
TRADING OPERATIONS SUB COMMITTEE

ITEM 5

3rd December 2008

REPORT BY DIRECTORS OF TECHNICAL SERVICES AND CORPORATE RESOURCES

REVIEW OF THE REMIT & SCOPE OF THE TRADING OPERATIONS SUB COMMITTEE

1 Purpose of Report

- 1.1 To recommend proposed changes to the remit and scope of the Trading Operations Sub Committee.**

2 Background

- 2.1 The Trading Operations Sub Committee receives regular reports on those services operating as Trading Operations (as defined by the Local Government in Scotland Act 2003) which are all within the Technical Services Department:

- SBC Contracts
- Vehicle Maintenance
- Grounds Maintenance
- Catering and Building Cleaning

- 2.2 In recent months areas for improvement and review in the business of this sub committee have been identified by both Members and Officers. In particular:

- There is lack of clarity of the sub committee's remit
- The report format has not focussed on potential risks faced by Trading Operations and how the financial projections link to operational issues
- SBC Contracts, with significant external trading, would benefit from more attention on the key operational decisions that drive this organisation
- The link of the sub committee's work to improving performance in trading operations has not been transparent
- There has been little consideration by the sub committee of strategic decisions relating to the exposure to and nature of external trading and charging by other services across the Council as a whole, where these charges are made in a competitive environment.

3 Proposals

- 3.1 In devising a revised remit for the sub committee, it is proposed that there should be a consideration of the key differences and risks between 'trading organisations' and other services. Those key differences are listed below:

- There is an increased financial risk due to exposure to external trading.
- Policy decisions relating to charging could further increase that financial risk.
- There is a risk to the viability of the services involved due to the potential impact of external competition, market forces, or trading legislation.
- These risks may lead to conflicts between the management of trading operations and corporate council policies (for example employment policies)

The revised remit should recognise these differences. Proposals are set out in Appendix 1.

- 3.2 The recommendation is that the Trading Operations Sub Committee focuses primarily on the strategic management of the Council's exposure to trading and charging risk, and thus on the financial and performance management of SBc Contracts.

In addition, all general issues relating to the application of trading and charging powers should be considered by the sub committee for all services of the Council that provide services to external customers in a competitive environment. The sub committee should also consider operational issues and policies relating to all services of the Council that trade and charge externally – but these should be in relation to trading and charging issues primarily.

- 3.3 The scope of the sub committee's work to date has been to focus on those services set out in paragraph 2.1 that have historically been determined as trading operations. Other than in SBc Contracts, however, the level of external competition and risk for these services is quite limited. There are also services operated within other Council Departments that potentially should be reviewed for inclusion, most significantly the letting of industrial estates and civic halls and care/residential services.

Appendix 2 is an assessment of those services that should be considered trading organisations in future.

It is recommended that other than SBc Contracts, no other Council service is treated as a trading organisation. (Unless there is a significant service development that would justify a new one.)

- 3.4 It is proposed that policy issues formerly considered by the sub committee in respect of Vehicle Maintenance, Catering and Cleaning and Grounds Maintenance would in future go forward to the Administration Policy Working Group and ratified by Executive, as do other Council services.
- 3.5 Service review and performance issues related to these three services can be reported to the Performance Management Panel in future, in common with other services.
- 3.6 Currently the information reported to Executive on financial monitoring for Trading Operations is consolidated into one line. If the proposal that three services no longer would be reported as Trading Operations is approved, it is proposed that information for these services is set out separately within the General Fund reports. Where the service is largely recharged this would be presented in a similar way to information provided for Passenger Transport, with separate income and expenditure lines.
- 3.7 Given the revised remit of the sub committee, Members may wish to consider whether the constitution of the sub committee should be reviewed.
- 3.8 Under this new remit, in addition to more detailed reporting of SBc Contracts, other reports that could be considered might include:

- Policies on expansion or reduction of external trading
- Budget and business plans in respect of trading and charging activities
- Review and develop risk mitigation plans for external trading
- Review and develop policies and plans for working with sub-contractors
- Review and develop partnership risks
- Review of Council-wide external charging income budgets, where the income is generated in a competitive environment.

4 Financial Implications

4.1 For trading operations that continue to meet the trading account criteria they will continue to be required over a 3 year period to:

- Recover their operating costs from recharges made to internal and external customers i.e. breakeven.
- Make a surplus which contributes to the general fund revenue budget.

4.2 Where a service is no longer required to be operated as a trading operation an expenditure budget would need to be created in the Technical Services revenue budget. These would be funded from:

- Income generated from work for internal client departments
- External income from work for external customers.

There is not anticipated to be any net budgetary impact to the Council as a result of this accounting change.

4.3 There is no net financial impact to the Council as a result of this paper.

5 Consultation

5.1 The Heads of Corporate Finance, Financial Administration, Corporate Administration, and Legal Services have been consulted and their comments have been incorporated into the report.

6 Equality

6.1 There are no equality issues directly associated with this report.

7 Environment

7.1 There are no environmental issues directly associated with this report.

8 Risk Commentary

8.1 There is a financial risk to the authority as a result of undertaking trading activity, and this needs to be effectively managed.

8.2 The recommendations for the revised remit of the Trading Operations Sub Committee will ensure focus is on mitigating the greatest risks.

9 Summary

9.1 It has been recognised that the scope and remit of the trading operations sub committee required review.

9.2 This review has recognised that the greatest risks and issues associated with trading and charging powers are currently not being mitigated as effectively as possible by the

operation of the current sub committee business.

- 9.3 It is recommended that three of those organisations currently defined as trading operations cease to be so defined.
- 9.4 It is recommended that none of the other Council Services be newly defined as trading operations.
- 9.5 It is recommended that the remit of the sub committee is widened in a number of areas to mitigate risk and consider strategic issues of trading and charging for all Council Services, generated in a competitive environment. It is recommended that other Committees of the Council receive further financial and performance information as appropriate.

10 Recommendations

10.1 I recommend that the Sub Committee:

- (a) **Agrees that SBc Contracts continues as a significant trading operation.**
- (b) **Recommends to Executive that Catering and Cleaning, Grounds Maintenance and Fleet Management cease to be classed as trading operations and be transferred to the General Fund Revenue Budget within Technical Services.**
- (c) **Recommends to Executive that the letting of industrial units, car-parking facilities, printing services, professional and support services, civic halls, theatres, museums, and care/residential services are not reclassified as trading operations and that their budgets continue to be reported as at present.**
- (d) **Recommends to Executive that the remit of the sub committee be set out as in Appendix 1.**
- (e) **Considers the points made in paragraphs 3.4 to 3.7 in order to recommend an approach to Executive regarding the links to other Committees and Working Groups.**

Approved by

Name	Designation	Signature
Callum Hay	Director of Technical Services	[insert signature]
John Campbell	Director of Corporate Resources	[insert signature]

Author(s)

Name	Designation

Background Papers:

ADD AS APPROPRIATE

Previous Minute Reference:

Future Remit of Trading Sub Committee

- To ensure an appropriate level of scrutiny to the financial risk held by the authority as a result of exposure to external trading, charging and competition.
- To monitor detailed performance and financial information for SBc Contracts Significant Trading Organisation.
- To be an initial sounding board for the setting of priorities and policy for the Council regarding the level and nature of exposure of the organisation to operating external trading risks.
- To be an initial sounding board for the setting of long term strategy for the development of the use of trading and charging powers.
- To consider initial alternative options for service delivery such as partnering and joint working for services in the organisation where there is a trading element.
- To manage the Council's overall external risk as a result of external trading and charging.
- To consider the most effective means of managing such risk – for example, policies and procedures on income management, management structures.
- To be an initial sounding board to consider appropriate charges and profit margins for work undertaken by the Council in an external competitive environment.
- To maximise the benefit to the Council, and to the well-being of the Scottish Borders through effective use of trading powers.

APPENDIX 2

INTRODUCTION

- 1.1 Local Authorities are required to prepare trading accounts for those parts of their services which meet the two criteria below **and** which pass the test of “significance” (see 3.3 below)
 - The service is provided in a “competitive environment” -i.e. the user has discretion to use an alternative provider, and;
 - The service is charged for on a basis other than a straightforward recharge of cost -i.e. users take the service on the basis of quoted lump sums, fixed periodical charges or rates, or a combination of these.
- 1.2 The CIPFA guidance note “A Best Value Approach to Trading Accounts“ outlines a model for the appraisal of such operations. If the results identify that an operation fits the “trading operations” criteria, a further check is made to determine whether that operation should be deemed as “significant”.
- 1.3 If a service counts as a significant trading operation it is required to prepare and disclose trading accounts and to ensure that expenditure is no greater than income over a rolling three year period. SBc Contracts is the only trading operation that is currently reported as being “significant”.
- 1.4 In accordance with CIPFA / LASAAC guidance each existing trading operation within the Technical Services department has been appraised against the standard tests of whether or not it is a trading operation, and if so, if it is a “significant” trading operation.
- 1.5 The CIPFA guidance also suggests that Authorities should continue to identify others which could be considered as “trading” within the terms of the 2003 Local Government in Scotland Act (The Act).

THE EVALUATION PROCESS

- 2.1 The guidance on the Act defines a “competitive environment “ as one where the users have discretion to use alternative providers.
- 2.2 Where a service does not satisfy both criteria then it does not meet the definition of a trading operation.
- 2.3 A trading account is only required if both criteria are met **and** satisfied, further tests must be applied to determine it is a “significant” trading operation.
- 2.4 When assessing the “significance” of a trading operation the Act states that it is the duty of each local authority to determine the parameters of what constitutes “significance”. The following key tests are proposed:
 - Size of turnover relative to the Authority’s net revenue budget.
 - Risk of financial loss to the Authority in carrying out the operation.
 - Exposure to service risk or loss of reputation in carrying out the operation.

REVIEW OF CURRENT AND POTENTIAL TRADING OPERATIONS

Status as a Trading Operation

- 3.1 An analysis of the charging mechanism and competitive environment of the existing trading operations is contained in table 1 below.

Table 1: Current Trading Operations Recharging Mechanism and Competitive Environment

Trading Operation	Competitive Environment	Recharging Mechanism
SBC Contracts	Yes	Tariff / Cost Plus / Quoted Fixed Price
Catering and Cleaning	No	Uplifted Historic Contract Price
Grounds Maintenance	No	Uplifted Historic Contract Price / Hourly Rate
Fleet Management	No	Contract Price per Vehicle / Hourly Rate Plus Parts

Status as a Significant Trading Operation

- 3.2 Given that Grounds Maintenance, Catering and Cleaning, and Fleet Management fail the initial two tests, there is no further need to consider whether they are “significant” trading operations.
- 3.3 The guidance outlines a number of tests of “significance”. These include
- Size of the turnover of the Trading Operation in relation to the Council’s net revenue budget;
 - Risk of financial loss to the Council
 - Risk of reputational loss to the Council in carrying out the operation

Relative Size of Trading Operations Turnover

- 3.4 An analysis of the relative size of each of the current trading operations 2007/08 budgeted turnover in relation to the Authority’s net revenue budget of £223 million has been undertaken. This is detailed in table 2 below:

Table 2: Trading Operations Budgeted Income as a Percentage of the Council’s Net Budgeted Turnover of £223 million

Trading Operation	2007/08 Base Income Budget	As a % of the Council’s Turnover
	£000	%
SBC Contracts	(27,288)	12.2
Fleet Management	(3,208)	1.4
Catering and Cleaning	(5,015)	2.2
Grounds Maintenance	(3,470)	1.5

- 3.5 Executive, 20th March 2004 agreed that of 5 % of Scottish Borders Council's net revenue budget would be classified as significant. Only SBc Contracts should continue to be treated as "significant" trading operation. This is consistent with the baseline used when the CIPFA guidance note "A Best Value Approach to Trading Accounts" was originally used by the Council to identify the current trading operations.

Financial Risk

- 3.6 Financial risk is defined in terms of factors that would result in the Trading Operation making a financial loss. This would occur when it was unable to cover its operating costs over a 3 year period.
- 3.7 The level of financial risk has been assessed by analysing:
- The proportion of total income that is earned from external sources
 - The size and nature of the external competition.
- 3.8 Table 3 below analyses the 2007/8 income base budgets of each trading operation between income from internal and external sources.

Table 3: Analysis of Trading Operation 2007/8 Internal and External Income Budgets

Trading Operation	2007/08 Budgeted Surplus	Internal Income Budget		External Income Budget		Level of Financial Risk
	£000	£000	%	£000	%	
SBc Contracts	(302)	(14,406)	52.79	(12,882)	47.21	High

- 3.9 SBC Contracts has by far the largest element of external income at over 47% of its baseline income budget. This budgeted income is made up of:
- Contracts that have been won and are in place at the beginning of the financial year
 - Work that has still to be secured at the beginning of the financial year where quotes may or may not have been supplied to potential customers.
- 3.10 External income has in the past made a significant contribution to the surplus generated by SBc Contracts. Table 1 also indicates it is exposed to a high level of external competition. As a result the Council is exposed to a medium to high level of financial risk in carrying out this operation. SBc Contracts should therefore continue to be classified as a "significant" trading operation.
- 3.11 With Fleet Management table 1 indicates it is not exposed to a high level of external competition. In addition, its turnover is well below the 5% of the net revenue budget agreed by the Executive. The operation has a low proportion of fixed costs, which means that costs can be effectively curtailed in response to lower income. These factors recommend treating the operation as non-"significant".
- 3.12 With Catering and Building Cleaning table 1 indicates that it is not exposed to a high level of external competition. Its turnover at £5m at 2.2% it is also well below the 5% of the Councils net Revenue Budget
- 3.13 With Grounds Maintenance table 1 indicates that it is not exposed to a high level of external competition. Its turnover at £3.4m at 1.5% it is also well below the 5% of the Councils net Revenue Budget

Risk of Service or Loss of Reputation

- 3.14 In terms of service risk or loss of reputation, all the trading operations are exposed to service risk. In terms of the level of risk the trading operations with the largest element of external income are exposed to the highest risk, namely SBc Contracts.

Other Council Services to Be Considered As “Trading”

- 3.15 The CIPFA guidance note “A Best Value Approach to Trading Accounts” provides a list of services that should be considered as “trading” within the terms of the Local Government Act. Services listed that are provided by Technical Services and the Council’s other departments include:

- a) The letting of industrial estates (Planning and Economic Development)
- b) Car parking facilities (Technical Services)
- c) Civic halls (Education and Lifelong Learning)
- d) Theatres and museums (Education and Lifelong Learning)
- e) Care / residential services (Social Work)
- f) Printing services (Corporate Resources)
- g) Professional and support services (Corporate Resources)

- 3.16 The results of applying the initial tests to the above services are set out below:

Service	Competitive Environment	Basis of Charge	Trading
Letting of industrial estates	Yes-tenant has choice of landlords	Yes-rents set by market factors	Yes
Car-Parking Facilities	No-no other provider of parking in the Borders		No
Printing Services	No-user has no choice		No
Professional and Support Services	No-user cannot use alternative providers		No
Civic Halls	Limited-some competition exists in form of rugby clubs, private halls etc but they do not match the capacity of the Council facilities.	No-Halls are let at a loss	No
Museums	No-individual nature of museums excludes competition		No
Residential Care Services	Yes-user has a choice of private care home provider or Council facilities	No-charge is designed to recover cost of providing that place	No

- 3.17 Letting of industrial estates is the only service which meets the two initial tests for a trading operation. The service fails to meet the test for a “significant” trading operation because;

- (a) The income from lettings of £1.4m is well short of the agreed 5% threshold;
- (b) Risk of financial loss is low due to a broad spread of customers.

SUMMARY

SBC Contracts should remain a Trading Organisation

The Catering and Cleaning, Grounds Maintenance and Fleet Maintenance services do not meet the criteria for trading operations set out by the Local Government Act, and are thus not required to maintain a separate trading account.

A review of other services across the Council has not identified any which would be required to prepare a separate trading account.