.61 A fundamental requirement of a charging system is that all parties are clear that such a system is in operation. There are situations in which an apportionment system may be preferred, and there are situations in which charging may be preferred; but hybrid systems, typified by above-the-line apportionments, are not good practice and should be avoided.
- 2.15.62 It should be noted that the accounting arrangements for charging regimes are not fundamentally different to those required under apportionment arrangements. Charging regimes will be associated with providers' trading accounts, which may have a balance at the end of the year (subject to the requirements of BVACOP), whereas apportionments will be associated with holding accounts, which will always be cleared out at the end of each year.

2.15.63 Charging systems should follow the same general principles as apportionment systems but the application of those principles raises particular issues, covered below.

Complete recharging of overheads

2.15.64 Application of this principle implies that the charges set for any service should be such that the provider recovers their costs over the course of the year. The total cost concept takes this further by requiring that the provider's trading account does not have a material balance on it at all at the end of the year, whether deficit or surplus.

2.15.65 Paragraph 2.36 of BVACOP includes the requirement for the reapportionment of any balance on a provider's trading account, for total cost reporting purposes, if failure to do so would materially misstate one or more of the published total costs. For this requirement not to undermine the SLAs and charging processes, it is important to try to ensure that such significant balances only arise in occasional, specific and therefore readily explicable circumstances. For example, the support service provider may, with users' agreement, be accumulating 'reserves' over a specified period to spend on a particular piece of equipment.

Correct recipients

2.15.66 The particular issue that may arise here is the need to ensure that all affected budget holders are properly involved in the negotiation of the SLA in circumstances where the agreement is primarily between two departments, as defined in structural terms. For example, if the school library service is managed by another department, eg Cultural Services on behalf of Children's and Education Services, and there is an agreement between Finance and Cultural Services, this is likely to cover financial services provided to the whole Cultural Services department. However, some of the resulting charge will be borne by the Children's and Education Services SEA, and so the budget holder for this aspect of education should also be a party to the SLA.

2.15.67 There may also be issues about how the charge that results from the application of the SLA is distributed between the various divisions of service covered. This may be immediately apparent because of the basis used for the charge but, if not, there would be merit in covering it explicitly within the SLA to prevent subsequent disagreements.

Transparency

2.15.68 This is not usually an issue within charging regimes since the requirements for clarity about what is covered by each aspect of the agreement, the basis of the charge and at what level of detail it is calculated, as well as the various associated information requirements, should be covered within the SLA.

Flexibility

2.15.69 Similarly, issues about the extent to which users can request more detailed information about their charges, to enable them to carry out more detailed costings, either regularly or on an ad hoc basis, should be spelt out in the SLA.

Reality

2.15.70 The concept of total cost and the reality principle do not allow for anything other than the cost of support services to be included within total cost. This would not allow for any of the sort of cross-subsidisation between users, or between users and providers, that can result if a charging mechanism is used. However, because of the nature of support services, there is no way of reflecting their cost accurately in this way in any event, and the issue, therefore, is to ensure that the negotiated charges are in no sense less accurate than the alternative of apportionments.

2.15.71 There are certain constraints on the parties' freedom to negotiate charges, not least the statutory requirement for the main revenue and capital accounts to reflect expenditure. This means that the charges made to each user must at least cover the costs that result directly from their use of the support service. Fixed costs must be recovered too, so charges must be pitched with a view to avoiding a loss on any support service overall. The scope for negotiations about charges is therefore effectively about how much each user contributes to fixed costs.

2.15.72 Even this is constrained, however, by the need, under the total cost concept, for cross-subsidisation between users to be minimised. So, for reasons that parallel those detailed above in respect of apportionments, the same basic charging structure should be applied for all users (including trading accounts). Users' freedom to negotiate the cost to themselves would thus depend on things such as the level, quality or speed of service they require of the support service, and not, for example, on the basic unit cost charged.

2.15.73 Charging systems are often designed to influence behaviour; for example, in some cases a user would be required to pay more for a printing job that was required particularly quickly or at short notice. This also means that the cost

to users is not a reflection of the 'true' cost of the service they have received. However, provided the same basis applies to, and has been agreed by, all users, there is no reason to argue that it is not accurate enough for total cost purposes. Indeed, similar charging structures are applied by external printers.

- 2.15.74 Where charging systems are designed to influence users' behaviour, it is particularly important that information on charges is fed back to users promptly or they will not realise that they have triggered the surcharge, or equivalent, to which they are expected to respond.
- 2.15.75 Similarly, if there are penalty clauses within the SLA which give users a reduced charge for performance that falls short of specified quality standards on the part of providers, then the provider will need to respond quickly to address these shortcomings. If they respond too slowly and receive less income than expected, this may lead to a year-end deficit which may be material enough to require reapportionment back out to the users. This would clearly undermine the original 'rebate' intention, although the real aim of maintaining or at least restoring agreed quality standards would have been achieved.
- 2.15.76 The other 'reality' issues identified within 2.15.36–2.15.49 above will also affect charging regimes but it is acknowledged that changing SLAs to use more output measures, to eliminate smoothing and pooling and to ensure a consistent charging basis for all users, at least to division of service level, will require negotiation with users. As part of this, users are likely to require quantification of the impact of the changes so that they can assess any consequential impact on their performance indicators and other total costs.

Predictability/stability

- 2.15.77 The requirement for predictability is often a major reason why users and providers participate in a charging regime. One specific consequence of such a regime is the way in which redundant support services are dealt with. Under their SLA, users will have agreed to a particular level of service for a fixed period. This gives providers (and other users) some stability over that period. As the end of that period approaches, the SLA will require renegotiation and, if there is a desire on the user's part to adjust their volume (up or down), the provider will need to respond by altering the total volume of service provided so that there is no adverse effect on the costs borne by any other user. The notice period should be set to enable this to happen.

Materiality

- 2.15.78 One important materiality issue that arises under charging regimes is the level of detail which needs to be built into SLAs. Indeed, the bureaucratic nature of some early examples put others off charging regimes altogether. As with apportionment systems, there is a need to have regard to the balance between the efforts involved in an 'accurate' system and the benefits which result.
- 2.15.79 The materiality issues identified in 2.15.55–2.15.59 are also relevant to charging regimes but they may need consideration earlier, at the time when the SLA is negotiated. For example, in an apportionment system materiality is an issue in determining how often the base data used to calculate the amount of the apportionment should be reviewed. Where a charging system is in operation, the SLA should specify how often such reviews take place. At the time when this agreement is reached it will be necessary to take account of how quickly such data may change and the effort involved in recalculating charges. Users should then receive updated information whenever such reviews take place to ensure that they are receiving the most accurate information possible as the year progresses.
- 2.15.80 There is also one additional materiality issue that arises when a charging regime is in place, and that concerns when it is necessary to apportion back to users the surpluses or deficits on providers' trading accounts. This has already been referred to in paragraph 2.15.65, as have the difficulties which would result from such a reapportionment. The most important aim is therefore to ensure that no material balances arise, at least unintentionally, but each authority, with its auditor, will need to determine materiality in this context as in all others.

Impact on Specific Services

- 2.15.81 The seven general principles identified apply equally to all services and to all users, including trading accounts and non-General Fund services such as the HRA and pension funds, as far as the calculation of total cost is concerned. However, there are some particular issues which arise in some services, as a result of either legislative or other reporting requirements, and these are considered below.

Housing Revenue Account

- 2.15.82 Although the direct costs which may be charged to the HRA are defined, there is no statutory definition about how overheads can or cannot be apportioned

to it. Authorities should therefore apply the same bases when recharging overheads to the HRA as they do for other services, in accordance with the 'reality' principle.

- 2.15.83 CDC and NDC are not overheads and are therefore not allocated or apportioned to services. However, the HRA will benefit from the overall democratic process and corporate management reflected in CDC. In addition, some of the costs in NDC may have arisen from previous HRA activities.
- 2.15.84 For these reasons, the HRA is permitted to make contributions to CDC and NDC provided these comply with the statutory framework for the HRA (see paragraphs 6.0 and 6.1 and 9.0–9.2, Central Services, Section 3).
- 2.15.85 This contribution by the HRA, which is outside its total cost, should be determined by each authority according to principles that it can explain and justify. For example, one possibility would be to consider the extent to which CDC and NDC would reduce if the authority transferred all its housing stock and closed its HRA. If this was the amount of the HRA contribution it would lead to comparable costs being carried by the General Fund by authorities with and without HRAs. Alternatively, it could be done on an average rather than on a marginal basis, assessing a reasonable HRA contribution towards each CDC/NDC heading.

Pension funds

- 2.15.86 As for the HRA, there is no statutory definition about how administration costs and other overheads can or cannot be apportioned to pension funds, provided they can be justified. Authorities should therefore apply the same bases when apportioning or charging overheads to the pension fund as they do for other services. If changing the apportionment bases gives rise to liquidity issues, these should be addressed at the next revaluation.
- 2.15.87 Where, however, admitted bodies are required to contribute towards such administration costs, there should be a clear link between the charge made and the actual costs incurred. There should also be consultation with admitted bodies about the basis of the charge and they should be provided with appropriate supporting information.

Schools

- 2.15.88 The main issue here arises as a result of the differences between the accounting framework for education as defined by BVACOP and the reporting requirements, which relate to funding, imposed by the DCSF on education authorities in England and Wales. These place pressure on such authorities to

include on their section 52 returns as high a proportion of delegated expenditure as possible.

2.15.89 Another potential issue in the context of schools is that it may be difficult to reapportion back to them any share of a trading account surplus or deficit (see paragraph 2.15.65), making it particularly important to try to avoid the need for such a reapportionment.

Other services

2.15.90 There may be other services or activities in individual authorities that give rise to particular issues in the context of recharging overheads, especially where a change to the bases used gives rise to a significant change in total cost. For example, all trading or ring-fenced accounts, such as building control, which recover their costs through charging, may find their overall trading position altered.

2.15.91 Arrangements involving partnerships and work for external bodies may also be affected if total cost is used as a feature within the funding arrangement and if total costs change as a consequence of reviewing overhead recharge systems.

2.15.92 In all these cases, authorities will need to have regard both to the need to apply the general principles laid out here and to the impact that their detailed recharging arrangements, within these principles, may have on the services concerned.

2.16 The physical nature of property, plant and equipment means that depreciation and impairment can usually be identified as a direct cost for services. However, where there is shared use of the assets and depreciation and impairment need to be apportioned to the service headings defined in Section 3 of BVACOP, the seven principles listed in 2.15 above will apply.

2.16.1 It will usually be clear which division of service is occupying a particular property or using a particular vehicle. Examples of where this may not be the case, and costs would need to be apportioned, include:

sports centres in schools might provide education services by day and leisure services in the evening

an authority might have pooled arrangements for its vehicle fleet

civic centres are often multi-functional buildings accommodating both direct services to the public and support services.

2.16.2 Where an apportionment of depreciation and impairment losses to divisions of service is necessary, then the seven principles of apportionment defined in

paragraph 2.15 of BVACOP should be applied. It is important to note that there may be occasions where total cost, including attributable depreciation and impairment losses, will need to be reported at a subdivision of service level. In such cases, the seven principles of apportionment will also apply.

Complete recharging of overheads

- 2.16.3 Depreciation and impairment losses should be fully recharged to service expenditure headings as defined in Section 3 of BVACOP (including CDC) except where the depreciation and impairment losses fully satisfy the definition of Non Distributed Costs (see paragraph 2.45).
- 2.16.4 Authorities will have to consider carefully why assets might be unused before withholding depreciation and impairment losses from apportionment:

It will not always be the case that assets can be used to their full capacity. It will often be unavoidable, if assets are to be made available to services as required, that there will be surplus capacity. The costs of this surplus capacity should normally be recharged to users. For instance, Children's and Education Services would not expect to be able to avoid depreciation and impairment losses on schools premises whilst they stood empty during holidays. Users of a vehicle from pooled transport provision should expect to be charged with a share of the costs of 'idle time' for cars, rather than just the direct costs incurred in 'drive time'.

Where parts of an asset are not used at all (eg a floor of an office building), then the costs of this type of surplus capacity might exceptionally be withheld on the specific conditions that:

The assets are long-term unused but unrealisable assets (ie are NDC) – this requires that there is no possibility of the surplus capacity being disposed of by sale, lease or rental or being applied for an alternative use by the authority. These circumstances will be rare – a floor in an office building would have to be incapable of disposal (eg being held under a non-cancellable lease) and unusable for an authority's remaining functions (perhaps because the assets are specialised).

The assets are surplus to requirements (ie are non-operational) – this requires that a separate asset can be identified that is recognised as surplus to the requirements of any particular service and therefore any charge is within the definition of NDC. It is not necessary for the property to be formally declared surplus, but there must not be any sense in which a service is seeking to achieve a policy objective through the continued ownership of the asset. For example, if a floor

of an office building is vacant and no service has a current or future policy objective that is in any way dependent upon occupation of the space, then it might be determined that this is non-operational. However, if an Adult Social Care department is short of resources and 'mothballs' a wing of a residential home in the hope that it can be reopened when resources become available again, then the asset is being held for a policy objective and remains operational.

Correct recipients

- 2.16.5 Depreciation and impairment losses should be apportioned to each of the services defined in Section 3 of BVACOP benefiting from the use of the relevant fixed asset. Again, it is recognised that the services defined by BVACOP are not likely to match the organisational structure of the authority. Property and transport managers (and other asset managers) will need to ensure that they have the appropriate systems necessary to identify recipients for both the organisational structure of the authority and the BVACOP divisions of service. Their basic format will, however, be no different than for overhead apportionment systems.
- 2.16.6 The requirement to charge client services for the use of support services by external contractors at no charge will be particularly important in relation to fixed asset costs. See paragraph 2.14.7.

Transparency

- 2.16.7 The principle of transparency is more difficult to apply for depreciation and impairment losses because of the greater difficulties for service managers in understanding the implications of receiving depreciation and impairment charges. This makes it more important that recipients are clear what each recharge covers and are provided with sufficient information to enable them to challenge the approach being followed.
- 2.16.8 Where service users have depreciation and impairment losses apportioned to them, then they should be provided with information about the assets on which the charge is based. This would include, as a minimum, the value of the assets, the basis on which depreciation and impairment losses are calculated, and the basis on which their apportionment of the total charge has been determined.
- 2.16.9 Any recharges made should show separately the element comprising depreciation and impairment losses if users are able to influence this specific amount of the recharge. However, this will not be necessary in all cases. For

example, property recharges might include an apportionment of running costs as well as depreciation and impairment losses. If all of these costs are variable, depending on the extent to which a building might be occupied or a vehicle used, then the service manager might not need to know what element specifically comprises depreciation and impairment losses.

Flexibility

- 2.16.10** It is good practice for authorities to prepare budgeted and estimated outturn figures for depreciation and impairment losses, rather than just total cost for the production of the annual accounts. This enables budgeted performance indicators to be compared with the outturn figures.
- 2.16.11** Depreciation and impairment losses might change significantly between budget and outturn as fixed assets are acquired, disposed of, revalued, changed in use or impaired during the year. For example, if a school was destroyed by fire, this could result in a significant impairment charge for Children's and Education Services. The flexibility of recharging arrangements will depend on the extent to which an authority has decided that depreciation and impairment losses should be an absolute charge against budgets or benchmark figures, such that a change in the depreciation and impairment losses charge might result in a change in operations. This would entail making apportionments as and when significant changes take place.
- 2.16.12** The relationship between the basis of apportionment of depreciation and impairment losses and usage of the asset is important for one-off costing exercises for reviews. Any attempts at estimating an activity or outcome will also need to estimate the cost of depreciation and impairment losses – the accuracy of such estimates will be reliant on the ability to relate usage to depreciation and impairment losses.

Reality

- 2.16.13** Most depreciation and impairment losses can be directly identified to specific cost centres because of exclusive use of the relevant asset. Where apportionment is necessary, recharges should reflect real cost levels.
- 2.16.14** In terms of making a link between the cost to a user and the benefit they receive, the main issue will be the charging basis for fixed assets. For example, it will usually be reasonable to charge for use of buildings based on the time of occupation for multi-functional use of the building or office; if the building is simply shared with other users then a 'traditional' apportionment basis of floor space is likely to be appropriate. Vehicles might more fairly be

recharged on the basis of the intensity of use (eg mileage).

2.16.15 Depreciation and impairment losses have a potential to be lumpy, but the principle of reality does not allow for smoothing. The main causes of significant variations between years will be:

Acquisition or disposal of assets – resultant changes in depreciation and impairment losses should clearly be reflected in total cost.

Impairments of assets – where this has resulted in the exceptional consumption of the economic benefits inherent in assets, this should be recorded in the year the impairment has occurred, even where the charge would be very substantial (eg school arson). The significance should be marked by explanations of the charge, rather than attempts to avoid it.

Effect of revaluations – where assets are revalued every five years, this might result in a significant jump in depreciation between year 5 and year 6. Where this occurs, this could be an indication that the five-yearly revaluation is not appropriate and that assets may need to be revalued more regularly. CIPFA guidance on capital accounting recommends that each year-end the chief finance officer should consider with the valuer whether or not trends in property values have changed or varied materially and reassess the planned valuation programme.

2.16.16 The prohibition of pooling costs of property across users is discussed in paragraphs 2.15.46 and 2.15.47.

Predictability/stability

2.16.17 Recharges should be as predictable as possible, although this does not mean that they should be fixed. Service managers need to be assisted in understanding how apportionments of depreciation and impairment losses might change if their use of fixed assets changes.

2.16.18 The basis of apportionment should be the same for all users of the assets and there should also be stability in the method of apportionment of depreciation and impairment losses. The application of this principle is less likely to be a problem, depending on the accuracy and the sophistication of the systems used. There may, however, be a real need to reflect the reality of a change in the valuation of the assets as described in paragraph 2.16.15 above.

Materiality

2.16.19 The principle of materiality applies equally to depreciation and impairment losses as to overhead apportionment.

Conclusions

- 2.16.20** The inclusion of depreciation and impairment losses in the definition of total cost means that performance information will reflect the consumption of economic benefit of the fixed assets used by a service. Service managers and external stakeholders are therefore likely to be more interested in and challenge any 'non-controllable costs' to the service and will be encouraged to use assets more effectively. This, and the implications of the need for depreciation and impairment charges apportionment, will mean that it is increasingly necessary that asset registers have accurate, up-to-date and timely information that is continuously reviewed and reflects asset usage by the services of the authority.
- 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 material 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 and in cost-based performance indicators, whether local or national (this may require the adjustment of opening balances for cumulative effect).
- 2.18.1** 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.
- 2.18.2** 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 material errors. All formal reports of total cost should reflect and disclose such prior period adjustments where relevant. 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.
- 2.18.3** 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.

- 2.18.4 This treatment should be reflected in the reported total cost of a service in formal financial statements of performance. The main impact on reporting requirements of prior period adjustments will be on reports of total cost in the Statement of Accounts, in formal financial statements of performance and in cost-based performance indicators (whether local or national).
- 2.18.5 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.
- 2.18.6 The cumulative effect of any material 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 material error or change in accounting policy. The material error may, for example, not have just taken place over one financial year.
- 2.19 The total cost of a service includes (for defined benefits schemes) its attributable current service (pensions) costs, defined in the Code 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.
- 2.19.1 IAS 19 *Employee Benefits* is a complex accounting standard, but it is based on a simple principle – that an organisation should account for employee benefits (including retirement benefits) when it becomes committed to give them, even if the actual payment of benefits will be many years in the future. IAS 19 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.
- 2.19.2 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 IAS 19 ensures that this is done on a fair and consistent basis for retirement benefits, irrespective of the method of funding.

Current Service Costs

- 2.19.3 One of the objectives of IAS 19 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.

- 2.19.4 The IAS 19 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. IAS 19-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 IAS 19 is included in the definition of total cost.
- 2.19.5 Paragraph 2.19 includes within the total cost of a service the current service (pensions) cost as defined by the Code. The Code defines current service (pensions) costs as *“the increase in the present value of a defined benefit obligation resulting from employee service in the current period”*.
- 2.19.6 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.
- 2.19.7 Current service (pensions) cost applies to all defined benefits schemes. Any contributions receivable by an authority from employees should be offset against the current service cost.
- 2.19.8 Current service (pensions) cost applies equally to police and fire fighters’ defined benefit schemes.
- 2.19.9 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.
- 2.19.10 The Code 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 Code requires the assumptions on which the current service cost is based to be updated to reflect economic conditions at 1 April of the year of account, not 31 March.
- 2.19.11 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.

- 2.19.12** CIPFA recognises that there would be practical difficulties for actuaries in estimating the current service costs for each service division in the SEA. Local authorities will need to allocate current service (pensions) costs to services on the basis of reasonable, justifiable and consistent estimates of this cost to comply with the requirements of BVACOP.
- 2.19.13** The most reasonable, justifiable and consistent basis of allocation or apportionment of current service cost will normally be pro rata to the pensionable pay per service division. However, authorities should use a different basis where there is evidence to suggest that pro rating would lead to material misstatements of the pensions costs attributable to individual services.
- 2.19.14** It is important to note that such pro rating should be based on the same cost base used to calculate retirement benefits; for example, pro rating to employee cost is not likely to be an appropriate base if a significant percentage of staff within a service are not in the pension scheme.
- 2.19.15** The apportionment methodology used by authorities should comply with the seven principles of apportionment specified in paragraph 2.15 (and related guidance) of BVACOP in its application to the cost of retirement benefits. The methodologies used to attribute or apportion costs to service divisions specified in Section 3 of BVACOP will need to be considered by each local authority and be appropriate to its local circumstances. In applying the seven principles of apportionment in paragraph 2.15 of BVACOP, the following factors apply to current service (pensions) costs:

Complete recharging of overheads

- 2.19.16** Current service (pensions) costs should be fully recharged to service expenditure headings as defined in Section 3 of BVACOP (including Corporate and Democratic Core).

Correct recipients

- 2.19.17** Current service (pensions) costs should be apportioned to each of the services service divisions defined in Section 3 of BVACOP that benefit from an employee's service or portion thereof. It is recognised that the services defined by BVACOP are not likely to match the organisational structure of the authority. Their basic treatment will, however, be no different than for overhead apportionment systems.

Transparency

- 2.19.18 It is important that service managers are clear what elements of cost are included in the definition of total cost and are provided with sufficient information to enable them to challenge the approach being followed.
- 2.19.19 Service managers should be able to understand the basis on which current service (pensions) costs are attributed to their service and be provided with information about how the costs are attributed to services.

Flexibility

- 2.19.20 Performance reporting requirements mean that authorities should be preparing budgeted and estimated outturn figures for current service (pensions) costs, rather than just total costs for the production of the annual accounts.
- 2.19.21 Although some elements of the pensions costs borne by an authority in any year may be volatile (eg those reflecting investment performance), current service costs should be relatively stable, provided that the workforce is stable. Flexibility will normally be achieved by linking any apportionment of current service costs to pensionable pay, so that pensions recharges flex with salaries.

Reality

- 2.19.22 Attribution or allocation methodologies should reflect the reality of the current service (pensions) costs.
- 2.19.23 In terms of making a link between the cost to a user and the benefit they receive, the main issue will be whether particular groups of employees cause the authority to have a higher or a lower liability for retirement benefits. For instance, in a final salary scheme, one year of service is likely to be of higher value to a professional worker who expects his or her salary to increase substantially over their remaining working life than to a casual worker with little prospect of promotion before retirement.
- 2.19.24 However, even though the potential might exist for years of service to be worth more to some individuals than to others, this should not be reflected in an apportionment methodology unless it is actually given effect in the actuary's valuations. In assessing the contributions that different authorities should be making to pensions funds, some attention will be paid by actuaries to the characteristics of the contributing authorities' workforces, and contribution rates will be set to reflect differences. However, these assessments will probably be set at a fairly high level of aggregation and not take into account all the factors that would need to be considered to match

the differentiation to particular services. This means generally that contribution rates will be set commonly for employees, even though there was a potential for them to generate pensions liabilities at different levels.

2.19.25 The implication of this is that most authorities will be able adequately to reflect the reality principle by pro rating the current service cost evenly against pensionable pay. Only where the actuary has advised that an authority's contribution rate has been particularly affected by characteristics of its workforce, and these peculiar characteristics are concentrated in particular services, would an authority be expected to depart from pro rating.

Predictability/stability

2.19.26 Managers will be able to appreciate that their attributable pensions costs will rise if they employ more people, pay higher salaries, etc or that their costs will fall in reverse circumstances. Predictability will therefore depend on managers being provided with good estimates of the likely percentage of pensionable pay by which current service costs will be apportioned.

Materiality

2.19.27 The principle of materiality applies equally to pensions costs as to overhead apportionment.

2.19.28 The method adopted should be explained as an estimation technique in relevant disclosures.

2.19.29 Past service costs, curtailments and settlements should be charged to Non Distributed Costs (see paragraph 2.45).

2.20 The Code states that provisions should be charged to Surplus or Deficit on the Provision of Services. 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

2.21 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, Revenue Support Grant and other general grants, including all non-ringfenced grants; and capital grants and contributions).

Income in Total Cost

- 2.21.1 The consequences of the 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).
- 2.21.2 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.
- 2.21.3 Under the Code, capital grants and contributions are credited to the Comprehensive Income and Expenditure Statement when they are received. ~~These grants and contributions are included with non-specific grants, and do not form part of the net cost of services.~~

Deleted: , rather than being deferred and amortised to match depreciation, as was the case under the SORP.

Consolidation

- 2.21.4 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.

NET TOTAL COST EXCLUDING SPECIFIC GRANTS

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

2.22.1 Where a national indicator provides the definition of net cost to exclude specific grants, the definition must be adhered to. Paragraph 2.22, 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. In Scotland, Scottish Government Finance Settlement Circulars may provide an indication of what can be classified as a specific grant.

2.22.2 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.

2.22.3 Government treatment of various specific grants differs across the UK and it is not consistent with IFRS. It may also differ from year to year as new grants are introduced or have their status altered. Authorities should therefore be aware that the definitions used in government returns may differ from those in BVACOP.

2.22.4 The grants which should not be netted off to reach the net cost of services are redistributed non-domestic rates, Revenue Support Grant and other general grants, including all non-ringfenced grants such as Area Based Grant, and capital grants and contributions. With the move away from ringfencing, more grants will not be applicable to services and therefore will fall within this category.

RELATIONSHIP TO THE COMPREHENSIVE INCOME AND EXPENDITURE STATEMENT

- 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 2.41 to 2.48) and exceptional items disclosed on the face of the Comprehensive Income and Expenditure Statement (in Northern Ireland, the District Fund Summary) will equate to net expenditure of continuing operations.

ANALYSING COSTS ON AN INTERNAL CROSS-CUTTING BASIS

- 2.24 The modernisation agenda for local government is increasingly stimulating 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 an 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.
- 2.25.1 Where an authority has set internal cross-cutting outcomes for itself, CIPFA recommends that an authority use this guidance to calculate and report its costs on an internal cross-cutting basis. The CIPFA Building Blocks Methodology (described below) should be used for all regular reports of costs on an internal cross-cutting basis.
- 2.25.2 CIPFA has not set a national framework for internal cross-cutting outcomes, nor has it set standard definitions for some common cross-cutting outcomes. CIPFA feels that to set mandatory cross-cutting outcomes would limit the freedom to set priorities based on local consultation and local assessment of needs. Although there clearly is a comparability case for a national framework of standard internal cross-cutting outcomes and definitions, the case for local consultation and challenge based on local circumstances is

considered to be stronger. This means that the internal cross-cutting cost analysis will be a vehicle for local consultation and challenge rather than inter-authority comparison.

The Benefits of Calculating and Reporting Internal Cross-cutting Costs

2.25.3 Each multi-service authority is encouraged to follow this guidance where it judges that the benefits of the exercise exceed the costs. CIPFA believes that such an analysis of costs will be beneficial for the following reasons:

The analysis of costs on an internal cross-cutting basis will make the financial information available about the authority more relevant to its stakeholders and improve the process of consultation with stakeholders.

An internal cross-cutting analysis of costs will allow an authority to demonstrate to stakeholders how its spending supports its priorities.

Calculating the analysis of costs on an internal cross-cutting basis will provide useful information to managers and members about the links between the authority's activities/functions and the desired outcomes. This will contribute to the process of challenging what and how things are done.

The analysis of costs on an internal cross-cutting basis will inform comparisons, as the context of what are higher and lower priority areas, which may justify higher or lower spending levels, will be much clearer.

Calculating the analysis of costs on an internal cross-cutting basis will require finance staff and service managers to work together closely. This could help to better integrate financial and service planning and to improve the relevance of financial management information for service managers.

The production of an analysis of costs on an internal cross-cutting basis is highly consistent with developing areas such as public service agreements and community strategies.

The CIPFA Building Blocks Methodology

2.25.4 To help authorities to achieve the above benefits cost effectively, CIPFA has developed a highly practical methodology for the calculation of the internal cross-cutting costs analysis. A detailed worked example of the method is provided after 2.25.12. The methodology is summarised below.

2.25.5 The internal cross-cutting costs analysis will be built up, initially, from the existing mandatory divisions of service as detailed in CIPFA's standard SEA in Section 3 of BVACOP. This will ensure that:

all authorities build up their analysis of internal cross-cutting costs from a relatively consistent source of base data

the base financial data of authorities will remain harmonised with the existing CLG, Scottish Government and Welsh Assembly Government returns that are based on traditional services and functions

the internal cross-cutting costs calculated will be based on the total cost principle detailed in BVACOP

there will be a clear audit trail between the SEA and the new internal cross-cutting costs analysis; this will make the calculations transparent.

- 2.25.6** Where the costs built up from the mandatory divisions of service are not considered to be materially accurate, authorities can use subdivisions of service instead; this approach will also need to be followed by single-purpose authorities. The box below provides some useful questions that will help to determine whether an inaccuracy is material or not.

Would the inaccuracy alter the impression given to a consultee about how the authority allocates its resources between the different internal cross-cutting outcomes that it is pursuing?

Would the inaccuracy result in a cost effectiveness indicator being so significantly over- or understated that independent judgements about the cost effectiveness of the authority would alter?

Would the inaccuracy prevent challenges to an activity that is not making a contribution to the achievement of any internal cross-cutting outcome?

Would the inaccuracy mislead managers, auditors or inspectors who were investigating the efficiency/effectiveness of organisational arrangements?

- 2.25.7** Where subdivisions of service are used to improve the accuracy of the analysis, overhead costs and depreciation and impairment losses need to be charged to the relevant subdivisions so that the internal cross-cutting costs calculated represent total cost.

- 2.25.8** The subdivisions of service used to achieve greater accuracy may be those mentioned in the SEA or may be locally derived where this will achieve a better fit with the authority's internal cross-cutting outcomes or with local management arrangements.

- 2.25.9** The internal cross-cutting costs analysis should be comprehensive. It should include all service costs, but not Corporate and Democratic Core costs or Non Distributed Costs. This means that:

An 'other' category may need to be shown in the internal cross-cutting costs

analysis with an explanatory note.

CDC and NDC will need to be disclosed alongside the internal cross-cutting costs analysis and explained in a supporting note.

2.25.10 Each authority should prepare and retain a working paper that demonstrates the audit trail between the SEA and its internal cross-cutting costs analysis. The worked example shows what the working paper could look like.

2.25.11 Although authorities may feel that the costs of some activities relate equally to more than one internal cross-cutting outcome, the cross-cutting analysis will normally include any particular cost once only. Double counting is not recommended as it:

Makes comparison between the SEA and the cross-cutting cost analysis difficult. This could confuse stakeholders.

May leave authorities at risk of being accused of inflating spending pledges.

Departs from IFRS. This may be important if, in the long run, an outcome-based analysis of costs replaces the current service analysis in the annual Statement of Accounts.

2.25.12 In exceptional cases, an authority may believe that double counting is necessary to ensure that the internal cross-cutting costs analysis is effective and accurate. In such cases, the working paper should clearly show the double-counted item(s). It is also important that the internal cross-cutting costs analysis is supported by an explanatory note. The note should state:

what is double counted

how much is double counted

why double counting is considered necessary.

Worked Example: Calculation of the Analysis of Expenditure on an Internal Cross-cutting Basis

THE SETTING

1. This worked example is based on information gleaned at the 16 authorities visited during the research that CIPFA carried out in order to prepare its consultation paper on accounting for cross-cutting issues. The hypothetical local authority has seven cross-cutting priority areas. It provides the full range of local authority services and could be a London borough council or a unitary council.

THE COUNCIL'S CROSS-CUTTING PRIORITIES

2. The authority is pursuing seven cross-cutting outcomes.

HOW THE COUNCIL BUILT UP THE INTERNAL CROSS-CUTTING COST ANALYSIS

3. The council has followed CIPFA-recommended methodology based upon the standard CIPFA SEA, which provides the necessary building blocks. This means that the Corporate and Democratic Core costs and Non Distributed Costs do not feature in the internal cross-cutting costs analysis. They are, of course, still shown in the total spending analysis, which will reconcile to the SEA included in the annual accounts.
4. This particular council has presented its analysis on the basis of net costs. This was built up from the gross costs and gross income recorded against each cost centre as required by the total cost principle outlined in BVACOP. It would be equally acceptable to show income and expenditure separately in the analysis. Indeed this would be a very open way of demonstrating how charging policies relate to internal cross-cutting priority outcomes.
5. The council decided to split the following divisions of service between more than one internal cross-cutting area because it judged that coding the whole of each service division to separate internal cross-cutting outcomes was not accurate enough:

Non School Funding was split between Economic/Community Regeneration and Lifelong Learning

Youth Justice was split between Community Safety and Health Improvement

Regulatory Services was split between Community Safety, Health Improvement and Environmental Sustainability

Highways Environment, Safety and Routine Maintenance was split between Community Safety, Environmental Sustainability and Transport

Private Sector Housing Renewal was split between Community Safety and Economic/Community Regeneration.

6. In each case, the reason for splitting the costs of one division of service to more than one internal cross-cutting area was arrived at after asking the questions contained in 2.25.6 above from the chapter about the calculation of an internal cross-cutting costs analysis.
7. In this case, the reason for splitting the costs of one division of service to more than one cross-cutting outcome was because either:
 - a local performance indicator would be distorted, or
 - a user (manager or inspector) of the analysis could be misled by the information presented about spending as it relates to cross-cutting issues.

Coroners' Court Services	0.75							0.75
Other Court Services	0.05							0.05
Page Total	1.80	-	-	-	-	5.15	-	6.95
Cumulative Total	1.80	-	-	-	114.35	5.15	-	121.30

Net costs in £m allocated to which cross-cutting priority								
Children's and Education Services	1 (CS)	2 (ECR)	3 (LLL)	4 (ES)	5 (HI)	6 (OS)	7 (TRANS)	Total
Nursery Schools			4.50					4.50
Primary Schools			132.70					132.70
Secondary Schools			101.60					101.60
Special Schools			28.40					28.40
Strategic Management of Non-school Services			0.25					0.25
Pre-school Education			1.25					1.25
Youth Services		5.50						5.50
Adult Learning (Pre-primary and Primary)		1.30						1.30
Adult Learning (Secondary)								
Adult Learning (Post-secondary Non-tertiary Education)								
Adult Learning (Tertiary Education)								
Community Learning		0.60						0.60

Student Support									1.15	1.15
Other Non-school Funding									1.05	1.05
Page Total	-	7.40	270.90	-	-	-	-	-	278.30	278.30
Cumulative Total	1.80	7.40	270.90	-	114.35	5.15	-	-	399.60	399.60

Net costs in £m allocated to which cross-cutting priority									
Children's and Education Services	1 (CS)	2 (ECR)	3 (LLL)	4 (ES)	5 (HI)	6 (OS)	7 (TRANS)		Total
Service Strategy					5.75				5.75
Children's Services – Commissioning and Social Work					6.25				6.25
Children Looked After					19.00				19.00
Family Support Services					6.25				6.25
Secure Accommodation (Justice)					2.00				2.00
Youth Offender Teams	0.35								0.35
Other Youth Justice Services	0.55								0.55
Asylum Seekers					3.10				3.10
Other Children's and Families' Services					1.00				1.00
Page Total	0.90	-	-	-	43.35	-	-	-	44.25
Cumulative Total	2.70	7.40	270.90	-	157.70	5.15	-	-	443.85

Flood Defence and Land Drainage									1.00	1.00
Agricultural and Fisheries Services									0.55	0.55
Environmental Protection, etc									2.30	2.30
Food Safety, etc									1.00	1.00
Pricing, etc	2.75									2.75
Street Cleansing (not chargeable to Highways)									12.50	12.50
Waste Collection									11.10	11.10
Waste Disposal									6.30	6.30
Trade Waste									(0.20)	(0.20)
Recycling									1.40	1.40
Waste Minimisation									0.90	0.90
Page Total	4.10	-	-	36.60	2.05	-	-	-	-	42.75
Cumulative Total	19.00	8.60	282.00	52.35	159.75	5.15	-	-	-	526.85

Net costs in £m allocated to which cross-cutting priority									
Cultural, Environmental, Regulatory and Planning Services	1 (CS)	2 (ECR)	3 (LLL)	4 (ES)	5 (HI)	6 (OS)	7 (TRANS)	Total	
Building Control				1.10					1.10
Development Control				0.40					0.40

Planning Policy					1.00				1.00
Environmental Initiatives					1.75				1.75
Economic Development			3.55						3.55
Community Development	1.45								1.45
Page Total	1.45	3.55	-	4.25	-	-	-	-	9.25
Cumulative Total	20.45	12.15	282.00	56.60	159.75	5.15	-	-	536.10

Net costs in £m allocated to which cross-cutting priority									
Highways and Transport Services	1 (CS)	2 (ECR)	3 (LLL)	4 (ES)	5 (HI)	6 (OS)	7 (TRANS)	Total	
Transport Planning, Policy and Strategy							2.80		2.80
Structural Maintenance							16.20		16.20
Capital Charges relating to Construction Projects							1.00		1.00
Environment, Safety and Routine Maintenance:									
Maintenance: Environmental				3.25					3.25
Maintenance: Safety	3.50								3.50
Maintenance: Routine							3.60		3.60
Street Lighting (including Energy Costs)	3.55								3.55
Winter Service							2.00		2.00
Traffic Management and Road Safety	0.75								0.75
Parking Services				3.00					3.00

Public Transport							3.75	3.75
Airports, Harbours and Toll Facilities							0.75	0.75
Page Total	7.80	-	-	6.25	-	-	30.10	44.15
Cumulative Total	28.25	12.15	282.00	62.85	159.75	5.15	30.10	580.25

Net costs in £m allocated to which cross-cutting priority								
Housing Services (General Fund)	1 (CS)	2 (ECR)	3 (LLL)	4 (ES)	5 (HI)	6 (OS)	7 (TRANS)	Total
Housing Strategy		0.65						0.65
Enabling		0.75						0.75
Housing Advice		0.55						0.55
Housing Advances		1.50						1.50
Administration of Grants, etc		15.50						15.50
Management Orders, etc	1.30							1.30
Licensing of Private Sector Landlords		1.00						1.00
Homelessness		5.90						5.90
Housing Benefits Payments		10.60						10.60
Housing Benefits Administration		0.30						0.30
Other Council Property		0.20						0.20
Supporting People		0.80						0.80
Other Welfare Services		0.90						0.90

Page Total	1.30	38.65	-	-	-	-	-	39.95
Cumulative Total Spending by								
Cross Cutting Area	29.55	50.80	282.00	62.85	159.75	5.15	30.10	620.20
Democratic Representation and Management								0.75
Corporate Management								1.00
Non Distributed Costs								0.25
Total Spending by the council	29.55	50.80	282.00	62.85	159.75	5.15	30.10	622.20

PARTNERSHIPS

2.26 Chapter 9 of the Code recognises three types of joint venture – jointly controlled entities, jointly controlled operations and jointly controlled assets. Jointly controlled entities are consolidated into the Group Accounts, with the investment in the entity accounted for in the single entity accounts at cost or valuation. The single entity accounts will include transactions between the authority and the jointly controlled entity. Authorities will also need to account for their share of jointly controlled operations and jointly controlled assets in their single entity accounts, in accordance with paragraphs 2.27–2.30 below.

2.26.1 The requirements in relation to partnerships in paragraphs 2.26–2.30 of BVACOP relate to jointly controlled assets and jointly controlled operations only. Where an authority participates in a jointly controlled entity, it should account in its single entity accounts for transactions with the jointly controlled entity in the same way as with other entities. The figures will then be adjusted in the group accounts in accordance with paragraph 2.49 of BVACOP. Informal arrangements that do not meet the Code definition of jointly controlled assets or jointly controlled operations are not partnerships; authorities should account for their own income, expenditure, assets and liabilities.

2.26.2 In the context of Best Value, it is also important that, when interpreting this guidance, a Best Value authority ensures its disclosures are consistent with the four Cs of Best Value. To this end, the aim is to provide information that:
Facilitates consultation with stakeholders about partnership activity.

Enables the comparison of performance year on year and between authorities, regardless of service delivery arrangements.

Promotes challenges to what authorities do and how they do it. CIPFA takes the view that partnerships are often an excellent vehicle for achieving better value, but are not always a good thing per se. Accounting information and reports should, therefore, help authorities to constantly monitor the continued validity of each partnership arrangement.

Helps to demonstrate that an authority has a competitive approach to service delivery including any partnership arrangements.

2.27 The total cost of a service includes those costs attributable to an authority's proportion of a relevant partnership (ie a jointly controlled operation or jointly controlled asset). 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, but which do not give rise to an entity. Costs attributable to partnerships are recognised for total cost purposes within the Surplus or Deficit on the Provision of Services 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 Code.

2.27.1 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. The authority's share of the partnership income and expenditure should be reflected in the appropriate subjective grouping.

2.27.2 It follows, therefore, that total cost excludes the transactions of other entities that it works with as partners, unless:

The transaction is a contribution by the partner towards the authority's costs. In such cases the contribution is to be shown as income that part-funds the authority's activity.

There is a compelling case that in substance the transactions of the partner are those of the local authority, and, practically speaking, the authority is responsible for the commitments that arise from the transactions. Such situations can arise when an authority is a formal accountable body for a partnership (see paragraph 2.28 and related guidance for more details).

2.28 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.

- 2.28.1 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 'jointly controlled entities' as defined by the applicable accounting standard IAS 31 *Interests in Joint Ventures* and will be included in the authority's group accounts but not in the authority's net expenditure of continuing operations in the Comprehensive Income and Expenditure Statement. In the single entity statements, they are excluded from the total cost of the service(s) concerned, although transactions between the authority and the jointly controlled entity may be reflected in the total cost of one or more services.
- 2.28.2 This contrasts with partnerships that are not 'jointly controlled entities' (ie jointly controlled operations and jointly controlled assets), where the income and expenditure of the partnership attributable to the local authority is accounted for in its Comprehensive Income and Expenditure Statement and therefore the amounts included in the net expenditure of continuing operations 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.

What to Include in Total Cost

- 2.28.3 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.

2.28.4 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. Joint committees may have been incorporated as entities, such as those in Scotland which have been incorporated as joint boards by Order under section 20 of the Local Government (Scotland) Act 1994. These joint committees are jointly controlled entities and are not included in the net expenditure of continuing operations. Joint committees that have not been incorporated as entities should be accounted for as jointly controlled operations and/or jointly controlled assets. The Code incorporates the requirements of IAS 31 *Interests in Joint Ventures* and requires authorities to account for their attributable share of the income and expenditure (and the assets and liabilities) of such partnerships. Total cost thus includes the relevant proportion of actual income and expenditure of all organisations where statutory, contractual or informal partnerships exist. Any difference between the relevant proportion of actual income and expenditure and any contributions made will result in the authority recognising a creditor or debtor (where the partnership does not report its own cash, but reports a debtor or creditor with a lead authority) or a revised cash balance (being its share of the partnership's cash balance where the partnership reports its own cash) for the difference. If a surplus has arisen on a partnership, and the partners have agreed that this balance can be retained, authorities may wish to transfer their proportion of the surplus to an earmarked reserve (or earmarked portion of the General Fund).

2.28.5 The following table gives examples of common transactions that are included in or excluded from total cost.

Transaction type	Always include	Always exclude
Financial contributions measured on an accruals basis to all organisations where formal, contractual or informal partnerships exist.	Yes	
Grants paid by an authority to partner organisations.	Yes	
An authority's own (agreed) share of any expenditure, deficit or surplus arising from any partnership.	Yes	
Non-financial contributions to partnerships, eg the use of premises at peppercorn rents or the free provision of services to the partner by the authority's staff.	See paragraphs 2.28.7–2.28.12	

Transaction type	Always include	Always exclude
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.		Yes
Proportions of expenditure or income of an informal partnership to the extent that they relate to another authority 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.)		Yes
Expenditure and income, other than any contribution to revenue expenditure, attributable to (separate entity) joint boards, companies in which the body has an interest, industrial and provident societies and charitable trusts in which the authority has an interest.		Yes
Income and expenditure in relation to subsidiary or associated companies, jointly controlled entities 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.		Yes
Expenditure that has by statute to be performed through a separate corporate entity and where equivalent services are not performed by the authority, eg bus undertakings, airports and, in England and Wales, the operation of waste disposal facilities.		Yes
Where the authority is acting under a formal agency agreement (see also paragraph 2.11.6 of BVACOP).		Yes
Income and expenditure of a partnership for which the authority is acting as a formally appointed accountable body.	This will be dependent on whether the authority is of the opinion that it has control over the distribution of the grant which provides a real economic benefit to it as the controlling entity. See paragraphs 2.28.13–2.28.20.	

2.28.6 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.

Non-cash Contributions

2.28.7 Except where the amounts are immaterial, total cost should also include an authority's assessment of non-cash contributions to a relevant partnership.

2.28.8 Authorities frequently offer support to partners in the form of subsidised premises usage, by donating the time of their officers or by the provision of support services. Depending on the value of these non-cash contributions, a failure to account for them could lead to flawed decisions about whether to enter into a new partnership or continue involvement with an existing partnership.

2.28.9 As a matter of principle, CIPFA would, therefore, encourage authorities to identify and include material non-cash contributions in the appraisal and monitoring of partnership arrangements and to account for these arrangements in the relevant divisions of service contributing to the partnership. Using the above examples, this can be achieved by calculating:

- an appropriate allocation of the depreciation for the premises occupied or, where appropriate, the premises rental costs
- an appropriate hourly rate based on the full costs of employing an officer who supports a partnership
- support services: an appropriate allocation in line with the seven principles of apportionment outlined in BVACOP.

2.28.10 Once the value of the non-cash contributions has been calculated, it can be used as the basis for a dummy bill to the partner. Any material costs over and above the agreed grant level should, with the partner's agreement, be invoiced on an agreed basis. Note: the physical raising of bills, etc is not necessary. Journal entries would suffice and are normally less of an administrative burden.

2.28.11 The advantages of identifying and valuing non-cash contributions to partnership arrangements in this way are that it:

- Makes the full support to the partner organisation transparent as a grant is recorded. This transparency should thus improve the consultation,

comparison and challenge aspects of Best Value.

Shows the resources devoted to a partnership and, therefore, not available for other purposes, ie it gives an indication of the opportunity costs of supporting a partnership.

Is relatively easy to administer. This limits the costs associated with achieving greater transparency.

Reduces the risk that any debt raised will not be paid.

2.28.12 The obvious risk of calculating non-cash contributions is that the necessary administration costs are not justified. It is, therefore, only necessary to do this where the cost of collecting the information about premises values, officer time, etc is exceeded, in the authority's opinion, by the value of knowing the full cost of its involvement with a partnership. Accordingly, the effort to obtain accurate non-cash cost estimates should be in proportion to the materiality of the support provided to the partnership.

Issues Arising where an Authority is the Accountable Body

2.28.13 Where an authority is the formal accountable body for a grant, the authority will need to decide whether it should account for the whole grant as its income, and whether it should recognise any provisions or contingent liabilities. These issues are discussed below.

Deciding whether to include the costs of a partnership

2.28.14 The example below shows some questions that an authority could ask to help it ascertain the substance of its transactions as an accountable body. The answers to the questions will help to indicate the substance of any potential liability faced and, therefore, whether it should consider including the entire grant received as income and all the grant distributions as expenditure in its SEA.

Do the transactions being considered relate to:

activities or transactions by the authority's own staff or commissioned from its appointed agents?
work done within the geographic area for which the authority is normally responsible?

Does the authority:

have any responsibilities beyond passing funds on to other organisations identified by the grant-giving body, eg managing the quality of work done or deciding which entities qualify for the funds?

have any rights to apply the economic benefits underlying cash transactions for its own purposes other than in the interests of the partnership?

2.28.15 Authorities can use the questions above to assist in their assessments of whether or not they have control over the distribution of the grant and gains real economic benefits as the controlling authority. Any one of the questions is unlikely to give a complete answer in relation to the decisions as to whether it is in substance accountable for the income and expenditure. The ultimate decision should, therefore, be taken in the context of all the answers and all other information relevant to the assessment of whether, or not, an authority actually exercises control over the distribution of grants and receives the economic benefits through the ability to direct resources and/or is subject to the risks inherent in the partnership arrangement or agreement.

Liabilities of an accountable body

2.28.16 As the accountable body, an authority may have continuing contingent liabilities in relation to the funds it receives from the grant-giving body, eg a responsibility to make good any misapplied funds. It is likely that in substance the transactions are not those of the authority, but that a liability could conceivably exist. In this case, the authority will need to have regard to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Under IAS 37, commitments arising because a local authority was an accountable body could be shown either as a provision, provided that it meets the definition of a provision in IAS 37, or as a contingent liability, again in accordance with IAS 37.

Provisions

2.28.17 The recognition criteria for a provision require that:

- (a) an entity has a present obligation (either legal or constructive) as a result of a past event

- (b) it is probable that a transfer of economic benefits will be required to settle the obligation
- (c) a reliable estimate can be made of the obligation.

For example, an authority may recognise a provision in its accounts at year-end where a breach of grant entitlement conditions has been found and a reliable estimate may be made for the scale of repayments owed to a grant-paying department.

Requirement for a contingent liability disclosure

2.28.18 A contingent liability is:

a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the authority, or a present obligation that arises from past events but is not recognised because:

- (a) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or
- (b) the amount of the obligation cannot be measured with sufficient reliability.

2.28.19 A contingent liability note would match the likely circumstances where a grant-paying department was considering the recovery of a grant payment but the authority disputed the liability for repayment. If material, this would need to be disclosed in the annual Statement of Accounts.

Illustrative examples of the application of IAS 37

2.28.20 The following example shows how the circumstances surrounding a scheme can change and illustrates when and how to apply IAS 37 for partnerships for which the authority is the accountable body.

Stages in the development of the liability	Suggested disclosure
<p>The authority receives a £10m grant from a government department in the expectation that it will pass agreed amounts on to its partners in an agreed scheme. (NB the full £10m is distributed to its partners. The authority is not the recipient of the grant.)</p>	<p>A holding account in the general ledger records the receipt of the grant and the payments to partners, but the authority's total cost is unaffected. No further disclosure is needed.</p>

The grant-paying department suspects that some of the funds have been misapplied by one of the partner organisations and is investigating, with a view to recovering the misapplied funds from the authority.	This is a possible obligation arising from past events whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control. Therefore, a contingent liability note is appropriate.
The government department completes its investigation and indicates that it intends to seek to recover the misapplied funds from the authority.	This liability is of uncertain timing and possibly also an uncertain amount, but an estimate of the amount can be made and a provision can be charged to the revenue account and to total cost.

Illustrative Examples of What to Include in Total Cost

2.28.21 Take the example of five local authorities. Each provides sports outreach services in partnership with a local sports club. Each partner's net contribution to the partnership is £50,000. However, the financial arrangements differ in each authority, and the example shows how the different arrangements affect the accounts of the local authority.

Arrangements

Authority	Arrangements
	The authority is responsible for 100% of service delivery. It employs and supervises all the coaches. The sports club pays £50,000 in 12 equal instalments during the year to the authority towards the costs of the service.
	The sports club does all the coaching. It employs and supervises the coaches. The authority pays £50,000 to the sports club during the year in return for agreed levels of activity.
	An independent voluntary organisation committed to sport in the community recruits, pays and supervises the coaches. Some coaches are unpaid volunteers. The council grant aids the voluntary organisation £50,000 pa and the sports club donates £50,000 pa to the voluntary organisation.
	A private firm responded to a tender by the local authority for the provision of the sport outreach service and provides the contract under the supervision of the local authority for £95,000. Client officers' costs at the local authority are £5,000 per annum. The sports club pays £50,000 in 12 equal instalments during the year to the authority towards the costs of the contract.

The authority and the sports club established a jointly owned company limited by guarantee to provide the sports outreach service to an agreed specification. The authority provides administrative support valued at £5,000 to the company to pay wages, raise and pay invoices, etc. It also pays £40,000 to subsidise agreed loss-making activities and allows the company free use of an office in a leisure centre. The commercial rent for the office is estimated at £5,000. The company keeps any income from service users. The sports club annually pays £40,000 and provides £10,000 worth of equipment to the company.

Accounting entries

Authority	What the authority's SEA accounts will show
	£100,000 recreation and sports staff, supplies, premises, etc expenditure. £50,000 recreation and sports income from the sports club.
	£50,000 recreation and sports contract payment expenditure.
	£50,000 recreation and sports grant aid expenditure.
	£95,000 recreation and sports and recreation contract payment expenditure. £5,000 recreation and sports staff, supplies, premises, etc expenditure. £50,000 recreation and sports income from the sports club.
	£10,000 recreation and sports grant aid expenditure. £40,000 recreation and sports contract payment expenditure.

Note: Example assumes that the community sports activities normally take place at locations not owned by the authority; hence, there are no material premises-related non-cash contributions.

Splitting Partnership-related Costs Between Two or More Divisions of Service in the SEA

2.28.22 Some partnerships will relate to relatively narrow areas of activity accounted for in a single division of service in the Best Value authority's SEA. This is the case in the illustrative examples above, where all the transactions relate to the Recreation and Sport division of Cultural and Related Services. However, some partnerships will cover activities normally recorded in more than one division of service, ie the illustrative example could conceivably be extended to include:

outreach theatre workshops accounted for in the Culture and Heritage division of service

children's play outreach accounted for as Children's and Education Services expenditure.

- 2.28.23 Materiality is the main consideration when deciding whether to split the costs related to a partnership between more than one section of the SEA.
- 2.28.24 Partnerships can be quite diverse and could easily cover children's services, tourism, transport, economic regeneration and much more. In these circumstances the grant distribution and spending should be split between the relevant divisions of service. This may not be easy – the effort to make the split accurately will depend on the materiality of the transactions.
- 2.28.25 For the purposes of reporting performance, a materiality level based upon the accounting statements is too high. Material accuracy in performance reporting terms relates to the impact on individual service divisions, eg Tourism, and to performance indicators (national or local) that are affected by any inaccuracy.

Joint Arrangements with the NHS including Pooled Budgets

- 2.28.26 The partnership arrangements in section 256 of the National Health Service Act 2006 or in section 194 of the National Health Service (Wales) Act 2006 have been developed to give NHS bodies and local authorities the flexibility to be able to work with each other and other agencies to respond effectively to improve services, either by joining up existing services, or by developing new, co-ordinated services. Similar arrangements exist in Scotland, where the relevant legislation is Part 2 of the Community Care and Health (Scotland) Act 2002.
- 2.28.27 These partnership arrangements, which are variously referred to as lead commissioning, integrated provision and pooled budgets, allow each partner to make a contribution to the budget and retain statutory responsibility for their own services. If these arrangements are to work effectively, all partners need to maintain and demonstrate accountability.
- 2.28.28 Detailed guidance on accounting for these arrangements is given in the CIPFA publication *Pooled Budgets: A Practical Guide for Local and Health Authorities (Fully Revised Second Edition 2009)*. As the following extract from the first edition of that publication explains, the basic rule is that each partner accounts for its own contribution to the joint arrangement or pooled budget:
- “Given the nature of the pooled budget arrangement, each partner should*

account for their contribution to the budget. The host should send monitoring reports on a quarterly basis, and at the year end prepare a memorandum of accounts with their statement of accounts that shows what has been received, and spent, and what remains. This memorandum of accounts will be sent to each of the partners at the year end for inclusion in their statement of accounts. Records will need to be retained for at least six years.”

2.28.29 The contribution will be accounted for across an authority’s SEA according to actual spending as recorded in the quarterly monitoring reports mentioned above, which should be based on the pooled budget’s management accounts.

Other Issues

2.28.30 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) the authority should use a combination of financial and management accounts
- (3) if it is not a major entity, the authority 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 partnership balances at the date of consolidation or aggregation provided that this is within three months of the authority's reporting date.

Guidance on Governance Issues for Partnerships

2.28.31 The CIPFA/SOLACE publications *Delivering Good Governance in Local Government – Framework* and *Guidance Note* (2007) are essential guidance when evaluating governance issues in relation to partnership arrangements.

2.28.32 Sound governance arrangements are the key to harnessing the benefits of partnerships with others outside local government. The CIPFA/SOLACE Framework defines the core principles of good governance for local government:

- (i) focusing on the purpose of the authority and on outcomes for the community and creating and implementing a vision for the local area
- (ii) members and officers working together to achieve a common purpose with clearly defined functions and roles
- (iii) promoting values for the authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour
- (iv) taking informed and transparent decisions which are subject to effective scrutiny and managing risk
- (v) developing the capacity and capability of members and officers to be effective
- (vi) engaging with local people and other stakeholders to ensure robust public accountability.

- 2.28.33 These principles are taken from *The Good Governance Standard for Public Services* (2004) developed by the Independent Commission on Good Governance in Public Services with support from the Office for Public Management and CIPFA and have been adapted for local government purposes.
- 2.28.34 These principles need to be translated into a framework which seeks both to ensure that they are fully integrated into the conduct of the authority's business and to establish a means of demonstrating compliance. The fundamental principles should therefore be reflected in the dimensions of a local authority's business.
- 2.28.35 It is crucial that the principles defined are adhered to in developing strategic partnership arrangements and that such arrangements are monitored for effectiveness in practice and subject to review on a continuing basis to ensure that they are up to date. For example, in developing partnerships, local authorities will need to maintain sound arrangements for explicit accountability to stakeholders for the authority's performance and its effectiveness in the delivery of services and the sustainable use of resources. By adopting and maintaining an up-to-date local code of corporate governance in line with the CIPFA/SOLACE Framework, authorities will have the tools in place to underpin sound partnership arrangements. The CIPFA/SOLACE Framework also recommends that the governance arrangements with respect to partnerships and other group working incorporate good practice as identified by the Audit Commission's report *Governing Partnerships: Bridging the Accountability Gap* (2005).
- 2.28.36 Key issues relating to the governance of partnerships are:
- Decisions to enter into a partnership should be carefully evaluated to ensure the authority would benefit. This implies that very careful selection of partners is important.
 - To be successful, partnerships must benefit all the parties involved.
 - To be successful, partners must trust each other.
 - To be successful, clear objectives for the partnership should be identified and documented at the outset. There should be a simple but clear partnership agreement.
 - Structures to manage the partnership and report its activities to the partners are crucial.
 - Review mechanisms, including knowing the true costs (direct, indirect and opportunity) of partnerships, are important.

Partnership reviews should result in learning by and adaptation of the partnerships.

- 2.28.37 It is also important that the partnership agreement can be modified as the environment in which it operates changes and different solutions emerge. In CIPFA's view, any partnership memorandum or agreement also needs to allow scope for renegotiation of different elements of the arrangement, provided these are specified from the outset. Agreements should also include break clauses and set out disengagement procedures, including a wind-down plan.
- 2.28.38 It is critical that the partnership arrangement should be subject to the rigours of performance management. Continuous review and effective appraisal of the partnership operation should be an integral part of its management to ensure that it continues to meet the aims and objectives of all partners.

Links between partnership governance and accounting for partnerships

- 2.28.39 These findings lend further weight to the recommendation that extra information should be collected about significant partnerships and included in the notes to the accounts and in performance reports because:

The discipline required to identify what information needs to be collected for the notes will make each partner focus on the joint objective of the partnership.

Where rights and duties are clearly stated in partnership agreements, it becomes straightforward to identify the transactions that each partner is accountable for and, therefore, what an authority needs to include in total cost.

The discipline needed to collect the information identified, including the value of non-cash contributions, will also provide information that will inform management decisions about whether to enter into new partnerships or continue with existing ones.

The exchange of information by the partners should help to develop the openness and trust that is crucial to the success of partnerships. It also requires structures to be put in place to manage the partnership and report its activities to the partners. This in turn provides a mechanism for the effective ongoing review of each partnership.

Links between partnership governance and achieving Best Value

- 2.28.40 The good governance of partnerships requires clear objectives to be established for each partnership and regular reviews of information to demonstrate whether the partnership is achieving its objectives and at what

cost. The information required for the good governance of partnerships is, therefore, also supportive of Best Value, as it:

provides a good basis for consultation about the continued value of the partnership

may prompt challenging questions about the effectiveness of partnership arrangements

gives fuller information to set performance comparisons in context

allows the cost effectiveness and, therefore, the competitiveness of partnership arrangements to be examined.

- 2.29** For reporting within the Surplus or Deficit on the Provision of Services, 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 Surplus or Deficit on the Provision of Services prepared for the group financial reporting.
- 2.30** The requirements for preparing total cost figures for group accounting are set out in paragraph 2.49.

TRADING ACCOUNTS AND TRADING OPERATIONS

2.31 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 be maintained and disclosed for significant trading operations.

2.31.1 The Local Government in Scotland Act 2003 requires trading accounts to at least break even in every three-year period.

2.32 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.

2.32.1 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 external trading organisations and internal trading organisation 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.

2.32.2 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.

2.33 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 performance reporting purposes. Trading operations in categories (a) to (d) below 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 CIPFA Scotland's *A Best Value Approach to Trading Accounts – A Guidance Note for Local Authority Practitioners* (2003). There are five main types of trading operation that may be run by authorities:

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

2.34 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 (eg 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 costs and Non Distributed Costs 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.

2.35 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.

2.35.1 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.

2.36 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.

- 2.36.1** 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 the 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.
- 2.36.2** 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.
- 2.37** 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.
- 2.37.1** 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.
- 2.38** 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.

2.38.1 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.

2.38.2 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.

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

what operations should be reported on

how their performance information can best be presented.

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

1. Identify the trading operations that are provided in a 'competitive environment' (see paragraph 2.33 of BVACOP).
2. Set parameters (in terms of percentage) for 'significance' based on two performance criteria measured against the authority's overall net operating expenditure:

turnover of trading operation

size of surplus/deficit on trading account

consider adding **non-financial criteria**, such as the levels of interest in particular activities expressed in consultation with the public, the prominence of promises about the trading activity in policy statements, particularly those considering performance issues or a corporate assessment of the authority, and the risk of loss that the authority is exposed to in carrying out the activity

other non-financial criteria may also guide decisions on disclosure – eg trading services used to deliver targets included in local public service agreements in England or improvement agreement outcomes in Wales; as a result of reviews; or those services that may be provided or are supporting functions that are provided under the well-being

powers.

3. Review the criteria chosen to ensure that they properly balance comprehensiveness and understandability.
4. Where the methodology results in draft disclosures that are too voluminous or too sparse, review the parameters used for each criterion and raise or lower thresholds.

2.38.5 A list of possible trading operations which could be disclosed in performance reports and the Statement of Accounts is provided in the list below to assist authorities in their consideration of which services to disclose. This list is not intended to be prescriptive and is by no means exhaustive.

Possible external trading activity	Possible internal trading activity
Industrial estates	Building cleaning
Market undertakings	Building maintenance
Investment properties	Construction and property services
Building control	Finance services
Fishery harbours	Legal services
Trade waste	Personnel services
Crematoria	Office services (printing, security, etc)
Ports	Highways maintenance
Piers	Housing management
Airports	On-street parking
Toll bridges/roads	Environmental cleaning and sweeping
Car parks	Refuse collection
Civic halls	Leisure management
Theatres	Grounds maintenance
Museums	Vehicle management/transport
	Vehicle maintenance
	Catering services (staff, welfare, education, etc)
	Administrative education support services
	Specialist education support services
	Social services residential homes
	Social services home care services

2.38.6 Significance needs to be carefully judged. Limited, aggregated disclosures

will not give readers any insights into the financial performance of trading operations. However, too much information may prevent an appreciation of the substantial issues with which the authority is confronted. Disclosure should be considered if making the information public would result in:

better informed consultation with stakeholders, likely to result in tangible improvements in trading operations

effective comparison of trading performance year on year and between authorities and the private sector, where provision of information about trends, peers and competitors would enhance stakeholder involvement

promotion of challenge to what the authority does and how it does it in substantial areas of policy

demonstration that the authority has a competitive approach to key areas of service delivery.

- 2.38.7 Having determined the operations to be reported on, authorities will then determine the information to be disclosed:

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 cleansing’ or ‘county trading’. Relevant information will depend on precisely what the authority is doing but might include:

a description of the activities carried out – this could also include the volume of activity, key outputs, the value of these outputs to the community and any relevant performance indicators (either local or national)

the main customers

the basis on which work is won or commissioned

the policy objectives the authority is seeking to achieve through the activity

the extent to which the activity is carried out on a commercial basis and the risks involved.

Turnover – where there are substantial amounts of external and internal income, these might usefully be separated; an indication of the outputs represented by the turnover might also provide useful context.

Surplus/deficit – disclosure of the surplus/deficit for the year should be regarded as the minimum requirement for information on financial performance. Where the trading is external, then surplus/deficit might equate to profit/loss, as the income will be real income for the authority.

Where income is from internal recharges to the budgets of the authority's services, then the theory of surpluses and deficits being strictly linked to the performance of the trading operation relationship does not necessarily hold, ie all surpluses demonstrate good performance and all deficits do not. Surpluses and deficits may arise from an error in a pricing decision in a contract or a change of accounting policy, or may be a policy decision of the authority (see paragraph 2.40.11 for guidance on budgetary and management accounting implications). Therefore, surpluses and deficits will need to be put in the context of the trading operation's targets: for instance, a local authority may have decided to generate a surplus to support other spending priorities (eg investment and replacement decisions), to break even, or to run a subsidised activity at a loss, and the consequences of missing a target in either direction may need to be explained.

Any reapportionment of surplus/deficit – this information is required as it would otherwise be unclear how surpluses/deficits had been taken into account when aggregating the authority's overall position.

Any details putting financial performance in a context useful to the reader – especially important is the performance framework under which the activity is being carried out (see surplus/deficit above). Other useful contextual information might be:

- the basis of disclosure – ie whether figures are actuals or projected outturns (NB: increasingly, performance reports will require that final outturn information is required)
- information about previous year forecasts and actuals and projected performance for next year
- explanation where previous year actual outturn is significantly different from the disclosed forecast
- performance measures
- information on future prospects
- any remedial action that has been taken or is planned to recover a deficit.

2.38.8 There is some (limited) scope for authorities to group trading operations into a consolidated disclosure. Other groupings may be relevant to the way in which the service is organised in a local authority, eg refuse collection and street cleansing. However, care should be taken if grouping is to be used. If it is decided that the results of particular activities are significant, then this significance could be lost if results are consolidated. Also, grouping activities

together may confuse readers, particularly in relation to the demonstration of the performance of an activity. Grouping is not likely to be appropriate in the following instances:

the activities are not similar

the activities have different exposures to commercial risk

the activities are accountable to different senior officers

the trading results are a mixture of surpluses and deficits

the operations are working to different financial targets, for example break-even and/or surplus.

- 2.39** 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 COMPREHENSIVE INCOME AND EXPENDITURE STATEMENT (DISTRICT FUND SUMMARY IN NORTHERN IRELAND) IN THE ANNUAL STATEMENT OF ACCOUNTS

- 2.40** In the Comprehensive Income and Expenditure Statement, the aggregate performance of all category (a) operations in paragraph 2.33 of BVACOP 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 2.36 and 2.37 above) should be reported in the Financing and Investment Income and Expenditure line. 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.
- 2.40.1** Where trading operations are significant, an authority should consider whether separate disclosure on the face of the Comprehensive Income and Expenditure Statement is appropriate. Guidance on determining whether a trading operation is significant is provided in paragraphs 2.38.3–2.38.6.
- 2.40.2** The Code also requires the following note to be prepared:
- (2) 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.

Guidance on the information to be disclosed is provided in paragraphs 2.38.7 – 2.38.8 above.

- 2.40.3** Previous editions of BVACOP have also required disclosures in relation to the Local Authority Building Control Charge Regulations (England and Wales only) and the Local Authorities (Goods and Services) Act 1970. The Code does not require these disclosures, and they have therefore been removed from BVACOP. However, authorities should note that the removal of the requirement to report these amounts in the Statement of Accounts does not remove the requirement on local authorities to comply with the legislation.
- 2.40.4** Although significant trading operations may have their results disclosed separately in the Statement of Accounts (see paragraph 2.40.2), these results still have to be consolidated fully into the authority's overall financial outturn, represented by the Comprehensive Income and Expenditure Statement.
- 2.40.5** BVACOP has reaffirmed the importance that the real costs of services are reported comprehensively in all material respects; the concept of total cost. The costs of trading operations therefore need to be properly consolidated and the effect of internal recharges neutralised in determining what it really cost to provide a particular service. The treatment for income and expenditure on trading accounts should be as follows:

Some trading accounts will be an integral part of the total cost of particular services and should be consolidated fully into the total cost of that service (eg industrial estates, theatres and leisure management, trade waste, and car parks). The SEA in Section 3 of BVACOP notes the income and expenditure of these trading activities should be recorded gross within the appropriate service division(s). However, it should be noted that even though the income and expenditure of this service has been fully consolidated into the whole authority Income and Expenditure Account, if authorities view any of these services as significant trading operations then these should be disclosed in the Statement of Accounts.

Where a support service/internal trading account has a year-end balance attributable to under- or over-recovery of internal recharges, then the balance should be reapportioned to services, if doing so would have a material effect on total cost figures – the cost of the activity will then be absorbed fully by all its client services.

Where trading activity is with other parties and does not relate to the provision of the authority's own services, all transactions should be kept out of the total cost figures of individual services and the authority's net expenditure of continuing operations.

2.40.6 Authorities will need to be able to trace these various treatments through the accounts and provide a clear audit trail, to ensure that no income or expenditure has gone missing or been double counted in translating the ledger into the Statement of Accounts. However, there is no need for the reconciliation to be published. The results of trading operations can be disclosed as self-contained statements of performance, perhaps with a note setting out briefly how they have been reflected in the Statement of Accounts, but without a detailed proof that the aggregate surplus/deficit of all operations is reflected in the bottom line of the whole authority Comprehensive Income and Expenditure Statement.

2.40.7 For example, an authority might operate a building maintenance operation providing building maintenance services to the whole authority, to its council tenants' properties and to the neighbouring police authority. At the end of the financial year, the trading unit has the following financial results:

Element of the trading operation	Expenditure £000	Turnover (income) £000	Surplus/(deficit) £000
	3,045	2,980	(65)
	1,567	1,921	354
	1,232	1,308	76
	5,844	6,209	365

2.40.8 The trading account for building maintenance would be disclosed as indicated below, bringing together all aspects of its performance. (Note: the example below considers only the minimum financial information for disclosure. Full disclosure requirements for any activity should comply with paragraphs 2.38.7–2.38.8 above.)

Example disclosure note

The authority operates a building maintenance trading unit that carried out routine and programmed/planned maintenance on the authority's property portfolio, including council housing, as well as for the police authority. The projected financial outturn for the current year is:

		20yy/zz
		£000

	6,209
	5,844
	365

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.

- 2.40.9 However, each element of the operation will require separate treatment when incorporating the activity into the whole authority Comprehensive Income and Expenditure Statement. Ignoring implications of materiality for this example, the treatment would be:

Element of the trading operation	Treatment in the Comprehensive Income and Expenditure Statement
	The maintenance of dwellings is a function of the HRA and the activity should be reflected in the HRA. Subject to the guidance in the Housing Revenue Account Manual and the Housing SEA, the actual cost of maintenance should be incorporated into the net cost of the HRA. If the HRA has already been debited with trading recharges of £2,980,000, then debiting it with the attributable deficit of £65,000 would bring the total cost to the actual cost of £3,045,000.
	The surplus on the trading account shows that non-HRA services have been overcharged for the maintenance services provided (when comparing agreed recharges to actual cost). To avoid overstating the total cost of the service (divisions) or cost-based performance indicators, the surplus should be repatriated to services – an additional credit of £354,000 apportioned fairly across all client services would reduce the reported cost of maintenance work in service outturn to £1,567,000.
	By definition, support services provided to other parties should not be regarded as part of an authority's net cost of services. Neither the expenditure nor the income for this activity should be allocated or apportioned to services. Instead, the balance of £76,000 surplus will be consolidated into the Comprehensive Income and Expenditure Statement by adding it to the items in the Financing and Investment

2.40.10 This disaggregation of the building maintenance trading account is solely for the purposes of presenting the whole authority Income and Expenditure Account. It does not challenge the integrity of trading accounts when these are presented in isolation or used for management purposes.

Budgetary and Management Accounting Implications

2.40.11 The issue raised in the preceding paragraph highlights a general concern raised by practitioners: that of the relationship of BVACOP's requirements for reporting total cost and local authorities' budgeting or management accounting practices. BVACOP's provisions for trading accounts are dedicated to the consistent external reporting of performance. They are not intended to force authorities to adopt particular management practices or budgetary arrangements that strictly follow the total cost principle. For instance:

Authorities are not required to take all financial decisions on the basis of the accounting treatments prescribed by BVACOP. The treatments might be a factor in any decision, as the performance of the activity will eventually be reported in the BVACOP trading account format. But other accounting treatments can be judged as more appropriate when it comes to comparing internal and external tenders, setting targets and measuring performance for management purposes, determining budgets for trading managers or assessing the operational future of the trading operation.

Some of the requirements of BVACOP require the exclusion of costs from trading accounts for fairer presentation, particularly those relating to the Corporate and Democratic Core and Non Distributed Costs. Where elements of these costs were taken into account when setting tender prices, then excluding them from trading accounts may result in a 'windfall' surplus for the operation. It is for authorities to decide for themselves whether to recover these costs. However, it is also a matter for policy whether trading managers are able to retain (in budgetary terms) the windfall surpluses that would then arise in trading accounts – the accounting requirements of BVACOP would require these surpluses or deficits to be apportioned if they are material. Budgetary arrangements, rather than BVACOP provisions, will always determine the ownership of reserves arising on BVACOP-compliant trading accounts.

Reapportionment of surplus and deficits does not mean that accountability for the balance is taken away from trading managers – authorities can decide within their budgetary framework that trading operations can retain surpluses to meet future investment plans or be required to recover deficits from future trading. This is provided for in the Movement on Reserves Statement and in the general treatment of reserves as defined by the Code. Surpluses and deficits that have been consolidated can be appropriated to or from trading operation reserves. For instance, the authority might decide that the building maintenance operation described above can carry its surplus forward into the next year. £365,000 could be appropriated out of the General Fund Balance within the Movement on Reserves Statement and credited to the building maintenance operation's balances.

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.

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.

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

2.43.2 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.

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.

2.43.3 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.

2.43.4 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.

2.44 The composition of the CDC is given in Section 3.

2.44.1 The following table summarises the composition of CDC. Subsequent paragraphs provide guidance on individual elements of CDC.

Service	Division of service	What does it include?
	Democratic Representation and Management	<p>(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.</p> <p>(b) The costs associated with local government reorganisation.</p> <p>(c) The costs associated with officer time spent on appropriate advice and support activities.</p> <p>(d) Subscriptions to local authority associations and provincial councils.</p>
	Corporate	(a) The functions of the individual designated the head

	<p>Management</p>	<p>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.</p> <ul style="list-style-type: none"> (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; Revenue Support Grant; redistributed non-domestic rates and taxes. (f) The costs of statutory external audit. (g) The costs of external inspections. (h) The costs of treasury management. In Scotland treasury management charges are appropriately charged to the Loans Fund. (i) Bank charges, other than those that relate to accounts operated on a decentralised basis. In Scotland bank charges are appropriately charged to the Loans Fund. (j) The costs associated with supporting a local strategic partnership.
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2.44.2 Where overheads are not charged or apportioned, this fact should be disclosed. 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 Comprehensive Income and Expenditure Statement. CDC is included in the Central Services SEA.

Democratic Representation and Management

2.44.3 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.

2.44.4 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.

2.44.5 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 2.44.4.

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.

2.44.6 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 2.44.4

subscriptions to local authority associations and provincial councils.

2.44.7 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.

2.44.8 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.

2.44.9 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

2.44.10 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.

2.44.11 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; Revenue Support Grant; redistributed non-domestic rates and taxes

the costs associated with supporting a local strategic partnership.

2.44.12 CM also includes the following cost items:

treasury management and bank charges

external audit

external inspections.

Treasury Management and Bank Charges

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

2.44.14 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.

2.44.15 As the Code has adopted IAS 39 *Financial Instruments: Recognition and Measurement*, service revenue accounts should feature two potential transactions:

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 be a credit at the time the loan is advanced to the service or services benefiting from the financial assistance. 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 within Taxation and Non-Specific Grant Income.

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.

2.44.16 The CIPFA publication *Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes* (the TM Code), which was fully revised in 2009, 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.

2.44.17 The definition of treasury management in the TM Code is:

“The management of the organisation’s investments and 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.”

- 2.44.18 For consistency with the TM Code, BVACOP adopts the definition of treasury management used within the TM Code. This definition will be updated for any revisions to the approved TM Code in future years.
- 2.44.19 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.
- 2.44.20 In Scotland, bank charges and treasury management costs should be charged to the consolidated loans fund, where appropriate.

External Audit

- 2.44.21 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.
- 2.44.22 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.
- 2.44.23 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

2.44.24 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

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

Cross-service/Community Initiatives

2.44.26 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

2.44.27 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 responsible for the activities defined as CM, then such costs should be allocated to that service division.

The Costs of Producing the Budget

- 2.44.28 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.
- 2.45 Other central costs not included within the total cost of individual services are those that are defined as Non Distributed Costs (NDC). 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 Code as the increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits
- 2.45.1 IAS 19 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 IAS 19-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.
- 2.45.2 Past service costs (for a defined benefit scheme) are defined by the Code as the increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits.
- 2.45.3 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.
- 2.45.4 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.

- 2.45.5 The Code 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. 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.
- 2.45.6 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.
- 2.45.7 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.
- 2.45.8 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. This is not 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.
- (b) settlements relating to retirement benefits (if any) – these are defined by the Code

2.45.9 The Code defines settlements as follows:

“A ‘settlement’ arises when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan. Settlements have the effect of extinguishing a portion of the plan liabilities, usually by transferring plan assets to or on behalf of plan members to their new employer or an insurance company in settlement of the obligation.”

2.45.10 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

- (c) the transfer of scheme assets and liabilities relating to a group of employees leaving the scheme.
- (c) curtailments relating to retirement benefits (if any) – these are defined by the Code

2.45.11 The Code defines curtailments as follows:

“A ‘curtailment’ occurs when an authority either:

- (a) is demonstrably committed to make a significant reduction in the number of employees covered by a plan, or*
- (b) amends the terms of a defined benefit plan so that a significant element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.”*

2.45.12 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.
- (d) the costs associated with unused shares of IT facilities
- (e) the costs of shares of other long-term unused but unrealisable assets

2.45.13 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.

2.45.14 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.

2.45.15 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.

- (f) impairment losses relating to assets under construction, non-current assets held for sale, other surplus assets held for disposal (but which do not satisfy the criteria in the Code to be classified as held for sale) and depreciation on the latter category of assets

2.45.16 Impairment losses relating to any non-operational assets – ie assets under construction, non-current assets held for sale and other surplus assets (other than investment properties) form part of Non Distributed Costs. Costs associated with abortive capital projects are not impairments, and should be charged to the relevant service revenue account (see paragraph 2.13.4 of BVACOP).

2.45.17 Surplus assets are those assets which are not being used (or developed for future use) by a service, but which do not meet the criteria to be classified as either investment property or assets held for sale.

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

2.45.18 Where overheads are not charged or apportioned, this fact should be disclosed. 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 Comprehensive Income and Expenditure Statement. Non Distributed Costs are included in the Central Services SEA.

(h) income and expenditure in respect of the Carbon Reduction Commitment Scheme

2.45.19 Both the purchase of allowances and income from recycled allowances relating to the Carbon Reduction Commitment Scheme should be treated as Non Distributed 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 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 a subsidiary (or a jointly controlled entity consolidated using proportional consolidation) can be identified to service headings, gross total cost for services should include any impairment of goodwill that arose on the acquisition of an interest in a subsidiary (or jointly controlled entity consolidated using proportional consolidation). Where this is not possible, impairment of goodwill should be presented as a separate line in net expenditure of continuing operations.

2.49.1 Where an interest in a subsidiary, associate or joint venture is acquired and the consideration given for the interest is 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. Under IFRS, goodwill is not amortised. However, goodwill should be reviewed for impairment and any impairment charged to the relevant service revenue account.

Deleted: (as was the case under the SORP and UK GAAP)

2.49.2 Where the activities of the entity that has been acquired by the authority involve more than one service division, any impairment of goodwill should be apportioned on a reasonable and practical basis, following (where possible) the seven principles of apportionment. This may, for example, be on a basis of the group income and expenditure attributable to the subsidiary.

2.49.3 Where the activities of the entity include elements that are not included in the SEA, the impairment charge in relation to those elements should be made to a separate heading in the net expenditure of continuing operations.

Where the activities of a subsidiary (or a jointly controlled entity consolidated using proportional consolidation) 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.

- 2.49.4 The effect of these provisions is that for group financial reporting, the operating results of subsidiaries (and jointly controlled entities consolidated using proportional consolidation) (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 (including the corporate costs of Corporate and Democratic Core and any relevant Non Distributed Costs).
- 2.49.5 There may be two instances where allocation is not possible:
- The subsidiary (or jointly controlled entity consolidated using proportional consolidation) carries out activities that are not covered by the SEA – in this case, the authority will create appropriate new divisions of service.
- The subsidiary (or jointly controlled entity consolidated using proportional consolidation) has corporate expenses that cannot be allocated or apportioned to particular services – this will rarely be the case but subsidiaries (or jointly controlled entities) 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 elsewhere in BVACOP.
- 2.49.6 Authorities should also ensure that the allocations of subsidiary (or jointly controlled entity consolidated using proportional consolidation) expenditure across the SEA headings comply in all material respects with the seven general principles of overhead recharging.
- 2.49.7 Transactions of a subsidiary 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.
- 2.49.8 It is recommended that the authority advise the company of the structure and reporting requirements of the SEA so that it can provide relevant information to the authority. Authorities may insert a new line (or lines) in the segmental analysis where the activities of the company do not meet the definitions of any of the service divisions in Section 3 of BVACOP. These new lines will normally need to be added where services are provided by subsidiaries that offer diverse services that are not normally provided by local authorities. When adding new lines to the segmental analysis, local authorities should ensure that the descriptions of these services clearly demonstrate what services are provided and are understandable to readers of

Deduct £1m gross income from Adult Social Care segment.

Deduct £500,000 from gross expenditure on Facilities Management Services charged to Children's and Education Services segments.

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.

2.49.11 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.

2.49.12 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.

2.49.13 The following example shows how depreciation is adjusted:

Subsidiary Y provides building services to Anytown Unitary Authority. It has provided a new school building at a cost of £4m. At the end of the year, the council capitalised this at £4.5m based on the payments made to Subsidiary Y. The school is estimated to have a useful life of 30 years. Therefore depreciation charged for the year is £75,000 (the council has a policy of charging depreciation based on a mid-year figure). Depreciation charged on the actual cost of the asset would be £67,000 (rounded to the nearest thousand pounds).

Therefore, to adjust for the depreciation charge, the following entries are required:

Accumulated depreciation Anytown Unitary Authority	£8,000
Service Revenue Account in the adjusted Income and Expenditure Account of Anytown Unitary Authority	£8,000
To abate the depreciation charge in the council's adjusted Income and Expenditure Account	

Apart from any unrealised profits covered by the previous item, no adjustment should be made for associates and joint ventures consolidated using the equity method 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.

2.49.14 Associates and joint ventures (except jointly controlled entities consolidated using proportionate consolidation) are brought into group accounts using the equity methodology. The transactions of such entities are not consolidated on a line-by-line basis. 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 will be shown in the Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement.

2.49.15 Transactions between the authority and associates and joint ventures (except jointly controlled entities consolidated using proportionate consolidation) 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 2.49.9 and 2.49.10).



2.49.16 Authorities will also need to consider the following requirements of the Code:

Paragraph 9.1.2.48 of the Code states: "*Group Accounts shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances. The accounting policies of the subsidiaries, associates and jointly controlled entities shall be aligned with the policies of the reporting authority, for the purposes of Group Accounts, where materially different. Such adjustments as are necessary to align the group accounting policies may be made as consolidation adjustments.*"

The assets, liabilities, income and expenses of a subsidiary (and jointly controlled entity consolidated using proportionate consolidation) are combined line by line with similar items in the authority's single entity financial statements or reported as separate line items to the authority's single entity financial statements.

2.49.17 The effect of these references is that, where an authority has subsidiaries (and jointly controlled entity consolidated using proportionate consolidation) 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.

2.49.18 Examples of the group account statements, which may be presented alongside the single entity statements, are contained in the CIPFA publication *Code of Practice on Local Authority Accounting – Guidance Notes for Practitioners*.



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