
HM Treasury

Public Expenditure System

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CENTRAL GOVERNMENT FEES AND CHARGES POLICY (COST OF CAPITAL / RATE OF RETURN); AND REQUIRED RATE OF RETURNS FROM TRADING FUNDS

Purpose

1. This PES paper provides departments with guidance on how and when to implement revised cost of capital / rates of return for central government fees and charges services; and a consequent review of the financial objectives (the required rates of return) of Government Trading Funds.

Summary

2. The revised cost of capital/rates of return will shortly be announced in a Written Ministerial Statement. They should be used in determining fees and charges in the next Fees Order (or equivalent point for commercial or other charges). Where a consequent change in fees or charges is required, it **should be effective no later than 1 April 2004**. The overall rates of return required of trading funds should also be reviewed in the light of the update in fees and charges policy and the nature of each fund's activities, and adjusted if necessary, **during the financial year 2003-04, so as to be effective by 1 April 2004 at the latest**.

3. The budgetary impact of the changes will be treated as a classification change. Therefore departments will need to agree revised figures which reflect the effect of the new rates on income from departments and the required rate of return from trading funds and NDPBs and NHS bodies also affected by the fees and charges guidance so as to be ready to input these changes into the PES database **by week commencing 19 January 2004 for next year**. Departments will want to feed the impact of the resultant review into discussion on their SR2004 **baseline**.

Background

4. [PES \(2002\) 35](#) of 20 December 2002 provided guidance on managing the impact on departmental budgets of the reduction in the RAB cost of capital charge on departmental net assets (excluding their trading funds) and those of their NDPBs to 3.5 per cent which took place in 2003-04 Main Estimates. But departments were advised to wait for separate guidance before making any changes to the cost of capital included in fees and charges or the rate of return on capital employed in trading funds and other commercial services. Pending guidance on the required rates of return of trading funds, the cost of capital borne by departments on the net assets of their trading funds is still based on the required rates of return set out in the relevant Treasury Minute (see the [Resource Accounting Manual](#), paragraph 7.6.3.a.1).

5. On 16 July, the Chief Secretary wrote to the Deputy Prime Minister (copying to other Cabinet Ministers) advising that he had reviewed the normal recovery policy for services where fees and charges are set by central government. He attached a draft Written Ministerial Statement to Parliament, which will be tabled on 8 September, to announce:

- reduction in cost of capital rate in fees and charges where the norm is full cost recovery from

6 to 3.5 per cent (same as the reduction in RAB cost of capital);

- for commercial services where there is or may be private sector competition, and a profit may be appropriate, to replace the required rate of return of at least 8 per cent with an illustrative range starting with 5.5 per cent - we want departments to make their own assessment of the appropriate rate of return for commercial services, but we would expect the rate to fall in a range 5.5 per cent to 15 per cent depending on factors such as the level of risk:
- as a consequence of the revised policy on fees and charges, the financial objectives of Government Trading Funds (the required rates of return) will also need to be reviewed during the financial year 2003-04, and adjusted as necessary;
- where a consequent change in fees and charges, or in a Trading Fund's required rate of return, is required, it should be effective no later than 1 April 2004.

The final text of the written statement is at [Annex 1](#). There are some minor changes to the first paragraph as it has been decided that [Annex 2](#) (which was originally an Annex to the draft statement need not appear in Hansard, though it is, of course, essential information for implementing the changes.

6. **Coverage** - The revised policy applies to central government departments (including agencies and Trading Funds) NHS Trusts, and other NHS bodies and appropriate non-departmental public bodies. The guidance does not apply to "self-financing public corporations" (as defined by Treasury GES Team) or where local authorities set the fees and charges, though broadly similar legal considerations apply.

7. **Accounting treatment** – Any changes, arising from this paper, in department's accounts will be treated as a change in estimation technique (in accordance with FRS18 "Accounting Policies") in 2004-05. There will be no restating of previous year's figures in the accounts.

8. **Budgeting treatment** - With the exception of trading funds, the cost side of departments' DEL has already been adjusted for the reduction in the cost of capital from 6 to 3.5 per cent of net assets. Adjustments now will be in respect of income from fees and charges, and of the cost of capital borne by departments on the net assets of their trading funds. In departments' settlement letters in SR2002 the CST said that in the event of a change in cost of capital charge departments' budgets would be restated. The intention was that departments should neither suffer nor benefit as a result of these changes. This principle applies also to the effect of the adjustments in this paper. We will therefore be treating these changes as **classification changes**.

Action required

9. A Dear Accounting Officer (DAO) letter will be issued next week including the Hansard reference for the Ministerial Statement noting the revision of the rates of cost of capital/rates of return in Treasury guidance such as the *Fees and Charges Guide* and the *Guidance on Selling Government Services into Wider Markets*.

10. Departments should therefore consider whether they have a regular Fees Order for a statutory service (or equivalent point for other types of charges), which would be effective before next April. If so, it is from that point that they should use the new rate in determining the level fees and charges. (The exact timing of the implementation will depend on any requirement for Treasury approval, eg in the legislation, or for Parliamentary approval, etc.) Otherwise the objective is an effective date no later than 1 April 2004. The effect on income from fees and charges from 1 April 2004 should be estimated in time to meet the timetable for adjusting DEL.

11. A review of the required rates of return of Trading Funds should be got underway in discussion with the Treasury Spending Team with a view to laying a new Treasury Minute effective from 1 April 2004. A decision will need to be made by end-November 2003 so that the effect on the cost of capital borne by departments on the net assets of their trading funds can be assessed in time to meet the timetable for adjusting DEL.
12. Departments are required to agree consequent changes to their DEL with their Spending Team and GEP by mid-December, and before the changes can be committed on the database.
13. A timetable for agreeing these changes is set out below:

Action Required	Completed by
Departments to use new rates of cost of capital/rates of return to determine the level of fees and charges seeking any necessary Treasury approval from the Spending Team	Main Estimates 2004-05
Departments review the required rate of return from their Trading Funds in discussion with their Spending team and submit a new Treasury Minute to Departmental and Treasury Ministers for approval	End-November 2003
Departments assessment of the impact on their DEL received by Spending Team, copied to Liz Passman in GEP	mid-December
Departments reflect their view of changes on database	w/c 19/1/04*
HMT Assess and agree changes with department	24/1/04
Departments submit final updates to database to reflect agreed changes	w/c 16/2/04*
Database closes for spring Budget and 2004-05 Main Estimates	w/c 23/2/04*

*** - The exact timetable for the PES Winter Update Round has not yet been finalized. Full timetable details for updating the PES database will be included in the relevant PES paper, to be published in November 2003.**

Adjustment needed in fees and charges

14. From the details in Annexes [1](#) and [2](#) attached, departments will observe that:
- For **statutory fees and charges, commercial services where there is no competition, and inter- and intra- departmental services**, the change to be made is a straightforward reduction in cost of capital from 6 to 3.5 per cent. Depending on the size of the cost of capital element within total costs, this may mean that the level of individual fees or charges, and hence the income from them, will have to be reduced, or will increase to a lesser extent than would otherwise have been the case.
 - For **commercial services where there is or may be private sector competition** departments should make their own assessment of the appropriate rate of return, taking account of the illustrative range in paragraph five above, and the further advice in [Annex 3](#). For some this may mean a significant change in the rate of return and level of prices. For some it may be that the level of charges is already be consistent with the revised guidance and will need no change.

Adjustment needed to Trading Funds required rates of return

15. The statutory duty of a Trading Fund is to at least break even taking one year with another. Funds are also required to achieve such further financial objective as has been determined by the

responsible Minister (with Treasury concurrence) and set out in a Treasury Minute laid before the Commons. It is this further objective which needs review. The further financial objective should therefore be determined individually for each Fund to reflect the nature of their activities. Further guidance is given in [Annex 4](#).

Impact of the changes on departmental budgets

16. For fees and charges other than those operated by Trading Funds departments should assess the impact of any relevant reduction in income on their budgets and advise their Treasury Spending team who will need to agree whether or not a classification change is necessary and in which years.

17. For Trading Funds, the sponsor department's DEL will need to be adjusted to reflect any change in the required rate of return on capital employed and will also need to be agreed with the Treasury Spending Team.

18. Details of changes to be made to the PES database, and the RFC code to be used, will be given in the Winter Update Round PES paper to be issued in November 2003.

Performance measurement

19. Although the cost of capital charged on the expenditure side of departments Resource Accounts and Budgets has been 3.5 per cent since April 2003, in their Memorandum Trading Accounts or other accounts used in determining whether or not full cost recovery (or the agreed financial objective for the service) has been achieved, performance should be measured on the basis of 6 per cent cost of capital/rate of return until the date of the reduction in the level of the fee or charge to reflect 3.5 per cent.

Queries

20. If you have any queries regarding the content of this PES paper please contact the appropriate person listed below:

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Impact of the changes on DEL	Liz Passman	020 7270 5778 elizabeth.passman@hm-treasury.x.gsi.gov.uk
Classification and recording issues	Russell Coleman	020 7270 5338 russell.coleman@hm-treasury.x.gsi.gov.uk
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Database update issues	Your usual data unit contact	
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Previous PES papers

21. Electronic versions of PES papers issued since November 1999 may be found on [the Treasury's GSI website](#). The [PES Secretariat](#) on 020 7270 5525 can supply further information on PES Papers.