

GUIDE TO THE ESTABLISHMENT AND OPERATION OF TRADING FUNDS

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HM Treasury

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1. This guidance updates that issued in January 2001 and is for the benefit of departments, trading funds and prospective trading funds. It will be subject to future review and amendment in the light of developments that impact on trading funds.

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EXECUTIVE SUMMARY

ES.1 Trading funds are a means of financing the revenue-generating operations of a government department which takes them outside the Supply process. They are not separate legal entities and remain part of a department (or are departments in their own right) (*chapter 1*).

ES.2 The statutory framework within which trading funds operate is set out in the Government Trading Funds Act 1973, as amended by the Government Trading Act 1990 and the Finance Acts 1991, 1993 and 2001. Further guidance is contained in the White Paper *The Financing and Accountability of Next Steps Agencies* (Cm 914) issued in December 1989 which sets the scene for the Government Trading Act 1990 (*chapter 1*).

ES.3 The primary advantages of trading fund status are that it engenders a more commercial and business-like approach to managing the activities and that, compared with being financed from Supply, it offers more flexibility in matching income and expenditure and financing minor capital expenditure (*chapter 1*).

ES.4 Trading funds retain their trading income which is used to meet expenditure. Capital expenditure is financed from loans arranged through either their parent department or, if there is none, directly from the National Loans Fund. It may also be possible to use accumulated cash resources (*chapter 1*).

ES.5 Although the 1973 Act appears to restrict the suitability of trading fund status to activities that are already revenue-generating, legal opinion has confirmed that a trading fund can be established where a customer/supplier relationship can be introduced which involves full payment for the goods or services provided. It is important to obtain the agreement of the Office for National Statistics to the establishment of a trading fund in case of any problem over the nature of the income (*chapter 2*).

ES.6 Trading funds are established by secondary legislation, (ie a statutory instrument also described as a trading fund Order) with the approval of the Treasury. Trading fund candidates must satisfy a number of statutory and administrative tests (*chapter 3*).

ES.7 The operations which a trading fund is established to undertake are described in its Order; due consideration must be given to the implications of expanding the business into areas which are not covered by the Order (*chapter 3*).

ES.8 Trading funds are established with opening loan capital and public dividend capital which, together with any reserves brought forward, match the value of the assets and liabilities appropriated to the fund (*chapters 5, 6 and 7*).

ES.9 Only transactions between a trading fund and a department score for budgeting purposes, ie (mainly) interest and dividends paid by the fund to the department, and any borrowing (net of repayments) (*chapter 11*).

ES.10 Trading funds set their charges in accordance with the *Fees and Charges Guide*,

ie to recover full costs and earn the appropriate return on capital employed (*chapter 12*).

ES.11 Trading funds are required to achieve agreed financial targets and to pay a return in the form of interest on the loan capital and dividends on the public dividend capital and reserves (*chapters 11 and 12*).

ES.12 A trading fund is under the “control and management” of the responsible Minister with the Chief Executive of the trading fund, as the Accounting Officer, being personally responsible for the day-to-day management of the trading fund. He or she is supported by a Board which includes non-executives. Governance arrangements for trading funds are currently being reviewed by the Shareholder Executive (*chapter 13*).

ES. 13 Although trading funds may establish joint ventures with the private sector to further the exploitation of information gathered or of research undertaken in the course of its core operations, it would be inconsistent with the provisions of trading fund legislation if core operations were undertaken through joint ventures (*chapter 14*).

ES.14 Trading funds are required to prepare medium-term corporate and annual business plans for approval by the department; and to submit regular monitoring reports to the department and, if requested, to the Treasury (*chapter 15*).

ES.15 Trading funds are required to prepare an annual report and accounts in accordance with guidance issued by the Treasury. The accounts are audited by the Comptroller and Auditor General and the combined report and accounts laid before Parliament before the Summer Recess (*chapter 15*).

CHAPTER 1

INTRODUCTION AND OVERVIEW

- 1.1 PURPOSE OF THE GUIDE
- 1.2 DEVELOPMENT OF THE GUIDE
- 1.3 HISTORICAL BACKGROUND TO TRADING FUNDS
- 1.4 KEY CHARACTERISTICS OF A TRADING FUND
- 1.5 FINANCING FRAMEWORK
- 1.6 BENEFITS OF OPERATING AS A TRADING FUND
- 1.7 GOVERNMENT-OWNED COMPANY AS AN ALTERNATIVE TO TRADING FUND STATUS

1.1 PURPOSE OF THE GUIDE

1.1.1 This guide details the policy and procedures involved for the establishment and operation of Government trading funds. It is intended for all those who have an interest in, or are involved in, setting up or operating trading funds. Chapter 1 provides an introduction and overview; Chapters 2-4 cover issues relating to the establishment of trading funds; and chapters 5-16 cover operating issues.

1.2 DEVELOPMENT OF THE GUIDE

1.2.1 The guide, which updates that issued in January 2001, is a development of guidance originally issued in 1991 and incorporates comments from trading funds, departments and the National Audit Office. It also reflects comments made in response to the *Review of Trading Fund Policy* (H M Treasury, October 2003).

1.2.2 A bibliography of the statutory and other guidance on trading funds – with, wherever possible, their website addresses - referred to in this guide is given in Annex A.

1.2.3 A list of abbreviations used in this Guide is given in Annex B.

1.3 HISTORICAL BACKGROUND TO TRADING FUNDS

1.3.1 Trading funds were introduced by the Government Trading Funds Act 1973 (“the 1973 Act”) as a means of financing the revenue-generating operations of a Government department which hitherto had been financed through the Supply-process. The 1973 Act does not define “trading fund”, but section 4 of Cm 914 *The Financing and Accountability of Next Steps Agencies (December 1989)* describes it as a “financing framework which covers operating costs and receipts, capital expenditure, borrowing and net cash flow.”

1.3.2 The 1973 Act was limited in its application and was significantly amended in 1990 by The Government Trading Act 1990 (“the 1990 Act”) which allowed a wider range of activities to be considered as being eligible for financing by means of a trading fund. The Finance Acts 1991, 1993 and 2001 introduced more minor amendments to the 1973 Act. The background to the changes introduced by the 1990 Act is contained in Cm 914 and many of the current policies and practices stem from the approaches described in that White Paper.

1.3.3 The 1973 Act predated the Next Steps initiative in the late 1980s/early 1990s in which operational activities of a Department were transferred to separate agencies. However, both this initiative and the principles of trading fund status have, as their basis, the concept of undertaking commercial or executive activities in separate self-accounting units, and trading funds fall within the overall umbrella of Executive Agencies under the Next Steps initiative. The most obvious difference is that a trading fund operates outside the Supply process, whereas other executive agencies remain Supply-financed. Almost without exception, trading funds established since the implementation of the 1990 Act have been established from existing Supply-financed agencies. A list of trading funds as

at April 2004 is shown at Annex C.

1.3.4 Although a trading fund may be described as "a statutory fund" it is not a body corporate operating at arms-length from Government in the same way as executive NDPBs, public corporations or NHS trusts. Establishing a trading fund from an existing executive agency or division of a department does not in itself alter its constitutional position or create a body corporate. The responsible Minister remains accountable to Parliament not only for the policy and resources framework within which a trading fund operates but also for all of its operations and actions. The aim of establishing trading funds is, as described in Cm 914, to enable them to operate within a 'strategic control framework', and Ministerial responsibility for a trading fund is no different from that for any other Next Steps Agency.

1.4 KEY CHARACTERISTICS OF A TRADING FUND

1.4.1. The key characteristics of trading funds may be summarised as follows:

- a trading fund remains part of a government department (or may be a department in its own right) and hence is a Crown body. It is subject to the requirements of *Government Accounting* and the *Fees and Charges Guide*. Its staff are civil servants, and hence enjoy the same conditions of service applying to all civil servants;
- a trading fund operates outside the Supply-process and has standing authority to meet all outgoings from receipts. Being outside the Supply-process means that no detailed advance approval by Parliament of its income and expenditure is required;
- on establishment, the Crown assets and liabilities needed by the trading fund for its operations are appropriated to it; the value of the net assets is matched by loan capital, public dividend capital and (if applicable) certain reserves (*see 1.5 below for further information about the financing framework*);
- although the opening loan capital is a deemed loan (ie does not involve the transfer of cash) the trading fund is required to pay interest and to repay the loan over an agreed period.
- A trading fund is expected to pay a dividend on its public dividend capital and reserves (*see 6.5 below*). The arrangements outlined in the Spending Review (SR) 2002 are for trading funds to pay interest and dividends equivalent to the cost of capital borne by their parent departments on the net assets of their trading funds. As the cost of capital is the equivalent of the return on the capital employed, the level of dividends will, in practice, be a balancing figure between the interest payable and the required return. These arrangements remain in force for SR 2004. Somewhat different arrangements apply to those trading funds

which are also departments in their own right (*see 6.5.2 below*);

- only transactions between a trading fund and its parent department score for the purposes of the departmental budget (*see chapter 11*). This control framework is designed so as to be consistent with the fiscal rules, which require a capital and current budget split and the creation and maintenance of incentives through cost of capital charges and the correct recording of subsidies. Trading funds are free to manage their resources and capital expenditure within the parameters agreed with their sponsor department through consideration of corporate plans and the setting of profit targets;
- it pays for all goods and services it receives and receives income in respect of the goods and/or services which it provides;
- a trading fund has powers to borrow (but only from its parent department or, in some cases, the NLF) and create reserves (in the form of cash deposits) and, within the corporate planning framework, to purchase and dispose of assets;
- it is only statutorily required (a) to ensure that its revenue “is not less than sufficient taking one year with another to meet outgoings which are properly chargeable to revenue account” and (b) to meet such “further financial objectives as may be set by the responsible Minister with the agreement of the Treasury.”¹ (*see 2.4.1 below*);
- a trading fund is driven, i.e. fixes its charges, in accordance with its “further financial objective”, which is normally to earn an average rate of return on capital employed (currently at least 3.5 per cent);
- it charges, unless otherwise agreed, for the full cost of services provided; it does not normally aim to make a “profit” except where it provides goods and services in competition with other suppliers or is specifically authorised to charge what the market will bear;
- it is set a borrowing limit which recognises its need to finance capital expenditure and meet its short term financing requirements (*see 5.7.1 below*). Those trading funds which borrow from the NLF are, in addition, set a temporary borrowing limit on any temporary borrowing (*see 5.9.1 below*);
- it is allowed to carry over agreed levels of cash balances from one year to another and invest any cash surplus to immediate requirements elsewhere in the public sector (*see 8.3.1 below*);

¹ These two requirements are complementary. The first is a requirement (at least) to break-even after the payment of interest and dividends. The “further financial objective” is normally expressed in terms of a return on capital employed, ie a measure of the operating surplus. As the operating surplus, ie the required return, is surrendered in the form of interest and dividends, the theory is that trading funds should break-even each year.

- it can only be set up where the responsible Minister and the Treasury agree that this will be "in the interests of the improved efficiency and effectiveness of the management of those operations" (See *Section 1(b) of the 1973 Act*);
- trading fund status is suitable where charges can be made for services through genuine customer/supplier relationships and where such income is both reliable and constitutes at least 50 per cent of the total.

1.4.2 This financial regime provides more flexibility than is possible for a body that is Supply-financed to meet unanticipated demands for its output and higher or lower than anticipated capital expenditure. Trading funds are not subject to any form of controls over their administration costs – see *guidance issued by the Treasury to Departments on 23 December 2002* - and there may be virement between current and capital expenditure, providing it is consistent with the strategic control framework established by the responsible Minister, and with resource budgeting guidelines (*chapter 11*).

1.5 FINANCING FRAMEWORK

1.5.1 The financing framework set out in the 1973 Act is for the assets and liabilities attributable to the activities of a trading fund to be identified and valued. In the opening balance sheet of the trading fund, the value of the net assets is matched by a combination of loans and public dividend capital (*but see 1.5.3 below*). The 1973 Act does not specify appropriate proportions of loans and public dividend capital, and the current practices derive from guidance in Cm 914 (*see 6.2.1 below*). While indicating that the split of loans to PDC should be determined in the light of prevailing interest rates and repayment terms, Cm 914 suggests that there should be no more than 50 per cent PDC. This approach reflects the interaction of interest rates when Cm 914 was issued (about 12 per cent) and the required rates of return (then about 6 per cent). Restricting the loan capital to half of the value of the net assets and forgoing a dividend on the PDC enabled a trading fund to achieve its financial target and to break-even (*see 2.4*).

1.5.2 As interest rates have fallen since Cm 914 was issued, theory would suggest that trading funds could afford to service higher levels of debt, and consequently levels of PDC should be lower. But in practice, the guidance in Cm 914 for a 50:50 split is followed; with the implementation of full resource budgeting, trading funds are required to remunerate both their loan capital and the PDC each year and the exact split is of less significance than hitherto.

1.5.3 As noted above, the 1973 Act originally envisaged that the value of the net assets would be matched simply by loans and PDC. However, the Act was amended in 1993 to allow the recognition of existing reserves in the opening balance sheet of the trading fund. In practice, this is restricted to the revaluation reserve relating to the assets being appropriated and, more recently, to any Government Grant Reserves relating to the funding of assets from central initiatives. The usual practice is to maintain the proportion of loan capital as 50 per cent of the value of the net assets with the remaining 50 per cent being represented by PDC and reserves but this approach may be subject to negotiation in the light of specific circumstances.

1.5.4 The 1973 Act also provides for trading funds, post incorporation:

- To take out additional borrowing (*section 2B*). Such loans may be short-term loan to finance temporary cash flow fluctuations, or long-term to finance capital expenditure and long term working capital requirements;
- To be given additional deemed loans and PDC to match assets appropriated to the fund (whether or not associated with any extension to the funded operations) (*section 2(4)*); and
- To be given additional PDC to finance long-term working capital requirements (*section 2A(2A)*).

1.5.5 Further guidance on loans is given in *chapter 5*, on PDC in *chapter 6* and on reserves in *chapter 7*.

1.6 BENEFITS OF OPERATING AS A TRADING FUND

1.6.1 The *Review of Trading Fund Policy* identified the following benefits which result from operating as a trading fund:

- It provides a real focus on outputs and performance;
- It leads to a change in culture within the organisation in that it becomes a value-driven business with greater focus on the needs of the customer;
- It facilitates the funding of minor projects (which can be financed from self-generated income);
- It allows more autonomy to management on financial and managerial issues;
- It enables the recruitment of staff who are comfortable with working in a commercial environment;
- Being outside the Supply process can lead to quicker responses to changing circumstances and can aid longer term planning;
- It encourages managers and staff to think commercially, find opportunities to cut costs and seek more efficient ways of operating and to expand the business.

1.6.2 Other benefits include

- **Improved use of working capital.** The more commercial approach engendered by trading fund status will lead to greater awareness of the cost of holding stocks or having monies tied up in debtors and result in pressures to reduce working capital.
- **Asset disposals and rationalisations.** The financing regime of a trading fund should lead to greater pressure to dispose of surplus assets and get the best return out of those which are to be retained (although these benefits arise more generally as a result of resource accounting);

- **Pricing flexibility.** A trading fund has to price to cover costs and meet its financial targets. But where it is operating in a competitive market, it can price appropriately to that market (*see chapter 12*).

1.7 GOVERNMENT-OWNED COMPANY AS AN ALTERNATIVE TO TRADING FUND STATUS

1.7.1 A few recent reviews of existing trading funds have suggested that the trading fund framework does not offer sufficient flexibilities in two particular areas – the ability to structure pay and conditions to ensure the recruitment and retention of suitable individuals, and in obtaining additional financing. To overcome these perceived inflexibilities the reviews put forward the idea of converting the trading fund to a government-owned company.

1.7.2 Although the staff of a government-owned company would no longer be civil servants, they would still be subject to public sector pay guidelines and thus conversion to a limited company would offer few advantages.

1.7.3 The ability of a government-owned company to borrow from the market is restricted to those companies which are on the path to privatisation. If there is no such intention, the company would still be required borrow from the NLF as rates of interest are more competitive.

1.7.4 The only advantage which limited company status offers over trading fund status is in corporate governance in that the directors of a company are jointly responsible for its management (in contrast to a trading fund in which the accounting officer is personally responsible) which should lead to a greater involvement of the key personnel in the running of the business (*see also 13.8.4 below*).

1.7.5 But, as a generality, government-owned company status does not offer any advantage over trading fund status.

1.7.6 A distinction should be drawn between the arrangements described above (in which a Secretary of State owns the share capital of the company) and a GOCO (Government Owned Contactor Operated) in which assets are owned by Government but operated and managed by a private sector partner.

CHAPTER 2

SUITABILITY

- 2.1 INTRODUCTION
- 2.2 TRADING FUND CANDIDATES
- 2.3 STATUTORY TESTS
- 2.4 FINANCIAL TESTS
- 2.5 TREASURY MINUTE ON FINANCIAL OBJECTIVES
- 2.6 ADMINISTRATIVE TESTS

2.1 INTRODUCTION

2.1.1 This chapter considers the various statutory and administrative tests which need to be satisfied before trading fund status can be considered. Suggestions for the general criteria which need to be considered when assessing candidates for trading fund status are given in Annex J.

2.2 TRADING FUND CANDIDATES

2.2.1 As executive operations of departments are now mainly undertaken by Next Steps agencies, most recent trading funds have been established from existing agencies. This is not however a requirement and, although the powers in the 1973 Act appear to limit trading fund status to operations which are already revenue-generating, legal advice has confirmed that it is possible to consider any activity as a potential trading fund candidate if a customer/supplier arrangement which involves full payment for the service provided can be introduced even if this results in the department becoming the main customer of the trading fund. In such circumstances, however, it is important that the efficiency and effectiveness of the management of the activities are adequately demonstrated as improvements in value for money do not automatically flow from simply substituting hard charging for supply-financing.

2.2.2 In addition, it is important to ensure that the Office for National Statistics agrees to the activities being classified as a public corporation. This may be an issue if there is any doubt about whether the income derives from trading or is, eg, in the nature of taxation.

2.2.3 Given the practical changes involved, the transition to a trading fund regime will undoubtedly be easier if candidates are already operating successfully under net administration cost control, or on a repayment basis with full cost charging. However, this does not rule out activities with other forms of financial regime moving directly to trading fund status.

2.2.4 Any trading fund candidate must ideally have in place adequate and tested management information and accounting systems, as the need to introduce such systems and run a shadow trading regime adds considerably to the time needed to process the application for trading fund status. In addition, there is always a risk that the shadow trading regime will not identify all of the problems that may arise in practice.

2.3 STATUTORY TESTS

2.3.1 Section 1 of the 1973 Act imposes three statutory tests which must be met before a body can be established as a trading fund.

2.3.2 The **first** is that *the operations to be financed by means of the trading fund are "operations of a department of Government for which [a Minister of the Crown] is responsible"*(section 1(1)(a));

2.3.3 This means that any operations for which it is proposed to establish a trading fund must first already be being financed through the Supply process. In practice, this should not be a problem as the trading fund will normally be established from an existing agency. However, it may not always be possible to extend the funded operations of a trading fund to encompass new operations if these operations have not been financed through the Supply process for a reasonable period (e.g. 6 months). In practice, this means that, while the trading fund can undertake the new operations, it will need to receive financing through the Supply process for a period before they can be fully incorporated into the trading fund. The Government's general policy on extending the activities of Agencies and trading funds is set out in a separate guidance note *Selling into Wider Markets: A Policy Note for Public Bodies* (HMT December 2002). Because of the statutory requirement for the operations of a trading fund to be those of a department of Government, departments and trading fund candidates should discuss any proposed extension of a trading fund's operations with their legal advisers and the Treasury as soon as practicable (*see also 12.10*).

2.3.4 The **second** statutory test is that *the revenue of the proposed fund would consist principally [i.e. more than 50%] of receipts in respect of goods and services provided by the fund in the course of its operations (section 1(1)(a))*.

2.3.5 Receipts may be derived from:

- Internal supply transactions (where the customers are other parts of central government and can include the parent department), or trading transactions in external markets (where the customers are other parts of the public or private sector), or both. Examples of the former include the maintenance of vehicle and aircraft fleets; provision of advertising and publicity material for central government, and of the latter, provision of conference facilities or production of coins for overseas customers;
- Other services to users outside Government financed directly by receipts from charges, even where these services and charges have a statutory basis – for example, the provision of driving tests, registering title to land, or licensing medicines.

2.3.6 As made clear in paragraph 4.14 of Cm 914, the powers in the 1973 Act only extend to bodies which generate receipts in respect of goods or services provided in the course of their operations, thus excluding for example, tax revenues and block payments from Votes. The precise interpretation of these provisions is for the Government's legal advisers. However, legal opinion confirms that there is no legal obstacle to setting up a trading fund in any case where it is possible to establish a purchaser-provider relationship which involves full payment for services provided.

2.3.7 Trading fund candidates are advised to confirm with the Office for National Statistics (ONS) at an early stage that the proposed arrangements for the generation of income satisfy ONS' classification of a trading fund and that ONS is prepared to classify the new body as such.

2.3.8 The **third** statutory test is *that the financing of the body's operations by means of*

a trading fund would be in the interests of the improved efficiency and effectiveness of the management of those operations (section 1(1)(b)).

2.3.9 Agencies are expected to deliver improvements in efficiency and effectiveness, e.g. improvement in service to customers, measured by the targets set them, when they are established. They are also expected to be vehicles for on-going management changes as they develop. It may therefore be difficult to establish, and attribute to the creation of a trading fund, specific additional gains in efficiency and effectiveness. In particular, it may be difficult to measure such gains as distinct from the overall package of management change. But that does not mean that trading fund candidates should not attempt to identify specific improvements which will arise from trading fund status. It is therefore important that parent departments ensure that all candidates go through this analysis, although it may be necessary to take a decision based on a judgement about benefits rather than on specific and measurable improvements.

2.3.10 It will generally be easier for trading organisations which are selling goods or services in external or internal markets to show clear benefits to efficiency and effectiveness from becoming a trading fund. It may be more difficult for statutory or regulatory bodies to show such benefits - not least because they are more limited in the use they can make of trading fund flexibilities. They should not, for example, use any available pricing flexibility to extract monopoly profits.

2.3.11 The enabling powers in section 1(1) of the 1973 Act are very wide. The question of whether an agency falls within section 1(1)(a) [undertaking operation of a department] will essentially be a matter of fact. Whether any eligible agency should become a trading fund will however turn on section 1(1)(b), i.e. whether it will lead to improved management efficiency and effectiveness.

2.4 FINANCIAL TESTS

2.4.1 In addition, section 4(1) of the 1973 Act imposes two financial tests :

- a. to ensure that the revenues of the fund are “sufficient, taking one year with another [see 2.4.2], to meet outgoings which are properly chargeable to revenue account” (ie to break-even after interest and dividends); and
- b. to achieve such further financial objectives as the Treasury may from time to time by minute [see 2.5] laid before the House of Commons indicate as having been determined by the responsible Minister (with Treasury concurrence) to be desirable of achievement”.

2.4.2 “Taking one year with another” is not defined. Taken literally, it would suggest that a deficit in one year should be made good in the following year. In practice, the wording has been taken to mean “over a period”, usually, but not necessarily, linked to the period over which the further financial objective is set. *See also 12.2.2 for the interaction of the policy on fees and charges with that of measuring performance over a period.*

2.4.3 The “further financial objective” for most trading funds is the achievement of an agreed return on the capital employed. This objective relates to the operations of the business as a whole, and trading funds will be expected to meet other targets agreed with their departments which will relate to more specific financial operations and non-financial aspects such as quality of service. As controls over trading fund operations are strategic and are related to key targets, it would be inappropriate to set up a trading fund if the potential fund’s targets (both financial and non-financial) cannot be quantified accurately and are not linked to robust management information systems.

2.5 TREASURY MINUTE ON FINANCIAL OBJECTIVES

2.5.1 As noted in 2.4.1 above, section 4(1)(b) of the 1973 Act provides for the further financial objective to be set out in a minute laid before the House of Commons. Responsibility for preparing the minute rests with the relevant Treasury Spending Team (although in practice, this is often undertaken by the Central Accountancy Team). Ideally this should be done about 2 months before the trading fund begins although, in practice, it cannot be finalised until the Parliamentary debate has been held. This is because the number of the Statutory Instrument has to be shown in the minute. It will also be necessary for the Treasury to consult the relevant department before the expiry of any period mentioned in the minute to ensure that a new financial objective is set and that the appropriate minute is prepared and laid before Parliament.

2.5.2 The minute covers:

- a. The responsibilities of the Departmental Minister;
- b. The date the trading fund will be established (or was established, when the minute is being renewed);
- c. The agreed financial objectives.

2.5.3 Although section 4(1)(b) refers to the financial target being determined by the responsible Minister, in most cases it is agreed at official level during the negotiations establishing the trading fund. Some departments do, however, seek Ministerial approval to the agreed target. Once all parties are content, the draft minute is sent to the Chief Secretary to the Treasury for his approval after which it is submitted to Treasury Parliamentary Section who arrange for the Minute to be laid before the House of Commons. The minute itself does not have to be signed. An example of a Treasury Minute is given at Annex F.

2.6 ADMINISTRATIVE TESTS

2.6.1 Paragraph 4.15 et seq of Cm 914 sets out three further criteria to be met.

2.6.2 The **first** administrative test is to ensure that *Ministers have agreed that levels of expenditure and activity should be allowed to vary in line with demand and receipts.*

2.6.3. An increase in revenue to match additional expenditure does not necessarily justify expansion and there is a balance to be struck between the size of the Civil Service

and priorities in the allocation of capital resources and personnel and the evidence of customer demand.

2.6.4 Where a trading fund will be wholly or mainly providing goods or services to Government departments, the **second** administrative test is that there should be a *genuine separation between the body and its customers and there is as much competition as is feasible in supplying goods and services.*

2.6.5 The aim is to stimulate realistic trading relationships based on full cost charging by the fund to the customers for the goods and services provided. This may require the preparation and approval of Service Level Agreements or Memoranda of Understanding between the trading fund and its departmental customers.

2.6.6 The **third** administrative test is that there should be a *clear commitment to substantial and measurable improvements in performance both in terms of services and costs.*

2.6.7 This test is similar to the statutory test relating to the need to demonstrate efficiency and effectiveness in the management of the activities.

CHAPTER 3

KEY STEPS IN SETTING UP A TRADING FUND

- 3.1 INTRODUCTION
- 3.2 THE NEED FOR AN ACTION PLAN
- 3.3 LAUNCH DATE
- 3.4 SUMMARY OF THE KEY STEPS
- 3.5 ORDER ESTABLISHING A TRADING FUND
- 3.6 DEPARTMENTAL ROLE
- 3.7 TREASURY ROLE AND PROCESSES
- 3.8 FORMAL TREASURY CONCURRENCE
- 3.9 OTHER DOCUMENTS ISSUED BY THE
TREASURY
- 3.10 AMALGAMATION OF EXISTING AGENCY AND
TRADING FUND

See also Annex H, which provides a timetable for establishing a trading fund

3.1 INTRODUCTION

3.1.1 This section of the guide describes, in summary, the actions needed when setting up a trading fund, including the Parliamentary processes. It should be noted that the 1973 Act requires the consent of the Treasury before a trading fund can be established. *Annex H* provides further guidance, including a timetable for establishing a trading fund.

3.2 THE NEED FOR AN ACTION PLAN

3.2.1 Each trading fund candidate should draw up an action plan, in consultation with its parent department and the Treasury, which sets out who does what, and when. The two key dates are:

- a. The date on which the Agency will become a trading fund. This will determine;
- b. The date on which the draft Order is to be laid.

3.2.2 A detailed check-list of the actions required in setting up a trading fund is given at *Annex H*. This provides a chronological timetable for converting an Agency into a trading fund, and indicates respective responsibilities of the department, trading fund candidate and the Treasury. In practice, the 24-month timescale noted in *Annex H* can be reduced although it is sensible to allow about a year for all the necessary discussions and negotiations to take place.

3.3 LAUNCH DATE

3.3.1 Most bodies which become trading funds will currently be operating as Supply-financed agencies. As moving outside the Supply-process other than at 1 April involves additional work for the trading fund candidate, the parent department and the Treasury, trading funds should normally be set up at the beginning of a financial year. There is, however, no statutory bar to establishment part way through the financial year – although, irrespective of the date of establishment, the financial year-end of a trading fund has to be 31 March. Establishment on 1 April means that the draft Order setting up a trading fund (see 3.5 below) will normally need to be laid sometime in January to allow the Parliamentary debate to take place during February (or at the latest, early in March). It may be necessary to consider the dates of Easter; if this is early, it will reduce the time available for the Parliamentary debate. Time should also be built in to allow the Joint Committee on Statutory Instruments to review the wording of the draft Order.

3.4 SUMMARY OF THE KEY STEPS

3.4.1 The impetus for conversion to trading fund status usually arises from a review by a department of the most appropriate vehicle for delivering its services. In some cases, the Treasury may be involved in discussions with a department over various options for the future status of some of the department's operations. One of the recommendations

of the Cabinet Office's review of agency policy *Better Government Services: Executive Agencies in the 21st Century* (August 2002) is that departments should explore the advantages of trading fund status for their agencies.

3.4.2 Assuming that the Treasury is satisfied that there is a prima facie case for funding some of a department's operations by means of a trading fund, the key steps (in outline) in setting up a trading fund are as described below. They assume that a trading fund is being established from an existing agency, but it is not a requirement that the revenue-generating functions of a department have to be transferred to an agency before a trading fund can be set up. References to an agency should thus be read to include divisions of a department.

a. At official level, the department, the agency and the Treasury discuss the case in principle to confirm that the statutory criteria are met. It is usual to establish a Project team consisting of representatives from the department (normally from the branch which sponsors the agency and the finance branch), the agency, the Treasury and National Audit Office. This does not preclude separate consultation on specific issues (eg financial aspects or the terms of any Service Level Agreements or Memoranda of Understanding) between interested parties. These early discussions may involve:

- consideration of the establishment of a customer/supplier agreement between the department and the trading fund candidate where current levels of income do not match expenditure;
- the introduction of shadow trading arrangements;
- discussing billing arrangements with the department where services are currently provided at no charge;
- confirmation that trading fund status will result in efficiencies and effectiveness in the management of the activities; and
- in appropriate cases, confirmation that there are no existing statutory barriers to a candidate becoming a trading fund (for example, if a department or agency has been established under specific legislation).

ONS should be involved in these preliminary discussions in order to confirm that they are satisfied that the trading fund can be classified as a public corporation.

b. As part of these initial discussions, target dates for laying the Order establishing the fund should be agreed and a detailed timetable for the whole process prepared.

c. The department should secure from its Minister agreement in principle to the establishment of a trading fund. In turn, the Minister will seek similar approval from the Chief Secretary to the Treasury. This process will require the department and the trading fund to prepare an outline business case and financial forecasts (although these will be subject to further discussion and refinement). Guidance on business cases is given in *Annex J*.

d. Once agreement in principle has been obtained, the department, agency and the Treasury will continue to work at official level to prepare a full business case

and financial forecasts, including structure of opening balance sheet (eg which assets and liabilities to be appropriated, how they should be valued and the split of loans to public dividend capital). It may also be appropriate to consider whether the functions currently undertaken by the agency should be taken over by the trading fund or whether any changes (either additional or fewer functions) are desirable. ***The business case and financial forecasts are to be subject to independent review.***

e. The department and the trading fund agree financial and quality of service targets with the Treasury and the date by which the Treasury will need to see a first draft of a corporate plan.

f. Consider (perhaps in conjunction with National Audit Office) whether any improvements to the management accounting/information systems are needed before the body becomes a trading fund.

g. The independent review (*see d. above*) should indicate whether or not the business case and financial forecasts support the application for trading fund status. If not, further consideration will need to be given to overcoming the shortcomings.

h. The department's finance branch and the Treasury spending team should discuss the public expenditure implications of moving away from the Supply-process.

j. The department is to make any necessary revisions to the Agency's Framework Document, particularly sections dealing with financial planning and control.

3.4.3 Once the details of the proposals have been agreed at official level, formal approval should be obtained from the Treasury for the laying of the Order which establishes the trading fund. Further guidance on the Order and the Parliamentary process are given in *section 3.5* below.

3.4.4 The department arranges the Parliamentary debate and prepares briefing notes for the Minister.

3.4.5 This summary notes only the key steps. In practice, there may well be issues specific to a particular trading fund candidate which will require discussion and resolution. The list above should not be taken to be comprehensive. A more detailed review of the key steps is given in *Annex H*.

3.4.6 Advice on general policy questions on trading funds should be sought from the Central Accountancy team in the Treasury (*see "contacts" on page 2*), although negotiations with the Treasury on trading fund applications will be handled in the first instance by the relevant spending team. It should be noted that several teams within the Treasury may have an interest in an application for trading fund status and departments should allow sufficient time for internal consultation.

3.5 ORDER ESTABLISHING A TRADING FUND

3.5.1 Section 6(2) of the 1973 Act requires Orders establishing a trading fund to be subject to an affirmative resolution procedure. This requires a draft of the Order to be laid before Parliament and for a formal debate to be held either in Committee or (less usually) on the floor of the House. The Order comes into effect only after Parliamentary approval has been granted. The Joint Committee on Statutory Instruments will need to approve the wording of the Order before it can be laid in draft. The roles and responsibilities of (a) the department and (b) the Treasury are summarised in, respectively, 3.6 and 3.7 below. The processes for varying the Order are considered in *chapter 4* below.

3.6 DEPARTMENTAL ROLE

3.6.1 As noted above, the department will be involved throughout the negotiations which will culminate in the preparation of the draft Order establishing a trading fund. The department, in conjunction with its legal advisers, is responsible for preparing the draft Order which should be sent, under cover of a formal submission in the name of its Minister, to the Treasury seeking concurrence to laying the Order (*see 3.7.1 below*)

3.6.2 The department is also responsible for arranging the Parliamentary debate (*see also 3.3 above*).

3.6.3 There is a duty under Section 1(3) of the 1973 Act in some circumstances to consult customers of the service. In accordance with Section 6(4) of the 1973 Act a report on these consultations and the responsible Minister's conclusions must be laid before Parliament in advance of the draft Order. Experience has shown that, in such cases, Parliament will wish to see that the representations sought were sufficiently wide i.e. they covered the whole range of customers and other interested parties.

3.6.4 An example of an actual Order is given at *Annex E*. The contents are fairly standard and cover:

- Preamble and the Minister's endorsement of the change in status for the body;
- Citation and commencement;
- Establishment of the Fund;
- Source of loans;
- Assets, liabilities, revaluation and, perhaps, other reserves, and public dividend capital;
- Limitations of indebtedness;
- Schedule 1 – describing the “funded operations”;
- Schedule 2 – describing in general terms the assets and liabilities appropriated to the fund; and
- Explanatory notes.

3.7 TREASURY ROLE AND PROCESSES

3.7.1 On receipt of the draft Order in Treasury (see 3.6.1 above), officials, including Treasury Legal Advisers, will check that the detailed contents accord with understandings reached in discussions with the parent department.

3.7.2 The draft Order, as well as meeting any Treasury policy issues, will need to address the following points:

- a. that the operations to be funded are indeed those of a government department, as required by the 1973 Act; and;
- b. that they are suitable to be financed by a trading fund, and, in particular, to be so managed that the revenue of the fund will consist principally (i.e. more than 50%) of receipts in respect of goods and/or services provided in the course of the operations in question;
- c. that the proposed scope of the operations to be funded is satisfactory;
- d. that the financing of the operations in question would be in the interests of improved efficiency and effectiveness of their management;
- e. that there is correct determination of the valuation of the assets and liabilities and the difference between them which is to be public dividend capital, revaluation or other reserves and originating debt;
- f. that the proposed maximum lending to the fund which has to be specified in the Order is appropriate, but may be varied;
- g. that the responsible Minister will be able to manage the funded operations to ensure that the receipts will be sufficient taking one year with another to meet outgoings of the fund which are properly chargeable to revenue account and that the fund will achieve the further financial objectives set for it.

3.7.3 Treasury administrative process requires the Chief Secretary to be consulted and requested to give agreement to the proposed Order. Following the Chief Secretary's agreement to the Order, the department may proceed with laying the Order before the House of Commons.

3.8 FORMAL TREASURY CONCURRENCE

3.8.1 After the debate by the House approving the Order, the department should send the Order to the relevant Treasury Spending Team who will submit it, together with a covering Guard Sheet to Treasury's Parliamentary Section. They will arrange for two of the Lords Commissioners of HM Treasury to sign the Order.

3.9 OTHER DOCUMENTS ISSUED BY THE TREASURY

3.9.1 The 1973 Act provides for the Treasury to issue directions relating to the:

- bases on which the assets and liabilities appropriated to the fund are to be valued (*section 2(2A)*);
- form and content of the accounts (*section 4(6)(a)*); and
- content of the annual report (*section 4(6A)(b)*).

3.9.2 An example of an **asset valuation direction** is given at *Annex G*.

3.9.3 Individual **accounts directions** are no longer issued. A generic direction is issued early in the calendar year to apply for the financial year which will end on the following 31 March, which lists the trading funds to which it applies. The direction requires compliance with *Trading Funds: Accounts Guidance* issued by the Treasury and updated annually.

3.9.4 The Treasury no longer issues a direction on the form of the **Annual Report** as the accounts direction requires compliance with the *Trading Funds Accounts Guidance* which in turn refers to *Next Steps Agencies, Trading Funds and Non-Departmental Public Bodies: Guidance on Annual Reports* issued by the Cabinet Office in January 2003.

3.10 AMALGAMATION OF EXISTING AGENCY AND TRADING FUND

3.10.1 Two recent proposals have involved the transfer of functions from an existing agency within the department to an established trading fund. Legal opinion differed over whether this could be treated simply as an extension of the existing operations of the trading fund or whether it required the winding up of the existing trading fund and the establishment of a new one. The former approach is simpler to administer (*see chapter 16 for the arrangements for winding up a trading fund*) but much seems to depend on the presentational aspects, ie whether the proposals were announced as being a merger or the creation of a new trading fund. In view of the uncertainty, it is suggested that legal opinion should be sought where the proposals involve the amalgamation of an existing agency and an established trading fund.

CHAPTER 4

VARYING THE TRADING FUND ORDER

- 4.1 INTRODUCTION
- 4.2 CHANGES REQUIRING AN AFFIRMATIVE RESOLUTION
- 4.3 CHANGES REQUIRING A NEGATIVE RESOLUTION

4.1 INTRODUCTION

4.1.1 This chapter considers issues affecting variations to the original Order.

4.2 CHANGES REQUIRING AN AFFIRMATIVE RESOLUTION

4.2.1 Once a trading fund has been established, the 1973 Act provides for Orders to effect changes to the original Order. Orders that extend or restrict the operations of the fund are subject to the same procedure as that for establishing a fund, ie **affirmative procedure**, including consultation (*see section 3.5 above and section 6(2) of the 1973 Act*). This procedure will also apply to Orders which:

- remove assets and liabilities from the fund which are attributable to operations ceasing to be funded (*section 4A(2) of the 1973 Act*); and
- those which reduce or extinguish originating debt or public dividend capital when only some of the funded operations cease to be funded (*section 4(8) of the 1973 Act*)

4.3 CHANGES REQUIRING A NEGATIVE RESOLUTION

4.3.1 Orders which amend the original Order, **but do not extend or restrict the operations of the fund** are subject to negative procedure i.e. the Order is made (signed by the responsible Minister and Treasury) before laying. It then comes into force unless there is a successful vote against it within 40 days – *section 6(3) of the 1973 Act*. The 1973 Act identifies five circumstances in which such Orders are to be made:

- Removing assets and liabilities from the fund (s. 2(5));
- Reducing or extinguishing originating debt or public dividend capital (s.2(6));
- Varying the maximum limit on a particular fund's borrowing (s.2C(1));
- Deeming that the requirement in a statute other than the 1973 Act regarding reporting is satisfied by the annual report for the financial year (s.4(6B)); and
- Revoking an Order establishing a trading fund (s.6(1)).

CHAPTER 5

LOANS

- 5.1 INTRODUCTION
- 5.2 STATUTORY PROVISIONS
- 5.3 ORIGINATING DEBT
- 5.4 ADDITIONAL BORROWING
- 5.5 CONSTRAINTS
- 5.6 RATES OF INTEREST
- 5.7 BORROWING LIMITS
- 5.8 VOTED LOANS
- 5.9 LOANS FROM THE NLF
- 5.10 PREMATURE REPAYMENT OF LOANS
- 5.11 WRITING OFF LOANS

SEE ALSO ANNEX D FOR ADVICE ON THE DETAILED MECHANICS OF ISSUING AND REPAYING VOTED LOANS

5.1 INTRODUCTION

5.1.1 This chapter considers a number of aspects relating to loans issued both on establishment and subsequently. Reference should also be made to *section 1.5* above and chapter 29 of *Government Accounting*.

5.2 STATUTORY PROVISIONS

5.2.1 Section 1(4) of the 1973 Act requires the Order establishing a trading fund to designate either the responsible Minister or the National Loans Fund as the source of loans to the trading fund (“the authorised lender”). In practice, the NLF is the authorised lender to only those trading funds that are departments in their own right; in all other cases, the responsible Minister is the authorised lender. It is not possible for a trading fund to borrow from both the NLF and the responsible Minister. **Trading funds are not allowed to borrow from the market or overseas.**

5.2.2 Enquiries have been made about whether it is possible for one trading fund to lend money to another where they both fall within the responsibility of the same Minister. There are two objections to this approach. If a trading fund has surplus monies, the department should be seeking to maximise its returns on that money, by eg requiring the payment of “super-dividends” (see *6.5.3 and 8.2.3 below*). Lending between trading funds may not achieve this goal. Secondly, sections 1(4) and 2B of the 1973 Act prevent monies being advanced to a trading fund except from the “authorised lender”. Lending by one trading fund to another does not satisfy the requirements of the Act.

5.2.3 Loans to trading funds should not be made unless there is a reasonable expectation that they can be repaid. (see *29.2.4 of Government Accounting*).

5.3 ORIGINATING DEBT

5.3.1 The loan element of a trading fund's commencing capital – defined in section 1(7) of the 1973 Act as the *originating debt* - takes the form of a deemed loan from the parent department (a Voted loan) or, in some circumstances directly from the National Loans Fund. These loans will score against the department's capital DEL but are offset by the transfer of the assets to the trading fund. The transaction should thus be DEL-neutral. Some trading funds have required an injection of working capital when they are first set up; this will have an impact on the department's capital DEL. However, Supply-financed agencies which have received fees in advance from their customers which have had to be surrendered under the rules of Government accounting can, on conversion to a trading fund, be refunded with those fees (to match the corresponding liability which will form part of the trading fund's opening figures). This refund does not score for public expenditure control purposes.

5.3.2 Notwithstanding that the originating debt is a deemed loan (ie no cash is involved), interest and repayments of principal are payable on the loan in accordance with an agreed repayment schedule.

5.3.3 Section 2 (4) of the Government Trading Funds Act 1973 provides for further

amounts to be added to the originating debt where further assets (and liabilities) are appropriated to the fund. Such amounts do not count against the borrowing limit (see 5.7.1 below).

5.3.4 The rules determining the maturity period of loans forming the originating debt will need to be agreed with the parent department and the Treasury prior to the launch of the fund. In practice, the expected life of assets is likely to be the key consideration when determining the maturity period (see 5.3.5 below), but it may also be necessary to consider wider issues such as the nature of the business and the time horizons of the fund, and the likely pattern of future cash flows.

5.3.5 Where the maturity period of the originating debt is linked to the expected life of the assets, there are two options. The first is to have a single loan linked to the average life of all of the assets being vested in the fund and the second is to have more than one loan with maturity periods being linked to the main categories of assets. Thus, it may be appropriate to have a 20-year loan linked to the buildings and a 10-year loan linked to (say) plant and machinery which has a shorter useful life. Although the expected useful lives of assets will be reviewed as time goes on, there is no suggestion that the maturity periods of the loans should be adjusted.

5.3.6 Loans to be made for periods in excess of one year may be of the following types:

- a. **EIP loans:** these loans are repayable by *equal instalments of principal* with interest payable on the decreasing balance; or
- b. **ER (or Annuity) loans:** these loans are repayable by equal half-yearly instalments of principal and interest combined; or
- c. **Maturity loans:** these are repayable in full at the end of the period of the loan, with equal half-yearly instalments of interest payable throughout the life of the loan. Such loans should only be considered where the trading fund has significant assets in the form of land (which is not subject to depreciation). Assets with a finite life should be financed from EIP or annuity loans.

5.4 ADDITIONAL BORROWING

5.4.1 In addition to the originating debt, trading funds may take out further loans to fund capital expenditure or long-term working capital requirements subject to the various conditions described in section 2B of the 1973 Act. Section 2C of the 1973 Act requires each trading fund to be set a borrowing limit (see 5.7.1 below) which sets a ceiling on the amount of any such additional borrowings which may be outstanding at any given time.

5.4.2 Loans may be either;

- a. Temporary (ie with a life of less than 6 months);
- b. Term (ie with a life of one year or more).

5.4.3 **Temporary loans** should be used to finance short-term requirements and swings in working capital. Where elements of working capital give rise to a permanent financing need they should be financed by longer-term borrowing. It is for the department to consider the appropriate levels of any short-term borrowing which are to be repaid before the end of the financial year, and the impact on their capital DEL.

5.4.4 **Term loans** should be used to finance longer-term working capital requirements or, more usually, capital expenditure. The general expectation is that the maturity period of term loans will be linked to the remaining period of the originating debt or, with Treasury agreement, to the life of the assets being acquired. The second option will be most appropriate where the life of the assets differs significantly from the remaining life of the originating debt and is likely to be more relevant in the case of mature trading funds where a significant proportion of the originating loan has been repaid.

5.5 CONSTRAINTS

5.5.1 Trading funds are required to forecast their borrowing requirements in order to provide information for the budgeting process – see *chapter 11*. However, the department may have competing demands for its resources when a trading fund requires to draw down its loan and it does not necessarily follow that, despite having forecast its needs, the trading fund will be able to obtain the necessary loan finance. Trading funds should therefore liaise with their departments as early as possible to arrange the draw down of funds.

5.6 RATES OF INTEREST

5.6.1 Rates of interest on NLF loans (which will also apply to Voted loans) can be obtained from <http://www.pwlb.gov.uk>.

5.7 BORROWING LIMITS

5.7.1 All trading funds are subject to a statutory borrowing limit which is set out in the Order establishing the fund. Those in departments responsible for making loans to trading funds will want to check that this can be done within the existing limits, and that any loans being made would not be outwith the department's statutory powers.

5.8 VOTED LOANS

5.8.1 Where a trading fund has a parent department (ie it is not a department in its own

right) it obtains its loans from “money provided by Parliament” (*section 1(5) of the 1973 Act*) - so called “Voted loans”.

5.8.2 It is for departments to decide on the minimum amount which may be lent to a trading fund from Estimates – see 5.5.1 above. Factors which should be taken into account are the rule forbidding payment in advance of need, the scale of trading fund’s financing requirements and the administrative burden resulting from issuing large numbers of loans for small amounts. In view of this departments may like to stipulate a minimum loan amount, e.g. £100,000, which they are prepared to lend to individual trading funds from Estimates at any one time. This is comparable to the minimum amount currently available for temporary loans from the NLF. Detailed mechanics of issuing and repaying term and temporary loans are set out in more detail in *Annex D*.

5.8.3 The terms and conditions on which loans are made from Estimates will normally be identical to those made from the NLF. Temporary loans will normally be required to cover short-term fluctuations in working capital and should be repaid during the year. Long-term working capital needs should ideally be financed from term loans, although the 1973 Act provides for PDC to be used for this purpose (see 6.3.1).

5.9 LOANS FROM THE NLF

5.9.1 This section applies to those trading funds for which the “authorised lender” is the National Loans Fund. In accordance with the procedures for arranging loans from the NLF (see chapter 29 of *Government Accounting*), it will be necessary to agree a temporary borrowing limit before short-term loans can be taken out. This limit is different from the borrowing limit set out in the Order (see 5.7.1 above), but clearly cannot be in excess of this latter limit.

5.9.2 At present, the temporary borrowing limits are:

Central Office of Information	£37m
Ordnance Survey	£10m
H M Land Registry	None
Royal Mint	£12m

5.9.3 It should be noted that there is a specific obligation placed on the Treasury by Section 5 of the National Loans Act (as amended) to satisfy itself that loans made out of the NLF are on terms that are at least sufficient to ensure that the NLF would not make a loss if the money were raised at current rates. Loans from the NLF to a trading fund which is in competition with the private sector will normally bear commercial rates of interest.

5.10 PREMATURE REPAYMENT OF LOANS – BOTH VOTED AND NLF

5.10.1 Premature repayment of long-term loans may only be made with the agreement of the Treasury. In general, parent departments should not entertain proposals for

premature repayment solely on the grounds that this is likely to lead to a saving in interest costs. However, where trading funds have genuinely surplus funds (e.g. arising from the sale of assets or from trading activities), parent Departments may consider proposals for premature repayment of all or some of a trading fund's outstanding loans (except for temporary loans). Where premature repayment of Voted loans is agreed they will be subject to the repayment arrangements described below.

5.10.2 Partial prepayment of individual Voted loans should only be permitted providing the amount represents at least 20 per cent of total loans outstanding. Partial repayment of individual NLF loans is not permitted. However, there is normally no objection to a loan repayment being partially financed by a new loan or loans for a lower total value, subject to the arrangements set out in 5.10.4 below.

5.10.3 Proposals for premature repayment should be considered in the context of trading funds' corporate plans and put forward as part of Departmental bids in the Spending Review. Where the proposals are accepted, trading funds with NLF loans will be required to pay a sum equal to the present value of the future payments (of principal and interest) which would have been paid if the original repayment schedule had been met. The present value should be calculated by discounting the future payments at a rate of discount equal to the rate of interest currently being charged on new loans of a similar type to that being prepaid, with a life equal to the remaining life of the loan being prepaid. As explained in Chapter 29 of *Government Accounting*, the Treasury's Exchequer Funds and Accounts team will do the necessary calculations. There is no statutory requirement for a trading fund with a Voted loan to pay the early redemption penalty but departments may wish to make such a requirement. If no early redemption penalty is paid, the department's resource account should note this fact.

5.10.4 When accounting for the proceeds of premature repayment, departments should attribute the full outstanding amount to the original loan to principal and the balance, whether positive or negative to interest. In the case of Voted loans, the proceeds should be appropriated in aid, unless there is any reason why the amounts should be CFER'd, eg the amounts would exceed the level of voted AinA and hence is to be treated as excess AinA. In budgeting terms, the receipt would create headroom which, if approval to draw down more spending cover in Estimates were granted, could be rolled forward as end year flexibility. In the case of NLF loans, the full amount of the proceeds should be paid over as soon as possible to the NLF.

5.11 WRITING OFF LOANS

5.11.1 The Treasury must be consulted in all cases where it is proposed to write off loans to trading funds. Guidance on the arrangements for writing off loans from the NLF is given in *Government Accounting, sections 29.2.21-23*. Where loans are to be written off as a result of a reconstruction, they should be extinguished by way of a grant from the parent department. The arrangements for writing off or remitting Voted loans are described in *Government Accounting, sections 29.3.8 – 12*. The use of a Treasury minute to advise Parliament of the write-off of loans in excess of £20m should be noted. The purpose of these arrangements is to make these transactions transparent in accordance with the undertakings given in Cm 914.

CHAPTER 6

PUBLIC DIVIDEND CAPITAL (PDC)

- 6.1 INTRODUCTION
- 6.2 POLICY ON LEVELS OF PDC
- 6.3 TAKING OUT ADDITIONAL AMOUNTS OF PDC
- 6.4 REPAYMENT OR WRITE-OFF OF PDC
- 6.5 DIVIDENDS

6.1 INTRODUCTION

6.1.1 This chapter considers the arrangements for assessing the appropriate levels of originating Public Dividend Capital (PDC) and the statutory provisions for taking out further amounts of PDC. Further guidance on PDC is given in chapter 29.4 of *Government Accounting*.

6.2 POLICY ON LEVELS OF PDC

6.2.1 As noted in 1.5 above, the opening net assets are funded by a combination of loan capital, public dividend capital and, since 1993, reserves (*see chapter 7 below*). In looking at the proportion of PDC required, the parent department and the Treasury will consider the interaction between the fund's financial target and interest payable on the originating debt. The policy as set out in Cm 914 (*see 1.5.1 above*) is to issue the amount of PDC necessary to ensure that the fund can still meet its financial targets after taking into account the scope for efficiency gains, the fund's investment needs and a suitable pricing policy. However, as Cm 914 also notes that PDC may be issued "up to a maximum of 50 per cent of the commencing capital" the practice has arisen that such levels of PDC are regarded as the norm notwithstanding that interest rates have fallen since Cm 914 was written and higher levels of loan capital (and hence lower levels of PDC) could be expected. But with the introduction of resource budgeting, which puts more emphasis on expectations of a return based on the entire capital and reserves, the split of loans to PDC is not as critical as might have been the case hitherto. (There are cash flow implications, of course, in that loan capital, but not PDC has to be repaid.)

6.2.2 Where reserves form part of the opening balance sheet (*see chapter 7 below*), the general policy is for loan capital to represent at least 50 per cent of the opening value of the net assets with reserves and PDC together forming the remaining 50 per cent.

6.2.3 The Government has made it clear that the issue of public dividend capital is not intended to be a soft option for financing deficits or new investment (*see section 29.4.1 of Government Accounting*).

6.3 TAKING OUT ADDITIONAL AMOUNTS OF PDC

6.3.1 Section 2A(2A) of the 1973 Act provides for additional amounts of PDC to be issued to a trading fund to finance long-term working capital requirements. Such amounts will score against the borrowing limit (*see 5.7.1 above*). PDC may also be issued as part of the arrangements for appropriating further assets to the fund (*section 2(4) of the 1973 Act*).

6.4 REPAYMENT OR WRITE OFF OF PDC

6.4.1 The only reference in the 1973 Act to repayment of PDC (other than as part of a restructuring) is given in section 2A(3) which links any reduction in PDC to increases in loan capital – in other words, it envisages the replacement of PDC by loan capital.

However, there is no reason why a trading fund should not repay its PDC (*but see 6.5.4 below*).

6.4.2 If PDC is reduced or extinguished as part of a restructuring of the trading fund whereby assets and liabilities cease to be those of the fund, section 2(6) of the 1973 Act provides for the Minister to make such a reduction or extinguishment by means of an Order.

6.4.3 Section 4A of the 1973 Act describes the arrangements for repaying, reducing or extinguishing PDC (and loans) which apply in various circumstances when operations of a trading fund are to cease being funded in this way. These include repayment using surplus funds, the proceeds of sale of assets or money provided by Parliament, or writing off by means of an Order. For further details, see *chapter 16*.

6.4.4 In any case where it is necessary to write off PDC the procedure set out in section 29.4.3 of *Government Accounting* must also be followed.

6.5 DIVIDENDS

6.5.1 Where a trading fund has PDC, section 2A(5) of the 1973 Act requires the payment of a return on the PDC and reserves. Although the Act envisages some form of negotiation over the level of such return, recent developments in resource budgeting have formalised the arrangements in that, for trading funds which are not departments in their own right, the dividend and interest payable will equal the capital charge borne by the department on the net assets of the fund. In turn, the capital charge is the same as the return expected from the trading fund as set out in its Treasury minute describing its financial objective.

6.5.2 For trading funds that are also departments, the arrangements are slightly different in that the interest on the NLF loans is paid directly to the NLF and not, as is the case with Voted loans, to the department. For budgeting purposes (*see chapter 11*), the cost of capital borne by the department is abated by the amount of the interest, so that the cost of capital will equate to the dividends payable by the trading fund. (*see also 11.2.9 below*).

6.5.3 Under the arrangements for SR2002, trading funds may retain surpluses over and above those necessary to meet their interest and dividend charges. Such surpluses may be used to fund, eg capital expenditure. Departments may, however, require a higher level of dividends in order to reduce these “super surpluses” (*see 8.2.3 below*). Conversely, a failure to make the dividend payments will result in a charge to the department’s resource DEL. SR2002 notes that departments may chose deliberately to forego dividends in order to allow the trading fund to build up cash – but this approach does not impose the same financial disciplines on the trading fund as requiring them to pay the full amount of the dividend and take out additional borrowings to fund capital expenditure.

6.5.4 Section 4 (4) of the 1973 Act addresses the possibility that a trading fund has no PDC and hence there is no automatic requirement to pay a dividend. The section allows

the responsible Minister to determine how any surplus arising in the year should be disposed of, ie either being used in connection with the “funded operations” or repaid as a dividend.

CHAPTER 7

RESERVES IN THE OPENING BALANCE SHEET

- 7.1 INTRODUCTION
- 7.2 STATUTORY BACKGROUND
- 7.3 INTERPRETATION OF SECTION 2AA OF THE
1973 ACT

7.1 INTRODUCTION

7.1.1 This chapter considers the implications of section 2AA of the 1973 Act which allows the opening net assets to be financed in part by reserves.

7.2 STATUTORY BACKGROUND

7.2.1 Section 2AA was introduced by Schedule 22 of the Finance Act 1993 and was intended to address a comment that the original Act was written at a time when cash-based accounting within government was almost universal and there was a possibility that asset records would be unreliable. Hence it was necessary to identify the assets and liabilities to be appropriated to the fund and to value them in order to establish figures for the opening balance sheet of the trading fund. However, by the early 1990s, with an increasing number of trading funds being established from existing executive agencies, reliable asset records were becoming available and it was argued that it should be possible to bring forward the revaluation reserves and accumulated depreciation from the agency into the trading fund.

7.3 INTERPRETATION OF SECTION 2AA OF THE 1973 ACT

7.3.1 Section 2AA is widely drawn and provides for “general, capital or other” reserves to be treated as reserves in the opening accounts of the trading fund. Although this would appear to allow the opening balance sheet of the trading fund to be identical to the closing balance sheet of the agency from which it is established, this approach undermines the principle that the opening net assets of the trading fund should be financed by loans and PDC in order to impose financial disciplines on the trading fund. In practice, therefore, section 2AA has been interpreted (a) to refer to accounting reserves (and not cash balances) and (b) to mean only the revaluation reserve and accumulated depreciation relating to those assets appropriated to the fund, and more recently any Government Grant Reserve relating to assets funded from central sources – see 7.3.2 below.

7.3.2 In recent years, however, agencies have been able to take advantage of central initiatives to support projects – examples include the Capital Modernisation Fund and the Invest to Save Budget. Resource Accounting rules require funds for capital expenditure to be credited to a Government Grant Reserve and, under the provisions of section 2AA, any balance on Government Grant Reserves may also be recognised in the opening balance sheet of the trading fund. The Reserve will be matched by the assets funded by central funding. The implications for the levels of loan capital and PDC are considered in *chapter 6.2.2 above*.

CHAPTER 8

CASH DEPOSITS AND INVESTMENT OF SURPLUS CASH

8.1 INTRODUCTION

8.2 CASH DEPOSITS

8.3 INVESTMENT OF SURPLUS FUNDS

8.1 INTRODUCTION

8.1.1. This chapter considers the implications of section 4(2) of the 1973 Act regarding the establishment and maintenance of “reserves” and the uses to which any surplus funds may be put.

8.2 CASH DEPOSITS

8.2.1 Section 4(2) of the 1973 Act permits a trading fund to establish and maintain “general, capital and other reserves.” In this context, “reserves” has been interpreted to mean “cash balances” rather than reserves in an accounting sense. One of the key characteristics of a trading fund as described in section 3(1) of the 1973 Act (which provides for receipts to be paid into the trading fund to meet expenditure) is that cash received need not be surrendered but may be retained within the business.

8.2.2 As noted in the section on budgeting requirements (*Chapter 11*), the provisions of SR2002 (unchanged for SR2004), permit trading funds to retain cash surplus to that required to settle their interest and dividend liabilities to enable them to finance future capital expenditure. Trading funds undertaking statutory functions should not, however, deliberately aim to earn these surpluses as this may be construed as hidden taxation. Where surplus cash arises, then charging policies may need to be reviewed to ensure that they surpluses do not continue.

8.2.3 Cash reserves should not be built up as a matter of routine. If surplus cash is available and no significant investment plans are contemplated, consideration should be given to paying out surplus cash in the form of a higher dividend to the parent department. Such “super-dividends” are recorded as a withdrawal of equity and can be netted-off the department’s expenditure in its capital DEL (*see guidance issued by the Treasury to departments dated 1 May 2002*) and hence can be appropriated-in aid (*see also 5.10.4*) But if the agreed corporate plan includes significant investment plans, a decision will be needed on how best to finance this as between borrowing, accumulated reserves, and an in –year surplus.

8.3 INVESTMENT OF SURPLUS FUNDS

8.3.1 Section 4(5) of the 1973 Act provides for any funds which are not immediately required for the funded operations to be invested in “such securities of the Government of the United Kingdom ... as the Treasury may approve, including Treasury Bills and Ways and Means Advances.

8.3.2 As noted in 8.2.2 above, the budgeting rules under SR2002 allow trading funds to retain cash in excess of that needed to settle the liabilities relating to dividends and interest. Funds may be deposited with the National Loans Fund in multiples of £1,000, subject to a minimum of £1 million, for periods of one week up to 6 months providing the necessary facility has been opened in advance. Details of the procedures involved, which are available to all trading funds including those for which the NLF is not the authorised lender, can be obtained from the Exchequer Funds and Accounts team within

the Treasury. With the concurrence of the department and the Treasury, surplus funds may also be deposited with the National Loans Fund for periods of one year or more – although departments may wish to consider the alternatives described in *paragraph 8.3.5* below.

8.3.3 Trading funds may also wish to open an interest-bearing account with the Office of HM Paymaster-General. Trading funds wishing to take advantage of this facility may obtain more information from the Office of HM Paymaster-General, which is situated at:

Office of HM Paymaster-General
Sutherland House
Russell Way
CRAWLEY
West Sussex RH10 1UH
Tel: 01293 604410

8.3.4 Trading Funds do not have powers to invest with private sector bodies.

8.3.5 Departments may require trading funds to pay higher levels of dividends or, with Treasury concurrence, require the payment of surplus funds into the Consolidated Fund in accordance with section 4(3) of the 1973 Act .

8.3.6 Trading funds may use surplus funds to invest in joint ventures (*see chapter 14*) where this furthers their funded operations. (Although this may appear to be in conflict with section 4(5) of the 1973 Act, this section relates to money in the fund “which is not immediately required for the funded operations”; as the money is to be used in furtherance of the operations, this apparent conflict does not arise.)

CHAPTER 9

ASSETS

9.1 INTRODUCTION

9.2 VALUATION OF ASSETS – GENERAL

9.3 BASES OF VALUATION

9.4 TIMING OF VALUATIONS AND IMPLICATIONS FOR
THE TRADING FUND ORDER

9.1 INTRODUCTION

9.1.1 This chapter considers issues concerning the valuation of assets appropriated to a trading funds and the disclosure of information about assets in the trading fund Order.

9.2 VALUATION OF ASSETS – GENERAL

9.2.1 Under the provisions of Section 2(1) of the 1973 Act, Crown assets and liabilities properly attributable to the new fund are appropriated to that fund. At the time the Act was written, the preparation and maintenance of reliable asset registers and accruals-based accounting records was not so widespread as is currently the case, and identifying assets and liabilities was often time-consuming. However, as most trading funds are now established from existing agencies, identifying and valuing assets and liabilities should be straightforward. Since most trading funds will have a financial target linked to the return on capital employed, it is necessary to have an estimate of net assets in good time so that discussion can take place on suitable targets and the fund's debt/equity ratio.

9.3 BASES OF VALUATION

9.3.1 More detailed advice on valuation matters is given in chapter 7 of *Trading Funds – Accounts Guidance* which, in turn, is based on FRSs 11 and 15. The valuation of categories of assets will be governed by directions issued by the Treasury under section 2(2A) of the 1973 Act. (see 3.9.1 above and Annex G).

9.3.2 With the introduction of resource accounting, departments and agencies will have values for the assets to be appropriated to the trading fund.

9.4 TIMING OF VALUATION AND IMPLICATIONS FOR THE TRADING FUND ORDER

9.4.1 The Order itself may describe the assets and liabilities to be appropriated to the fund in general terms (*section 2(7) of the 1973 Act*) and does not have to include estimated values. However, the estimated aggregate values of the assets and liabilities are shown in the Explanatory Note to the Order.

9.4.2 The value or amounts of the assets or liabilities must be determined in accordance with Treasury directions before or at the same time as the Order (*section 2(2A) of the 1973 Act*). They cannot be left to be determined once the fund has been established. The figures in the Explanatory Note form the basis of the opening capital, ie the originating loan and PDC. If the actual figures on the starting date are different, the effect on originating capital may be adjusted, although the same proportions of loans and PDC are to be maintained (see also 6.2.2 above).

9.4.3 The Order need not describe individual assets or liabilities. It is sufficient to

describe assets or liabilities by categories e.g. land and buildings, plant and machinery. Where the category does not in itself describe the nature of the assets or liabilities e.g. current assets or current liabilities, it is preferable for the Note to indicate their nature more fully (e.g. trade debtors and creditors), but still in general terms.

9.4.4 It is unlikely – but not unknown – for there to be any significant change in the value of fixed assets in the period between preparing the Explanatory Note and the starting date for the trading fund. There could however be significant variation between the best estimates of current assets and liabilities and the actual figures at the starting date. This will not actually be known until some months after the setting up of the trading fund, when the previous year's figures are finalised and audited by the National Audit Office. The actual figures should be reflected in the balance sheet prepared for each trading fund to record the assets and liabilities as at the starting date, but in extreme cases, it may be necessary to prepare a revised trading fund Order showing the actual figures and the effects on the opening loans and PDC.

CHAPTER 10

MISCELLANEOUS ISSUES

- 10.1 INTRODUCTION
- 10.2 DEFICIT FINANCE
- 10.3 ADVANCE AND LATE PAYMENTS
- 10.4 COMMERCIAL INSURANCE

10.1 INTRODUCTION

10.1.1 This chapter considers a number of miscellaneous items viz. deficit finance, advance and late payments and commercial insurance.

10.2 DEFICIT FINANCE

10.2.1 Where the parent department and Treasury agree that a trading fund is in temporary deficit, i.e. is failing to meet both its statutory requirement to break even and its further financial objectives (see 2.4.1 above), a number of possibilities need to be considered. These include paying the interest on the loan capital by taking a further advance, taking out a new loan to cover principal and interest or for the parent department to pay a once-and-for-all grant.

10.2.2 However, if there is any evidence the problem is other than temporary and where there is any risk that a trading fund may default on any new loan, the position will need to be drawn to the attention of the Principal Accounting Officer and the relevant Treasury spending team who will consider appropriate remedial action. This may include restructuring the balance sheet with possible write-off of loans and/or PDC (see 5.11.1 and section 6.4 above), or in extreme cases, withdrawing trading fund status and undertaking the operations through an executive agency. A summary of the statutory provisions relating to the discontinuance of trading fund status is given in *chapter 16*. (See also 12.8.1 below.)

10.3 ADVANCE AND LATE PAYMENTS

10.3.1 Trading funds must pay special regard to their working capital needs since they should avoid, where possible, having recourse to temporary borrowing. In accordance with the principles set out in *section 16.3 and annex 16.2 of Government Accounting*, bills should normally be settled within one month. This includes bills paid by private and public sector customers and bills which the trading fund itself needs to meet. To ensure all customers pay on time, trading funds are free to offer discounts for early settlement and to increase charges for bills not paid within one month. In most cases, trading funds will find it convenient to set out payment arrangements in individual service or contract agreements so that customers are left in no doubt as to the basis on which services are being provided.

10.4 COMMERCIAL INSURANCE

10.4.1 The general policy for self-insurance is set out in Chapter 30 of *Government Accounting*, which is based on the following two considerations:

- a. the Government does not need to purchase commercial insurance to protect the viability of its business;

- b. in practice, because of the scale of government business, the ratio of claims to premiums will normally favour insurance companies.

10.4.2 Exceptions to this general policy must be based on sound value for money reasons. Chapter 30.2.10 of *Government Accounting* lists a number of situations in which statutory or value for money considerations indicate that commercial insurance may be taken out, eg where insurance is a condition of a lease; site insurance; insurance on boilers or lifts; wider markets activities or where commercial insurance is integral to a project. In practice, some trading funds have identified three types of risk which are met as follows:

- Low risks – claims and losses are met from internal resources (self insurance). Accounting standards prevent a trading fund from smoothing out the effect of such claims and losses by setting up provisions. Claims and losses are therefore charged against income in the year in which they are incurred;
- Medium risks – for which commercial insurance is taken out as this represents sound value for money;
- Catastrophic risks – which are not insured. In the event of such an eventuality, trading funds will need to discuss with their departments how such losses will be financed.

10.4.3 It is not possible to give examples of what might be considered “medium” risk as much will depend on the circumstances of the trading fund and the likely value of individual claims. Guidance on purchasing commercial insurance is given in chapter 30 of *Government Accounting*, and in particular annex 30.4.

CHAPTER 11

PUBLIC EXPENDITURE CONTROL

11.1 INTRODUCTION

11.2 BUDGETING FRAMEWORK

11.1 INTRODUCTION

11.1.1 This chapter considers the budgeting implications for **departments** as a result of their investment in a trading fund. Trading funds which are also departments in their own right are considered in 11.2.8-10 below.

11.2 BUDGETING FRAMEWORK

11.2.1 General guidance on the budgeting framework is given on the Treasury's public website (see *Annex A "SR2004"*) with more specific guidance for departments being given on the GSI website.

11.2.2 The underlying principle is that departmental budgets (ie the departmental expenditure limits (DEL) plus departmental annually managed expenditure (AME) include transactions between the department and its trading fund (s).

11.2.3 For trading funds which are part of departments, the department's **resource DEL** budget will include:

- Interest and dividends from the trading fund;
- The capital charge borne by the department on the net assets of the trading fund (see 11.2.4-5);
- Subsidies made by the department to the trading fund (see 11.2.6); and
- Any capital grants made by the department to the trading fund, including amounts to write-off debts (see 11.2.6).

Somewhat different rules apply to the Royal Mint as, uniquely amongst trading funds, it is classified as a Self-Financing Public Corporation. The interest and dividends receivable and the capital charge are recorded in resource AME and the transactions recorded as capital DEL for other trading funds are recorded in capital AME.

11.2.4 The cost of capital charge borne by a department in respect of the net assets of its trading fund will be the equivalent of the financial target set for the trading fund, ie will normally be a return on capital employed of 3.5 per cent or more.

11.2.5 Interest and dividends receivable by the department from the trading fund offset the capital charge borne by the department. To the extent that they do not offset the capital charge, the department has to bear the difference as a charge to its resource DEL; conversely, the department benefits to the extent that the capital charge is exceeded. This may happen if the department seeks to extract surplus cash from the trading fund (see *guidance issued by the Treasury to Departments dated 1 May 2002*).

11.2.6 As considered in Annex B of Cm 914, trading funds may, in principle, receive grants or subsidies, but such payments must be clearly defined and targeted for a specific purpose and be fully transparent. It is unlikely that the third bullet point above (11.2.3) will have widespread application. A trading fund may receive a capital grant (fourth bullet) where this relates to a central initiative (such as the Capital Modernisation Fund) which is available to all departments.

11.2.7 The department's **capital DEL** will include:

- Loans to the trading fund, net of repayments;
- Injections or withdrawals of public dividend capital.

11.2.8 These arrangements apply in principle to trading funds which are also departments in that **for budgeting purposes only** such trading funds have a “parent” department which records the resource and capital DEL (Land Registry – Department for Constitutional Affairs; Ordnance Survey – Office of the Deputy Prime Minister; Royal Mint – H M Treasury; Central Office of Information – COI Department).

11.2.9 These trading funds borrow directly from the NLF rather than through their parent department, and the loan interest is paid directly to the NLF rather than to the department. The budgeting arrangements for the treatment of interest are thus different from those described above. These are reflected in section 7.5.3.a.i of the *Resource Accounting Manual* which allows the cost of capital charge borne by the department to be abated by the interest payable on the NLF loan. In other words, the capital charge borne by the department equates to the dividend payable by the trading fund- see 6.5.2 above. (NB: This section of the RAM is under review to clarify these arrangements.)

11.2.10 It is worth clarifying that, although trading funds are consolidated with their parent department (or deemed parent department) this is only for budgeting purposes. All trading funds are outside the boundary for resource accounting purposes, and their accounts are not consolidated with the resource accounts of the parent department.

CHAPTER 12

FEEES AND CHARGES AND CHARGING POLICY

- 12.1 INTRODUCTION
- 12.2 FINANCIAL TARGETS
- 12.3 RATES OF RETURN AND CHARGING POLICY
- 12.4 DIFFERENT TYPES OF SERVICE
- 12.5 STATUTORY SERVICES
- 12.6 INTER/INTRA DEPARTMENTAL SERVICES
- 12.7 COMMERCIAL SERVICES
- 12.8 MISSED FINANCIAL TARGETS
- 12.9 PERFORMANCE TARGETS
- 12.10 WIDER MARKETS INITIATIVE AND
PROVIDING SERVICES AT MARGINAL COST
- 12.11 SERVICES PROVIDED AT LESS THAN FULL
COST

12.1 INTRODUCTION

12.1.1 This chapter considers the requirements for setting targets and the policy for charging. Guidance on fees and charges policy is set out in the *Fees and Charges Guide*. If further advice is required, it should be sought, in the first instance, from the Fees and Charges co-ordinator within the department, or from the appropriate spending team within the Treasury.

12.2 FINANCIAL TARGETS

12.2.1 Section 4(1) of the 1973 Act requires the responsible Minister

- to manage the funded operations so that the revenue of the fund is not less than sufficient, taking one year with another, to meet outgoings which are properly chargeable to revenue account; and
- to achieve such further financial objectives as the Treasury may from time to time by minute laid before the House of Commons indicate as having been determined by the responsible Minister (with Treasury concurrence) to be desirable of achievement.

12.2.2 Notwithstanding the reference in the 1973 Act to “taking one year with another” [see 2.4.2 above], fees and charges should normally be set to recover the costs in the forthcoming accounting period (usually the financial year). The only exception is where the specific charging powers in some existing legislation refer to fees being set “taking one year with another”.

12.2.3 It should be noted that “financial objectives” do not include mixed financial/output objectives such as unit costs, though trading funds should be set unit cost or similar objectives as key performance targets (see 12.9 below).

12.2.4 The “further financial objective” is normally set in terms of the achievement of an agreed return on the average capital employed during the year. Although there may be cases for an alternative approach, the “return” is the surplus on ordinary activities measured before interest (both receivable and payable) and dividends payable. “Capital employed” is the capital (ie PDC and loan capital) and reserves. Where capital employed has not fluctuated significantly during the year, it may be sufficient to take a simple arithmetic average when assessing the average capital employed; however, if this is not the case, eg where temporary loans have been taken out and repaid during the year, it may be necessary to apply a more sophisticated approach, eg by calculating the average capital employed on a quarterly, monthly or even weekly basis.

12.2.5 As noted above, the further financial objective is to be agreed with the Treasury, and promulgated by means of a Minute laid before the House of Commons by the Treasury (see 2.5 above).

12.3 RATES OF RETURN AND CHARGING POLICY

12.3.1 The main purpose of charges made by trading funds is to provide the “price signals” that will ensure that efficient resource allocation takes place within the public sector and between the public and private sectors. Charges should normally be set to recover full costs and to achieve the required rate of return. There is a relationship between the charging policy for individual goods or services and the rate of return achieved by the business as a whole. The required rate of return for a particular trading fund will vary according to the nature of the services it provides and the balance between them. For example, funds providing primarily statutory services will have different requirements from those which are in competition with other suppliers and charging commercial rates or those which have a mix of statutory and other services (*see also 12.7.3 below*).

12.3.2 The main principles underlying the charging policies to be followed by a particular trading fund will normally need to be agreed with the Treasury before the fund is set up and will need to be consistent with its financial objective. Where a trading fund wishes subsequently to adopt a policy which involves any substantive change in the basis on which it makes its charges, e.g. to reflect special factors noted above or in the *Fees and Charges Guide*, the revised policy must also be agreed with the Treasury before introduction. Advice on appropriate rates of return and charging policy is given in guidance issued by the Treasury to departments on 4 September 2003 and 14 October 2003; DAO(GEN)13/03 (15 September 2003); and the *Fees and Charges Guide*.

12.4 DIFFERENT TYPES OF SERVICES

12.4.1 The precise approach to be adopted will vary according to the types of products and or services supplied by a trading fund. The market in which the fund operates and the services provided by individual funds may fall into one or more of the following four categories:

- a. **Statutory Services:** these are services which a trading fund provides to recipients normally outside Government as a result of a specific provision in statute (*see 12.5 below*);
- b. **Inter Departmental Services:** these are services provided to one or more other Government Departments, (including agencies in other departments), non departmental public bodies, or National Health Service bodies or other bodies within Central Government (*see 12.6 below*);
- c. **Intra Departmental Services:** these are services provided to another part of the same department, including another agency within the department (*see 12.6 below*); or
- d. **Commercial Services:** these are services which a trading fund provides on a commercial basis to the wider public sector and/or the private sector (*see 12.7 below*).

12.4.2 Trading funds need to obtain Treasury agreement to their charging government customers more than full cost, including the agreed return on capital employed. The

existence of some competition might not, of itself, be enough to justify a fund making profits from government customers (who may need additional public expenditure provision as a result).

12.5. STATUTORY SERVICES

12.5.1 The costs of a statutory service should be calculated in accordance with the advice contained in the *Fees and Charges Guide*. Where the same statutory service is provided in different forms, for example a normal versus a high-speed service, the costs of each form of the service should be calculated separately and the fees charged in each case should be set to recover these costs taking each year on its own. The same fee should, of course, be levied to all customers for the same form of service.

12.5.2 For legal reasons, the price of a statutory service should never be set deliberately to generate a surplus above the agreed return on capital employed (3.5 per cent in the SR2002 and SR2004 periods), unless the statute specifically provides for this. A planned surplus would be interpreted as illegal taxation.

12.5.3 As is made clear in the *Fees and Charges Guide*, the treatment of surplus receipts and deficits of a trading fund needs to be considered in the light of a trading fund's financial objectives. Where, inadvertently, a trading fund earns surplus receipts, they may be used to mitigate or eliminate increases in charges, reduce charges, cover any planned loss in the following year or be used to finance capital expenditure, subject to the agreement of the sponsoring department and resource budgeting requirements. The budgeting rules for SR2002 (which remain valid for SR2004) are also relevant – see 11.2 above.

12.5.4 A trading fund which operates a statutory service may plan to charge more than full cost to cover a past deficit. Section 102 of the Finance (No 2) Act 1987 gives Ministers the power to seek an affirmative order to enable the level of fees to be increased in order to recover a deficit incurred in a previous year. The fact that a body is a trading fund does not relieve it of the need to obtain a Section 102 Order. The increased charges should provide sufficient income to pay the required dividend on public dividend capital, service additional debt or replace revenue reserves as agreed is appropriate following discussion with the parent department and the Treasury. Section 4.12 et seq of the *Fees and Charges Guide* describes the situation where a section 102 Order may also be used to recover costs which are not directly related to the service or sub-service for which the fee is being charged (ie cross-subsidisation of costs),

12.6 INTER/INTRA DEPARTMENTAL SERVICES

12.6.1 All payments to a trading fund which provides inter or intra departmental services should be made in cash (ie there should be hard charging) and the general provisions set out in the *Fees and Charges Guide* should be applied. As with statutory services, the normal required rate of return is currently 3.5 per cent.

12.7 COMMERCIAL SERVICES

12.7.1 As explained in section 7.1 of the *Fees and Charges Guide*, commercial services are services to the private sector or wider public sector; it may include services provided by Government bodies (including, for this purpose, trading funds) to other Government bodies if the Treasury has agreed that this should be the case. However, where a substantial proportion of a trading fund's operations involve sales to the private sector and its customers are under no obligation to use its services, it may be regarded as operating on a fully commercial basis including its dealings with other Government bodies.

12.7.2 Where a trading fund provides a low risk commercial service, perhaps in support of a statutory service, and there is no competition and no realistic likelihood of competition from the private sector, it is appropriate for the body to earn an average real rate of return of (currently) 3.5 per cent on that service, particularly where it is incidental to the trading fund's mainstream activities. However, where there is or may be competition from the private sector, the average real rate of return on capital employed should be set to reflect market prices. The actual ROCE will reflect the degree of competition and market forces and will normally be expected to be at least some 2 per cent higher than the minimum required.

12.7.3 In many cases, a fund's core activity is the supply of services within government but with a proportion being supplied in competition with the private sector, and it will normally be appropriate to set a financial target which reflects the weighted average return expected.

12.7.4 The required rates of return for the business as a whole will normally be expressed as an average measured over a period of years (usually 3 or 5). Trading funds will normally aim for a slightly higher rate of return each year to ensure that the target rate is not missed, although those engaged in statutory services should not deliberately aim to do so as this is tantamount to hidden taxation. Where funds which are not in competition with the private sector consistently achieve rates of return significantly in excess of the financial objective covering the required real rate of return on net assets, they should take steps to lower fees and charges. Charges that are too high result in inefficient resource allocation between private and the public sectors. Due regard should be made for appropriate segmental reporting in accordance with sections 3.8 and 3.9 of the *Fees and Charges Guide* to distinguish between profit and surplus through over cost-recovery.

12.8 MISSED FINANCIAL TARGETS

12.8.1 Where a trading fund fails to meet its target rate of return, the parent department will need to discuss with the Treasury whether this is a purely temporary situation which can be rectified, e.g. by increasing charges, or whether it represents a more deep-seated problem which calls into doubt the appropriateness of trading fund status (*see also 10.2.2 above*.) Fees cannot be increased to recover a deficit, whether in-year or for a previous year unless a section 102 Order has been obtained, or there is specific legislative provision to do so (*see 12.5.4 above*).

12.8.2 In looking at the financial prospects for a trading fund which is not meeting its financial targets, a distinction needs to be drawn between those which are operating in a competitive environment and those which provide a statutory or monopoly service.

12.8.3 For trading funds which provide a monopoly service, there may be circumstances beyond the control of the responsible Minister and the trading fund, which has led to the fund failing to meet its target in a particular year (eg an unexpected downturn of demand for the services provided). If so it should be possible to correct the position the following year. If it is not corrected, this suggests:

- that fees and charges are not being set at the level necessary to enable the fund to meet its financial objectives;
- that the fund may not be properly managed;
- that the nature of the operations means that the body is not suitable to be trading fund; or
- a combination of these.

12.8.4 Most trading funds have financial objectives set in terms of the achievement of an average return over a period – usually 5 years. There may be circumstances where a fund fails to meet its target in one year but anticipates higher returns in other years in order to meet the target over the period. But if it appears that the problems are more fundamental and that a trading fund will fail to meet its financial objective over the period, the responsible Minister will need to consider appropriate action. If rescheduling or writing off debt does not address the problem, the presumption is that the trading fund should be wound up and that the operations should revert to Supply-financing (see *chapter 16 for a summary of the statutory provisions relating to the winding up of a trading fund*).

12.9 PERFORMANCE TARGETS

12.9.1 Before a trading fund is set up, the responsible Minister will need to agree with the Treasury its key performance targets (i.e. the published targets). These should be robust and challenging, covering quality of service, financial performance and efficiency, except where otherwise agreed by the responsible Minister and the Treasury. Further guidance on the setting of performance targets is given in *Setting Key Targets for Executive Agencies: A Guide* issued in November 2003 jointly by the Treasury, the Cabinet Office and the National Audit Office

12.10 WIDER MARKETS INITIATIVE AND PROVIDING SERVICES AT MARGINAL COST

12.10.1 In accordance with the Wider Markets Initiative (see 2.3.3 above), a trading fund may, subject to agreement with the parent department and the Treasury, use surplus

capacity to provide services to a broad range of customers. Where the relevant Treasury guidance allows, or where the Treasury has specifically agreed, such services may be priced at marginal rather than full cost. However, if such services are provided over the longer term, they should generally be charged for at full cost as overheads will normally be incurred as a direct consequence of providing them. In all cases careful consideration of the approach to be adopted is needed to ensure that competition is fair and accords with the general presumption against expanding the public sector. Section 7.8 of the *Fees and Charges Guide* is also relevant.

12.10.2 In very exceptional circumstances, it may also be appropriate for a trading fund to recover less than the full cost of one commercial service, at least on a temporary basis, and for the deficit to be recovered from another more profitable commercial service. This approach might be used, for example, by bodies which seek to introduce services in the form of loss leaders. But in no case should a service be provided at less than its marginal cost. The comments above apply only to commercial services; specific legislative provision is needed before statutory services may be cross-subsidised.

12.10.3 The approval of the responsible Minister and the Treasury is required if profits from a commercial activity are to be used to cross-subsidise any statutory service provided by a trading fund; and Treasury approval is needed for the subsidy and associated performance target if the service to be subsidised costs more than £1 million a year (this threshold is currently under review).

12.11 SERVICE PROVIDED AT LESS THAN FULL COST

12.11.1 A key feature of a trading fund is that it operates outside the normal Supply process. However there may be exceptional cases where, as a matter of policy, it is agreed that a trading fund should provide certain services at less than full cost and the trading fund may receive a grant from monies provided by Parliament. Such grants should be clearly and separately identified in the relevant Estimate and in the annual accounts in accordance with the undertakings given in Annex B to Cm 914 for making all Supply –financed payments to trading funds transparent. The implications of Competition Law and EU Directives (especially the Transparency Directive which is concerned with demonstrating that there is no discrimination between public and private sector customers) should be considered if grants to a trading fund are being considered.

CHAPTER 13
ACCOUNTABILITY

- 13.1 INTRODUCTION
- 13.2 TRADING FUND ACCOUNTING OFFICER
- 13.3 PRINCIPAL ACCOUNTING OFFICER
- 13.4 DEPARTMENTAL MINISTER
- 13.5 TRADING FUNDS WHICH ARE DEPARTMENTS
- 13.6 FRAMEWORK DOCUMENT
- 13.7 AUDIT COMMITTEES
- 13.8 SHAREHOLDER EXECUTIVE

13.1 INTRODUCTION

13.1.1 This chapter deals with corporate governance issues, ie the relationship between the Accounting Officer of the trading fund (ie the Chief Executive), the Principal Accounting Officer (PAO) and the departmental Minister. The position of trading funds which are also departments in their own right is considered separately from that of trading funds which are part of departments. It also addresses questions on the Framework Document, Audit Committees and the Shareholder Executive.

13.2 TRADING FUND ACCOUNTING OFFICER

13.2.1 Section 4(6) of the 1973 Act provides for the Treasury to appoint the Accounting Officer of a trading fund. The trading fund's Accounting Officer, who is invariably the Chief Executive, is not subordinate to the Principal Accounting Officer (*see 13.3 below*) or - in appropriate cases - the Accounting Officer of the NLF.

13.2.2 The Accounting Officer for the trading fund is solely responsible to the Minister for use of resources in carrying out the functions assigned to him or her in the Framework Document (*see 13.6 below*). i.e. the organisation and management of the fund; the proper management of the funds entrusted to him or her; and the achievement of the statutory and other performance targets.

13.2.3 The Accounting Officer of the trading fund needs to be fully satisfied that the fund will be able to service and repay any loan from Votes or the NLF (*see 13.3.2 and 13.3.5 below*), and that the income of the trading fund will only be used for purposes authorised by Parliament, i.e. that those purposes fall within the ambit of the Order establishing the trading fund.

13.3 PRINCIPAL ACCOUNTING OFFICER

13.3.1 The duties of Principal Accounting Officers are set out in the Accounting Officer Memorandum (*see Government Accounting, annex 4.1*). As part of his or her responsibilities for the overall management and organisation of the department, the PAO is answerable to the Minister for the allocation of departmental resources and for preparing the Framework Document for the trading fund. The PAO should ensure that the Framework Document sets out the division of responsibilities between him or her and the AO for the trading fund. He or she will be responsible for ensuring that the trading fund is correctly set up on a viable basis and for ensuring that the trading fund's systems and procedures promote a high standard of financial management and safeguard propriety and regularity.

13.3.2 For trading funds which are **part of departments**, section 2B(2) of the 1973 Act provides for the responsible Minister to make advances to the fund from monies provided by Parliament ("voted loans"). Responsibility for ensuring the regularity and propriety of advances rests with the PAO (or additional AO) as AO for the relevant Estimate.

13.3.3 The PAO will need to be satisfied that all information to support the loan

application has been supplied by the trading fund and that a thorough assessment of the fund's future prospects has been made. It would be improper for a department to advance loans from Estimates where there is doubt about the ability of a trading fund to repay the loan.

13.3.4 The Treasury should always be consulted in the event of any proposal to offer loans on terms other than those agreed in advance for each trading fund.

13.3.5 Trading funds which are ***departments in their own right*** will normally borrow from the NLF. The Permanent Secretary to the Treasury is the Accounting Officer for the NLF and is therefore responsible for the regularity and propriety of all loans issued to the fund.

13.4 DEPARTMENTAL MINISTER

13.4.1 Under Section 4(1) of the 1973 Act, responsibility for all operations of a trading fund – whether the fund is a department in its own right or is part of a department - is borne by “a responsible Minister”. All officials, including Accounting Officers, derive their authority from the Minister and are accountable to him or her for their actions. In addition, Accounting Officers have certain responsibilities direct to Parliament, as set out in the Accounting Officer Memorandum.

13.4.2 If any differences of view arise between the PAO (see 13.3) and the Accounting Officer of the trading fund (see 13.4), it is for the responsible Minister to decide on what should be done. Both Accounting Officers are liable to be summoned before the Committee of Public Accounts to answer any questions relating to the discharge of their respective responsibilities.

13.4.3 Although the arrangements may differ from department to department, the Minister will exercise his or her responsibilities through some form of Ministerial advisory board (MAB) chaired by the responsible Minister and consisting of senior officials within the department together with members of the trading fund's management board (including non-executive board members). If the trading fund provides services primarily to the parent department, representatives of the customers may also be members of the MAB. The function of the MAB is to consider the performance of the trading fund and its strategy. See also 13.8 below which considers the role of the Shareholder Executive.

13.5 TRADING FUNDS WHICH ARE DEPARTMENTS

13.5.1 Trading funds which are departments in their own right are nevertheless treated as being part of another department for budgeting purposes (see 6.5.2 and 11.2.8 above). Although the trading funds arrange their loans directly from the NLF, the budgeting department will bear a cost of capital charge on the net assets of the fund. However, this cost of capital is abated by the interest payable by the trading fund on its NLF loans, which means that the cost of capital charge equates to the dividend payable by the trading fund (see also 11.2.5 above). The PAO for the budgeting department will

not have a day-to-day interest in the running of the trading fund, but can be expected to be interested in the performance of the fund especially where there is any doubt that the fund will make the required level of dividend payments.

13.5.2 The Accounting Officer of the trading fund also bears responsibility with the AO of the NLF (see 13.3.5) for ensuring that:

- any loan application is proper and supported by appropriate information;
- that a thorough assessment of the trading fund's ability to repay the loan has been conducted; and
- that the funds are utilised only for purposes authorised by Parliament.

13.6 FRAMEWORK DOCUMENT

13.6.1 The Framework Document for each trading fund (*but see 13.6.3*) is a key element in the accountability process. It sets out for each trading fund its aims and objectives, and the boundaries between policy and service delivery functions. It also describes the monitoring, accountability and reporting patterns between the trading fund and sponsor department, and the financial and personnel management flexibilities agreed for the trading fund. Further information on Framework Documents is given in *Guidance on Framework Documents* issued by the Cabinet Office in December 2002, but updated in January 2003 and January 2004.

13.6.2 Responsibility for preparing the Framework Document rests with the department, although Treasury officials should be involved, especially in respect of any proposals for delegations to the trading fund or if there are any unusual proposals. The Framework Document should be in place when the trading fund is established, and adequate time should be allowed for its preparation and review. The Cabinet Office's guidance currently requires the approval of both Cabinet Office and Treasury Ministers to be obtained before the Framework Document can be published, although this requirement is currently under review.

13.6.3 Although it has been traditional for each trading fund to have a separate Framework Document, the Cabinet Office's guidance also notes that departments may wish to consider some form of departmental framework setting out the governance arrangements for the whole department including its agencies and trading funds.

13.7 AUDIT COMMITTEES

13.7.1 All central government bodies, including trading funds, should appoint an Audit Committee the role of which is to support the Chief Executive in monitoring the corporate governance and control systems in the trading fund. The objectivity of the advice given is enhanced if the Committee is chaired by a non-executive or independent external member. The Audit Committee should be a committee or sub-committee of the Management Board and, if the Management Board includes non-executive members, membership of the Audit Committee should be drawn as far as possible from those non-executive members.

13.7.2 Guidance on the establishment and role of Audit Committees (*The Audit Committee Handbook*) was issued by the Treasury in October 2003, and the Cabinet Office has issued guidance on the appointment of non-executives. More general guidance on Audit Committees is given in *Audit Committees Combined Code Guidance*, a review of audit committees by a group chaired by Sir Robert Smith and published in January 2003.

13.7.3 The Audit Committee – which should consist of between 3 and 5 members - is an advisory body with no executive powers. Its main functions should be to:

- help to promote the highest standards of propriety in the use of public funds and encourage proper accountability for the use of those funds;
- promote a climate of financial discipline and control which will help to reduce the opportunity for financial mismanagement;
- promote the development of internal control systems which will help satisfy the board that the body concerned will achieve its key objectives and targets and is operating

(a) in accordance with any statutory requirements for the use of public funds;

(b) within delegated authorities laid down by the sponsor department and the public body's own rules on what matters should be referred to the Board;

in a manner which will make most economic and effective use of resources available.

13.7.4 The Chief Executive and Finance Director should normally attend meetings of the Audit Committee, as should the Head of Internal Audit and the External Audit representative but they should not be regarded as full members of the Committee. The Committee needs to give impartial advice to the Chief Executive and should be seen as being independent.

13.8 SHAREHOLDER EXECUTIVE

13.8.1 The creation of the Shareholder Executive (SE) was announced by the Chancellor of the Exchequer in the 2002 Pre-Budget Report and was established in September 2003 within the Cabinet Office. Its objective is to improve fundamentally the professionalism of departments in exercising their function as "shareholder" (ie owner). As it is primarily concerned with Government-owned commercial businesses, many trading funds are currently outwith its scope, although the intention is that all the commercially-orientated trading funds should come within its remit. The SE is currently involved with those trading funds sponsored by the MoD (ABRO, Defence Aviation Repair Agency, Defence Science and Technology Laboratory, UK Hydrographic Office, and the Meteorological Office), Ordnance Survey and the Royal Mint.

13.8.2 To deliver this objective, the SE will work with the teams within departments with responsibility for trading funds (“shareholding teams”) to:

- achieve a fundamental long-term improvement to the capability, structure and processes of departments; and
- support departments with timely and high-quality advice on issues such as objectives, strategy, appointments and corporate governance.

13.8.3 Trading funds not currently within the remit of the SE, and the respective responsible department, should nevertheless make contact with the SE so that they may become aware of the services offered by the SE.

13.8.4 The SE is considering appropriate corporate governance structures for trading funds. The statutory framework (*section 4(6) of the 1973 Act*) provides for the Treasury to appoint an Accounting Officer for the fund (without exception, the Chief Executive) – see 13.2 above. The Chief Executive is thus personally responsible for the operation of the fund. For trading funds that have commercial operations, taking decisions that balance risk with commercial upside, this arrangement runs counter to private sector best practice (eg as set out in the *Combined Code on Corporate Governance*). This is because it does not provide the challenge and support function of a board, with executive and non-executive directors who are collectively responsible for the success of the business. The SE is considering how more appropriate governance arrangements can be introduced into trading funds that have commercial operations. In addition, trading fund candidates should consider their proposed corporate governance arrangements with the SE.

13.8.5 One possible halfway house is for there to be a board of “directors” (both executive and non-executive) with a Chairman appointed by the appropriate Secretary of State. The Chairman would report to the Minister. Although under the current legislative framework, the CE has personal responsibility for the management of the trading fund, the board would share responsibility with the trading fund’s management for the success of the fund as judged against the framework of the aims and objectives set by the Minister (or owner if applicable). The role of the board might include responsibility to:

- review the performance of the trading fund against the strategic plans, targets and objectives (this would involve holding the chief executive and executive team to account);
- provide help, support and external challenge to the chief executive and executive team;
- review future business opportunities, plans for major investments, rationalisations etc and make decisions as appropriate;
- prepare recommendations to the Minister (or owner if appropriate) on matters requiring his or her formal approval. Examples might include strategic issues, key targets, corporate plans, major investments and “framework issues “ generally.

CHAPTER 14

TRADING FUNDS AND JOINT VENTURES

- 14.1 INTRODUCTION AND BACKGROUND
- 14.2 INTERPRETATION OF THE GOVERNMENT
TRADING FUNDS ACT 1973
- 14.3 KEY ISSUES
- 14.4 TRADING FUND AND JOINT VENTURE
SURPLUSES
- 14.5 DIVIDEND POLICIES
- 14.6 DIRECTORS' CONFLICT OF INTEREST
- 14.7 MANAGEMENT OF OPERATIONS
- 14.8 SOURCE OF INCOME
- 14.9 ACCOUNTING FOR BORROWING – LEGAL
POSITION
- 14.10 ACCOUNTABILITY
- 14.11 JOINT VENTURES WITH OVERSEAS
ORGANISATIONS
- 14.12 TAXATION

14.1 INTRODUCTION AND BACKGROUND

14.1.1 In the course of undertaking their core activities (ie those which they were established to undertake as described in the “funded operations” clause in the trading fund Order), some trading funds may build up databases of information, produce ideas, develop expertise in specific areas or undertake research which can be developed to provide services or products which can be marketed profitably. As this further development goes beyond the core activities, and may require additional skills and staff to develop and market the products successfully, it is not uncommon for trading funds to undertake this work in conjunction with the private sector through the vehicle of a separate limited company established for the purpose – “a joint venture” (JV). JVs may also be established to exploit spare capacity. (In accounting terminology “joint venture” has a particular meaning; in this context it simply means a limited company in which both the trading fund and a private sector company have a financial interest.)

14.1.2 The attractions of conducting business with the private sector include the synergies from existing expertise and products; use of established routes to market which may result in bringing the product to market more quickly; potential for additional investment funds; potentially less bureaucracy; and operating in a commercial culture. Against that, a potential disadvantage is that benefits from the developments have to be shared with the private sector partner and a trading fund should not embark on the process of setting up a JV unless there are demonstrable benefits.

14.1.3 Partnerships UK has published *A Guidance Note for Public Sector Bodies forming Joint Venture Companies with the Private Sector* (December 2001) which, although not aimed specifically at trading funds, contains much which will be of relevance to them. The guidance recognises that the nature of the joint venture company will vary for a number of reasons and does not describe the “best” way of forming one. It does, however, set out various considerations of which the public sector body should be aware.

14.1.4 Trading funds proposing to establish a JV should have regard to the recommendations in PUK’s Guidance. This stresses the need for an appropriate appraisal and feasibility study to consider other potential options in order to justify pursuing the JV company model. It also provides an algorithm of key steps and actions for setting up a JV company, included in which is a note that stakeholders – primarily the parent department - should be consulted at appropriate steps and the necessary approvals obtained. Formal approval from the Treasury will not normally be required although the spending team will need to be informed and made aware of any financial consequences for the department. The spending team may wish to consult other teams within the Treasury who may have an interest. The wider markets unit within PUK itself should also be involved, as should the Shareholder Executive (*see section 13.8 above*) as regards any issues arising from Corporate Governance.

14.1.5 This chapter, which is based on *Trading Funds’ Participation in Joint Ventures : A Guidance Note on the Requirements of the Government Trading Funds Act 1973* (HM Treasury April 1999) provides clarification on the circumstances in which the operations of a trading fund can be discharged through joint ventures. This Note was prepared to address uncertainty over whether the provisions of the 1973 Act were compatible with a

trading fund conducting operations in conjunction with the private sector and takes account of an opinion sought from Treasury Counsel and comments received from the National Audit Office at the time of its preparation.

14.1.6 The extent to which a trading fund may undertake its activities in conjunction with other parties (whether in the public or private sector) is limited in that section 4(1) of the 1973 Act requires a trading fund to be under the “control and management of the responsible Minister.” At one extreme there would be no conflict with the Act if a non-core activity (such as catering, security or accounting services) were subcontracted; conversely there would be doubt over the powers of the responsible Minister to control and manage the trading fund if its core activities were undertaken by sub-contractors, or by the trading fund in partnership with other organisations. However, there may be cases where a partnership arrangement can be structured to ensure that the responsible Minister retains control and management. For example, if a trading fund’s core function is to gather information and disseminate it in a variety of forms, it would not, in principle, offend the provisions of section 4(1) if a private sector firm were employed to print the information supplied in hard copy form rather than the trading fund undertaking this activity in-house. (Clearly, in this example, there would need to be safeguards to ensure consistency of supply and quality.)

14.1.7 The presumption is that a JV will be set up in such a way as to achieve classification to the private sector. Further guidance on the structuring of the JV company is given in chapter 4 of the PUK Guidance.

14.2 INTERPRETATION OF THE GOVERNMENT TRADING FUNDS ACT 1973

14.2.1 The Crown has the common law power of a natural person to establish or purchase a company, appoint directors and engage in activities through corporate entities, including joint ventures. The 1973 Act neither expressly nor implicitly limits or removes that power and, as confirmed by Treasury Counsel in his opinion of 15 December 1998 *“there are no legal principles or rules which prohibit a government department whose operations are financed by means of a trading fund from entering into joint ventures, whether the joint venture be corporate or contractual.”*

14.2.2 Income and other assets from the trading fund can be used for acquiring shares in the joint venture, provided the purposes of the joint venture come within the operations of the trading fund as prescribed in the trading fund Order. (A Minister would have to finance from an Estimate any investment in a joint venture which was outside the prescribed operations of the trading fund.) This may at first sight appear contrary to the provisions in section 4(5) of the 1973 Act which restrict the use to which surplus funds may be put (*see section 8.3 above*). However, this section refers to the investment of funds surplus to those for the immediate requirements of the operations of the fund – investment in a joint venture is in furtherance of the fund’s objectives. Chapter 2 of the PUK Guidance considers a number of issues relating to the constraints and conflicting priorities which should be considered before a trading fund proceeds with setting up a JV company.

14.2.3 Though there are no barriers in principle to the establishment of JVs, trading

funds are nonetheless, and in contrast to many other parts of Government, statutory bodies whose activities must fall within the scope of the 1973 Act.

14.2.4 Thus even though the 1973 Act is designed to provide an environment more suited to commercially-oriented bodies, the removal from Supply-financing still imposes a range of controls on trading funds' activities. These need not limit unduly the scope for joint ventures. Several aspects of the Act do, however, create potential difficulties which need to be addressed; these are considered in the following paragraphs.

14.3 KEY ISSUES

14.3.1 Caution should always be exercised when developing any joint venture to ensure that the arrangements provide value for money and suitable safeguards for the shareholders' interests. Joint ventures are by their nature complex entities. Where one of the shareholders is a department operating through a trading fund, there are additional considerations that will apply because of the issues raised above. The following paragraphs consider the key areas in which the Act requires trading funds to ensure that potential risks have been identified and necessary steps taken to avoid them. There are, of course, a host of other issues which apply to any joint ventures - for instance, but not exclusively, restrictions on share transfers; pre-emption and exit rights; guarantees; competition clauses; limitations to liability; confidentiality; default; voting rights; deadlock etc - on which any trading fund should seek expert advice. Advice should also be sought on the sector classification of the proposed joint venture for national accounts and expenditure control purposes (*see 14.1.7*).

14.4 TRADING FUND AND JOINT VENTURE SURPLUSES

14.4.1 Section 2A(5) of the 1973 Act provides for the responsible Minister (with the concurrence of the Treasury) to require the payment of a return on the public dividend capital and reserves of a trading fund which has regard to any balance in the fund at the end of the year and the amount of the balance which appears to be in the nature of a distributable profit. In practice, the dividend policy is now based on the requirements of resource budgeting which require the payment of interest and dividend equivalent to the cost of capital borne by the department on the net assets of the trading fund – which will include the value of its investment in the JV. Failure to meet the appropriate level of dividend will thus have financial consequences for the department (*see also 14.5 below*).

14.4.2 Trading funds' Accounting Officers should reflect the responsibility Ministers have under sections 2A(5) and 4(1) of the Act [need to pay a return on the PDC and reserves, and to meet financial targets] in their Framework Document and Corporate Plans, and should consider in each case whether Ministerial agreement is needed. This is to ensure that, where any joint venture is contemplated, the Minister and the trading fund are satisfied that nothing in the proposed joint venture could conflict with the responsibilities of the Minister under these sections.

14.4.3 Where joint ventures do not materially affect the overall asset base of the trading fund, there should not be difficulties with Sections 2A(5) and 4(1) since it is

unlikely that such arrangements would materially affect the trading fund's ability to pay a dividend. As the proportion of the assets of the trading fund vested in joint ventures increases so does the risk that a breach of these sections of the Act could occur. There are a number of contractual structures which the trading fund may consider to prevent breaches occurring. These include:

- a. Depending on the circumstances, licensing or leasing existing trading fund assets to the joint venture in return for a commercial fee rather than vesting them in the joint venture absolutely. This should ensure that the trading fund continues to receive some basic return on its assets, and so generate profits for distribution to the Exchequer, irrespective of dividend flow;
- b. Taking steps to ensure that where assets are vested in a joint venture, the trading fund secures value for money. As the JV may not be profitable in the early years, the trading fund should be earning sufficient returns elsewhere to compensate for the start-up period, and returns from the JV in later years should be higher to compensate for the lower initial returns.

14.5 DIVIDEND POLICIES

14.5.1 A provision to regulate the dividend policy of the joint venture should be agreed between the shareholders in a joint venture at the outset. The provision should be included within a shareholders' or joint venture agreement. Such a provision might include a presumption that amounts in excess of an agreed level should be distributed; or that (to the extent permitted by law and subject to the joint venture's cash requirements) a prescribed percentage of post-tax profits will be distributed.

14.6 DIRECTORS' CONFLICT OF INTEREST

14.6.1 Crown servants owe duties to the Crown whereas directors of companies owe duties to the company. In practice these duties are often indistinguishable but there is the possibility that the interests of the Crown and the interests of the company will diverge.

14.6.2 This issue is by no means unique to trading funds. Employees of any company nominated to the board of a joint venture face similar potential conflicts between their duties to the shareholders of the company of which they are employees, both in their capacities as employees and as nominees of the joint venture, and their duties to the joint venture as director.

14.6.3 One way round this problem (i.e. conflicts of interest) would be for the Memorandum and Articles of Association to be constructed so as not to conflict with the main interest of the trading fund.

14.7 MANAGEMENT OF OPERATIONS

14.7.1 Care should be taken to ensure that, in setting up a joint venture, a Minister

is not put in breach of his or her responsibility to manage the funded operations in the way stipulated by section 4(1) of the Act. In other words, the joint venture company should be structured to ensure that sufficient safeguards are in place to prevent any conflict with the trading fund's obligation to manage its core activities. In practice, this can be achieved by differentiating the outcome from the process – in other words, the Minister needs to be satisfied that he or she retains control of the outcome of the trading fund through eg shareholder agreements, the terms of the memorandum and articles and formal contracts, but he or she need not control all aspects of the delivery of that outcome.

14.8 SOURCE OF INCOME

14.8.1 The objects for which a JV company is established should further those of the trading fund. In other words, a trading fund cannot set up a JV company to undertake activities entirely unconnected with its “funded operations” as defined in its Order.

14.8.2 This can be effected through the Memorandum and Articles of Association and enforced as discussed above through a shareholders' agreement requiring unanimity on certain matters.

14.9 ACCOUNTING FOR BORROWING – LEGAL POSITION

14.9.1 One of Parliament's controls over trading fund finance is that they are prohibited from obtaining private loan capital by the provisions of section 2B of the 1973 Act. It *might* be seen as a circumvention of this requirement if a Minister invested in a JV company not bound by the section 2B prohibition, particularly where the accounts of the JV had to be consolidated with those of the trading fund. Counsel said, however, that in strict law there would be no contravention of section 2 since there would be no borrowing by the trading fund from the private sector. The borrowing would be undertaken by a separate legal entity, ie the joint venture company. In practice, if the joint venture is classified to the private sector and its borrowings are arranged without recourse to the trading fund there is unlikely to be any concern.

14.10 ACCOUNTABILITY

14.10.1 Trading funds should ensure that they have full rights of access to the joint ventures in which they are shareholders.

14.10.2 Where effective Parliamentary scrutiny of a trading fund's accounts and activities requires or may require the National Audit Office to have access to relevant documents relating to the trading fund's investment in a joint venture classified to the private sector, an appropriate clause (such as the one set out below) should be included in the shareholders' agreement.

“For the purposes of:

- a) *The examination and certification of the trading fund's accounts; or*
- b) *Any examination pursuant to Section 6(1) of the National Audit Act 1983 of the economy, efficiency and effectiveness with which the trading fund has used its resources,*

the Comptroller and Auditor General may examine such documents as he may reasonably require which are owned, held or otherwise within the control of the joint venture and may require the joint venture to provide such oral and or written explanations as he considers necessary. This condition does not constitute a requirement or agreement for the examination, certification or inspection of the accounts of the joint venture under Section 6(3)(d) and (5) of the National Audit Act 1983.”

14.10.3 In case of doubt the trading fund should consult the Treasury Officer of Accounts team at HMT, and the NAO.

14.10.4 Where a joint venture is classified to the public sector, the NAO should have the same access rights as apply to the trading fund.

14.11 JOINT VENTURES WITH OVERSEAS ORGANISATIONS

14.11.1 So long as the issues noted above are satisfactorily addressed, there is no reason, in principle, why a trading fund should not enter into a joint venture with an overseas government or a private sector organisation operating overseas, or to establish a JV company under overseas jurisdiction. Such an arrangement does, however, raise a number of questions and issues such as the legal and accounting framework which would apply; the location of the registered office (which may be different from the country in which the work is carried out); government to government issues; additional cost of the due diligence investigation and access to books and records.

14.12 TAXATION

14.12.1 As limited companies, JVs will be subject to corporation tax, and advice should be sought from the Inland Revenue about the tax implications on a case-by-case basis. The taxation position of each JV will vary according to the status and domicile of all parties. Trading funds should also be aware of advice given in DAO(GEN)6/00 (22 May 2000) which notes that it would be inappropriate for departments (and the bodies for which they are responsible) to use tax advisers to reduce their taxation burden. This may be at odds with the aim of the private sector partner to minimise its tax liability. Taxation issues are of especial significance in the case of JV proposals involving overseas organisations.

CHAPTER 15

MONITORING AND REPORTING

- 15.1 INTRODUCTION
- 15.2 STATUTORY AND OTHER PROVISIONS
- 15.3 ROLE OF DEPARTMENTS
- 15.4 MONITORING BY HM TREASURY
- 15.5 STAFF COUNT AND ADMINISTRATION COSTS
- 15.6 REPORTING PROBLEMS TO PARENT DEPARTMENT
- 15.7 ANNUAL REPORTS AND ACCOUNTS

15.1 INTRODUCTION

15.1.1 This chapter considers the role of the department and the Treasury in monitoring and reporting the performance of trading funds.

15.2 STATUTORY AND OTHER PROVISIONS

15.2.1 Paragraph 4.20 of Cm 914 suggests that a department's controls on its trading funds should concentrate on essential strategic matters. Although the specific examples quoted in Cm 914 have been superseded by developments in resource budgeting, the "essential strategic matters" in which a department will have an interest should be the funds' performance and the funds' corporate and business planning processes.

15.3 ROLE OF DEPARTMENTS

15.3.1 However, with increasing importance being placed on ensuring that bodies achieve maximum value both to the department as owners and to the customers, departments will be expected to monitor their trading funds' performance during the year to ensure that the targets are being met.

15.3.2 Each year, trading funds should prepare corporate plans for consideration by the department. The department will consider the plans against departmental objectives and discuss fully the strategy set out in the corporate plan, the proposed levels of surplus, capital spending and key targets (financial and non-financial). After approval by the MAB (see 13.4.3 above), the corporate plan is submitted to the responsible Minister. This means that a trading fund's corporate plan and its strategic planning arrangements are a crucial part of the process of meeting profit, capital and performance targets.

15.3.3 The corporate plan will be supplemented by a more detailed annual business plan which will be approved by the department and put in place by April in order to drive the business in the forthcoming year. Departments will monitor performance against this business plan. In practice, the corporate plan and the annual business plan are prepared simultaneously, with changes to the annual business plan being made as the corporate plan is amended.

15.3.4 In year monitoring should take place at three levels. Each trading fund should have its own controls and checks to ensure that targets are being met, or variations adequately explained. Secondly, the department should receive copies of the internal reports prepared by its trading funds which are monitored and appropriate action taken. Thirdly, the MAB should be provided with quarterly updates and have the opportunity to comment on progress and, if considered appropriate, suggest amended targets. In some cases, this information is also shared with the Shareholder Executive (see section 13.8 above).

15.4 MONITORING BY H M TREASURY

15.4.1 In most cases, the Treasury's spending teams will undertake a strategic role by ensuring that departments have adequate procedures for monitoring and controlling the performance of their trading funds. But when requested to do so by their respective Treasury spending teams, trading funds are to submit a quarterly report to the Treasury, via their sponsoring departments where applicable. The report should normally cover the following aspects:

- a. trading performance;
- b. cost summary;
- c. cash flow;
- d. capital employed;
- e. performance indicators.

15.4.2 Although the individual format of reports should be agreed between the trading fund/department and the respective Treasury spending team, it is expected that the reports prepared by the fund for its own management purposes or as submitted to the department will be sufficient and that it will not be necessary for the trading fund to prepare reports specifically for the purposes of the Treasury. The information provided by the fund should compare actual results to date against the yearly plan and identify and explain any material variances. Any revised targets should be highlighted and should be appropriately explained.

15.5 STAFF COUNT AND ADMINISTRATIVE COSTS

15.5.1 Trading funds will continue to provide parent departments with information on staff numbers and gross administrative costs in order that the service-wide aggregates e.g. the civil service staff count, are not understated.

15.6 REPORTING PROBLEMS TO PARENT DEPARTMENT

15.6.1 Should a trading fund experience any serious problem, such as shortage of cash liquidity, it should contact its sponsor department without undue delay, providing full details of the problem.

15.7 ANNUAL REPORT AND ACCOUNTS

15.7.1 Sections 4(6) and 6A of the 1973 Act describe the arrangements for the preparation and audit of the annual accounts, the preparation of annual report and their presentation to Parliament.

15.7.2 Section 4(6)(a) provides for the accounts to be prepared in accordance with directions issued by the Treasury. As noted in 3.9.3 above, individual accounts directions have been replaced by a generic direction issued annually and which requires compliance with *Trading Funds: Accounts Guidance* issued by the Treasury.

15.7.3 Section 4(6)(b) provides for the annual accounts to be audited by the Comptroller and Auditor General and presented to Parliament. The administrative timetable for laying the accounts is before the Summer recess, ie by mid-July.

15.7.4 Section 4(6A) provides for the preparation of an annual report. As noted in the Cabinet Office's guidance on annual reports (see 3.9.4 above) the annual report and the accounts are to be published as a combined document.

15.7.5 Trading funds should forward a copy of their annual report and accounts to their respective Spending Team contact and to the Central Accountancy Team in HM Treasury.

CHAPTER 16

WINDING UP A TRADING FUND

16.1 INTRODUCTION

16.2 STATUTORY BACKGROUND

16.3 OPERATIONS CEASING ARE ONLY PART OF THE
FUNDED OPERATIONS

16.4 OPERATIONS CEASING REPRESENT THE WHOLE
OF THE FUNDED OPERATIONS

16.5 PRIVATISATION

16.1 INTRODUCTION

16.1.1. This chapter considers various aspects to be borne in mind when the operations of a trading fund are to cease being funded by means of a trading fund.

16.2 STATUTORY BACKGROUND

16.2.1 Section 4A of the 1973 Act describes the arrangements where the operations of a trading fund are to cease to be financed by means of a trading fund. It does not apply in the case of a trading fund being privatised (*see 16.5 below*).

16.2.2 The section applies in the following cases:

- the operations in question represent the whole or part of the funded operations;
- the operations are to cease altogether;
- the operations are to be taken over by another fund or, while continuing to be operations of a government department, are to be financed in another way (eg by an executive agency or as a division of a department).

16.3 THE OPERATIONS REPRESENT ONLY PART OF THE FUNDED OPERATIONS OF THE FUND – WHETHER THEY ARE TO CEASE ALTOGETHER OR ARE TO BE FUNDED IN A DIFFERENT WAY

In the following paragraphs, “debt” means any amount outstanding in respect of principal or of interest on sums issued under section 2B of the 1973 Act (ie any debt other than originating debt – see 5.3 above) and “originating debt” includes any amount outstanding in respect of interest on such debt as well as any PDC. The references are to so much of the debt or originating debt as the responsible Minister, with Treasury concurrence, determines as being attributable to the operations ceasing to be funded.

16.3.1 Section 4A(2) of the 1973 Act provides for the responsible Minister to lay an Order outlining the assets and liabilities relating to the relevant operations which are to cease being those of the fund.

16.3.2 Sections 4A(3) and 4A(6) of the 1973 Act note that, if these operations are to cease altogether, any excess of the value of the assets over the liabilities shall be applied firstly to repay debt, and secondly to repay or extinguish PDC. (This suggests that the assets are to be sold and the liabilities settled, with any remaining proceeds being used to repay debt and PDC.) If the value of the net assets is insufficient to repay the debt or the PDC, the responsible Minister may reduce or extinguish the originating debt and PDC by means of an Order made with Treasury concurrence. The rules for writing off debt and PDC are contained in chapter 29 of *Government Accounting* (*see also chapters 5 and 6 above*).

16.3.3 Section 6(2) of the 1973 Act provides for any restriction of the funded operations to be advised to Parliament by means of an Order which is subject to the affirmative resolution procedure (*see 4.2 above*). This Order can, of course, address the question of

those assets and liabilities which are to cease to be those of the fund (16.3.1 above).

16.3.4 If the operations are to continue, but be funded in a different way, eg, but not exclusively as part of a Supply-financed agency, then the responsible Minister may use any monies in the fund which are surplus to immediate requirements or any surpluses from the last financial year, firstly, to repay debt and, secondly, to reduce or extinguish PDC (section 4A(5)). Any loans or PDC remaining after the use of these funds may be repaid by monies provided by Parliament (section 4A(7)).

16.4 THE OPERATIONS REPRESENT THE WHOLE OF THE FUNDED OPERATIONS – WHETHER THEY ARE TO CEASE ALTOGETHER OR ARE TO BE FUNDED IN A DIFFERENT WAY

16.4.1 If the operations are to cease altogether, the excess of the value of the assets over that of the liabilities shall be used firstly to repay debt and secondly to reduce or extinguish PDC (section 4A(4)). (This suggests that the assets are to be sold and the liabilities settled, with any remaining proceeds being used to repay debt and PDC.) Any balance remaining after the debt has been repaid and PDC extinguished is to be repaid to the Consolidated Fund (section 4A(6)). If the excess of the value of assets over liabilities is insufficient to repay the loans and extinguish the PDC, monies provided by Parliament may be used to settle the outstanding amounts (section 4A(7)).

16.4.2 If the operations are to be funded in a different way, eg, but not exclusively as part of a Supply-financed agency, then the responsible Minister may use any monies in the fund which are surplus to immediate requirements or any surpluses from the last financial year, firstly, to repay debt and, secondly, to reduce or extinguish PDC (section 4A(5)). Monies provided by Parliament may be used to repay any loans or PDC remaining after the use of these funds (section 4A(7)).

16.5 PRIVATISATION

16.5.1 Assurances were given during the passage of the Government Trading Act 1990 that trading fund status should not be seen as a stepping stone to privatisation. Nonetheless, the nature of a trading fund's business may evolve over time, or policies may change which indicate that retention of the activities within the public sector is no longer appropriate. Five trading funds have been wholly or partially privatised – Royal Ordnance Factories, Crown Suppliers, HMSO, Chessington Computer Centre and Defence Evaluation and Research Agency.

16.5.2 The arrangements for privatising a trading fund will differ from case to case and no hard and fast guidance can be given. Once the trading fund has been sold, a Revocation Order is needed to cancel the Order which established the fund. The Revocation Order can be implemented using the negative resolution procedure and there is no need to take the trading fund back on to the Vote before it is privatised.

ANNEX A

BIBLIOGRAPHY

TITLE	FIRST REFERENCE IN GUIDE
Audit committee Handbook http://www.hm-treasury.gov.uk/media/09D06/audit_committee_handbook2003.pdf	13.7.2
Audit committee – Combined Code Guidance http://www.asb.org.uk/documents/pdf/combinedcodefinal.pdf	13.7.2
Better Government Services: Executive Agencies in the 21 st Century http://www.number-10.gov.uk/files/pdf/opsr-agenciesm.pdf	3.4.1
Combined Code on Corporate Governance http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf	13.8.4
DAO(GEN) 6/00 (Use of tax consultants) http://www.hm-treasury.gsi.gov.uk/GFM/accounting/dao/dao.htm	14.12.1
DAO(GEN)13/03 (Rates of return) http://www.hm-treasury.gsi.gov.uk/GFM/accounting/dao/dao.htm	12.3.2
Fees and Charges Guide (1992 edition – new version in draft)	1.4.1
Finance Act (no 2) 1987 – section 102	12.5.4
Finance Act 1991 section 119	1.3.2
Finance Act 1993- schedule 22	1.3.2
Finance Act 2001 – section 108	1.3.2
Financing and Accountability of Next Steps Agencies (The) –Cm 914	1.3.1
Government Accounting http://www.government-accounting.gov.uk	1.4.1
Government Trading Funds Act 1973 (“the 1973 Act”)	1.3.1
Government Trading Act 1990	1.3.2
Guidance Note for Public Sector Bodies forming Joint Venture Companies with the Private Sector http://www.partnershipsuk.org.uk/news/jointventureguidance.pdf	14.1.5
Guidance on Framework Documents http://www.cabinet-office.gov.uk/agencies-publicbodies/guiddepts/docs/newframeworkdocguidance-version2.pdf	13.6.1
Next Steps Agencies, Trading Funds and NDPBs – Guidance on annual reports http://www.cabinet-office.gov.uk/agencies-publicbodies/guiddepts/docs/AnnualReport-Guidance.pdf	3.9.4
Rates of interest on NLF loans – details of	5.6.1

<http://www.pwlb.gov.uk>

Resource Accounting Manual http://www.resource-accounting.gov.uk/current/frames.htm	11.2.9
Review of Trading Fund policy. http://www.hm-treasury.gsi.gov.uk/GFM/CA/reviewoftradingfundpolicy.doc	1.2.1
Selling into Wider Markets: A Policy Note for Public Bodies http://www.hm-treasury.gov.uk/media/ED8AB/New_WM_guidance.pdf	2.3.3
Setting Key Targets for Executive Agencies http://www.cabinet-office.gov.uk/agencies-publicbodies/guiddepts/docs/HMTtargetsettingguide.pdf	12.9.1
Spending Review 2004 – draft Guidance http://www.hm-treasury.gov.uk/ps/SR2004/guidance/SR2004/guidance_homepage.htm	1.4.1
Trading Funds Accounts Guidance http://www.hm-treasury.gov.uk/media/DF005/trading_fund_guidance_2003-04.pdf	3.9.4
Trading funds' Participation in Joint Ventures: A Guidance Note on the Requirements of the Government Trading Funds Act 1973	14.1.3

ANNEX B

ABBREVIATIONS

AinA	Appropriations in Aid
AME	Annually Managed Expenditure
CE	Chief Executive
CFER	Consolidated Fund Extra Receipt
CST	Chief Secretary to the Treasury
DAO	Dear Accounting Officer (as in DAO letter)
DEL	Departmental Expenditure Limit
GTFA	Government Trading Funds Act 1973 (also referred to as the “1973 Act”)
HMT	Her Majesty’s Treasury
JV	Joint Venture
MAB	Ministerial Advisory Board
NAO	National Audit Office
NDPB	Non-departmental public body
NLF	National Loans Fund
ONS	Office for National Statistics
PAO	Principal Accounting Officer
RAM	Resource Accounting Manual
ROCE	Return on Capital Employed
TF	Trading fund
TOA	Treasury Officer of Accounts team (in the Treasury)

ANNEX C

LIST OF TRADING FUNDS – APRIL 2004

No	Name	Date of Establishment	Trading fund Order (*)
01	ABRO	April 2002	2002 No. 719
02	Central Office of Information	April 1991	1991 No 857
03	Companies House	October 1991	1991 No 1795
04	Defence Aviation and Repair Agency	April 2001	2001 No 1165
05	Defence Science and Technology Laboratory	July 2001	2001 No 1246
06	Driver and Vehicle Licensing Agency	April 2004	2004 No 1037
07	Driving Standards Agency	April 1997	1997 No 873
08	Fire Service College	April 1992	1992 No 640
09	Forensic Science Service	April 1999	1998 No 3197
10	HM Land Registry	April 1993	1993 No 938
11	Medicines and Healthcare Products Regulatory Agency	April 2003	2003 No 1076
12	Meteorological Office	April 1996	1996 No 774
13	NHS Estates	April 1999	1999 No 641
14	OGCbuying.solutions	April 1991 (**)	1991 No 875
15	Ordnance Survey	April 1999	1999 No 965
16	Patent Office	October 1991	1991 No 1796
17	Queen Elizabeth II Conference Centre	April 1997	1997 No 933
18	Royal Mint	April 1975	1975 No 501
19	UK Hydrographic Office	April 1996	1996 No 773
20	Vehicle and Operator Services Agency	April 2003	2003 No 942

In addition, the Registers of Scotland and the Driver and Vehicle Testing Agency are the responsibility of, respectively, the Scottish Executive and the Northern Ireland Assembly

* see an example of a trading fund Order at Annex E

** established as The Buying Agency. Name changed April 2001 (SI 2001 No 922)

ANNEX D

ISSUE AND REPAYMENT OF VOTED TERM AND TEMPORARY LOANS

See also Chapter 5

D.1 GENERAL

D.1.1 This Annex is concerned with the nuts and bolts of issuing term and temporary loans from monies provided by Parliament and repayment procedures. Reference should also be made to chapter 29 of *Government Accounting*.

D.2 TERM LOANS

D.2.1 The arrangement for term loans closely follow those for making fixed rate NLF loans.

D.3 TIMING OF APPLICATION FOR A LOAN

D.3.1 Trading funds proposing to take out a Voted loan should formally advise the sponsor division and Finance division in the parent department. In cases where this will be the first issue, trading funds should allow time to consult the Treasury. Subsequent applications should be made at least five working days in advance of the date on which the loan is to be made.

D.4 DETAIL IN THE APPLICATION

D.4.1 The application should be accompanied by a borrowing certificate which should include reference to the statutory powers under which the loan is being made (generally the Order made under the 1973 Act), the fund's borrowing limit and the total of Voted loans outstanding (including the amount requested).

D.5 PARENT DEPARTMENT CHECKS

D.5.1 The parent department should check the application and certificate against the Order establishing the fund and forecast of borrowing requirement, to ensure that the issue of a further loan will not contravene any statutory or administrative limits or any other questions of propriety. The parent department should also satisfy itself that the purpose for which the money is being borrowed is for agreed purposes e.g. to finance investment agreed in the context of the fund's corporate plan, and that it is needed by the Fund on, or shortly after, the date of the advance.

D.5.2 The department must also satisfy itself that the trading fund is in a position to repay the loan. Once the finance division has cleared the loan application it should aim to advise the fund of the repayment arrangements at least 48 hours before the required date of issue.

D.6 RATE OF INTEREST

D.6.1 The rate of interest charged on the loan will normally be that applying to NLF loans of similar duration. Details of the latest interest rates are available from <http://www.pwlb.gov.uk>.

D.6.2 As noted in *chapter 5*, most loans will be EIP loans in which equal instalments of principal are made and interest calculated on the reducing balance. Interest will normally be payable half yearly and is assessed by applying the annual rate to the balance outstanding at the beginning of the half year (as at 1 October). Payments on all loans outstanding to a particular borrower are normally made on fixed half yearly dates to avoid a multiplicity of repayment dates.

D.6.3 For the broken period from the time the loan is drawn, interest is payable on the first occurring fixed half yearly date. This is calculated by applying a daily rate derived from the annual rate and a 365 or 366 day year to the period up to and including the day before the fixed half yearly date. Details should normally be provided in a letter accompanying the repayment schedule.

D.7 REPAYMENT ARRANGEMENTS

D.7.1 In all cases where a department makes a loan it needs to draw up a repayment schedule covering the life of the loan. This should be verified by the borrower and approved by a designated officer in the parent department's Finance division, who should forward a copy of the repayment schedule to the appropriate spending team within the Treasury.

D.7.2 Servicing and repayments should be credited in the first place to the departmental account held within the PAYMASTER's Cash Account at the Bank of England.

D.7.3 Failure by a trading fund to service and repay debt will be regarded as a breach of the contract under which the loan is made. In the case of fixed rate loans, late repayment automatically results in interest being charged for the overdue period at the up to one year rate ruling on the date repayment should have been made, as shown in the Government Lending Rates circular or the original rate of interest at which the loan was made if higher.

D.8 TEMPORARY LOANS

D.8.1 Temporary borrowing is intended to finance short term capital requirements and swings in working capital. Where elements of working capital give rise to a permanent financing need, they should be financed - as necessary - by longer-term borrowing.

D.9 TEMPORARY BORROWING LIMITS

D.9.1 Temporary loans drawn down directly from the NLF are subject to a temporary borrowing limit (see 5.9.2 above) which is necessary to ensure that no element of a fund's long or medium term financing requirements is met from temporary lending. Thus fluctuations of net temporary borrowing and temporary surpluses should be around zero. The temporary borrowing limit should be agreed with the parent department and the Treasury. All temporary borrowing should be included in the limit.

D.9.2 Although no such formal limits apply in the case of Voted loans, departments should ensure that the loan is needed only temporarily and that it is not to be used to finance long or medium term financing requirements

D.9.3 In all cases, care should be taken to ensure that any borrowing does not cause the trading fund to exceed its borrowing limit as set out in the trading fund Order (see chapter 5.10.1 above).

D.10 APPLICATION PROCEDURE BY TRADING FUNDS

D.10.1 The request for a temporary loan should, in the first instance, be made to the senior official named in the framework document as the trading fund's main point of contact who will have ultimate responsibility to the Accounting Officer of the department for ensuring the correct procedures are followed. This will normally be the Chief Executive.

D.10.2 Application for a temporary loan from the CE to the department should be made in writing. Where this is impracticable, written confirmation of the loan application must be sent to the department within 24 hours.

D.11 PARENT DEPARTMENT ACTIONS

D.11.1 At the time of making an application, borrowers must be prepared to report their position on both temporary and overall borrowing and departments should check that they agree these figures.

D.11.2 On receiving an application, the department should inform the Bank of England of the expectation that they will be making a loan. This should be done at least one day before the loan is made so that the Bank can make the necessary arrangements and quote terms to the parent department.

D.12 RATES OF INTEREST

D.12.1 Temporary loans will bear the same rate of interest as those available on comparable NLF loans i.e. the rate at which the Government could itself borrow, plus a small margin to cover administrative costs.

D.12.2 Temporary loans will carry a fixed rate of interest with the principal and interest repayable on maturity. Interest should be calculated on the basis of actual number of days elapsed and a 365 or 366 day year. The Bank of England money desk will advise terms on the day on which the loan is made. In any case where it is proposed to go ahead with a loan the Bank of England should be requested to fax rates to the department. The rates at which the loan is made should be confirmed by the department in writing within 48 hours of the day on which the loan is made. A copy of this letter should be forwarded to the appropriate spending team within the Treasury.

D.13 REPAYMENT PERIODS

D.13.1 Temporary loans should be available for any period between 7 and 180 days (i.e. up to six months). It is open to departments to consider, with Treasury agreement, making loans for shorter periods, although it would be unusual to require funding for periods of less than one week. As temporary loans are only available for periods up to six months, any temporary financing requirements required for periods of between six months and one year should be met by a further temporary loan drawn down on the same day that the initial loan is repaid.

D.13.2 Early repayment of temporary loans should not be allowed.

EXAMPLE OF A TRADING FUND ORDER

NB: Each Order will be different and the wording used in this Order is not necessarily applicable in all cases. The numbers of the Order for each trading fund are given in Annex C.

STATUTORY INSTRUMENTS

1999 No.965

GOVERNMENT TRADING FUNDS

The Ordnance Survey Trading Fund Order 1999

Made - - - 24th March 1999

Coming into force 1st April 1999

Whereas:-

(1) It appears to the Secretary of State for the Environment, Transport and the Regions ("the Secretary of State") that-

- (a) the operations of the Crown service known as Ordnance Survey which are referred to in Article 2 of, and Schedule 1 to, this Order, being operations of a department of the government for which he is responsible, are suitable to be financed by means of a fund established under the Government Trading Funds Act 1973(a) ("the 1973 Act") and, in particular, to be so managed that the revenue would consist principally of receipts in respect of goods or services provided in the course of the operations, and
- (b) the financing of these operations by means of a Trading Fund would be in the interests of the improved efficiency and effectiveness of the management of the operations;

(2) In accordance with sections 1(3) and 6(4) of the 1973 Act, the Secretary of State has taken such steps as appear to him to be appropriate to give an opportunity to such persons as appear to him to be appropriate to make representations to him and has laid before Parliament a report about the presentations received and his conclusions;

3) The Secretary of State has, in accordance with section 2 of the 1973 Act and with the concurrence of the Treasury, determined what Crown assets and liabilities are properly attributable to the operations and are suitable to be appropriated to the fund;

(4) In accordance with section 6(2) of the 1973 Act, a draft of this Order has been laid before the House of Commons and has been approved by a resolution of that House;

Now, therefore, the Secretary of State in exercise of the powers conferred by sections 1, 2, 2A(l), 2AA(l) and 2C(l) of the 1973 Act, and of all other powers enabling him in that behalf, with the concurrence of the Treasury, hereby makes the following Order:

Citation and commencement

(a) 1973 c. 63, as amended by the Government Trading Act 1990 (c. 30). The 1973 Act, as so amended, is set out in Schedule 1 to the 1990 Act. The 1973 Act was further amended by section 119 of the Finance Act 1991 (c.31) and Schedule 22 to the Finance Act 1993 (c. 34).

1. The Order may be cited as the Ordnance Survey Trading Fund Order 1999 and shall come into force on 1st April 1999.

Establishment of the Fund

2. -(1) From 1st April 1999, there shall be established a Trading Fund to be known as The Ordnance Survey Trading Fund ("the Fund").

(2) The operations of the Crown service known as Ordnance Survey described in Schedule 1 shall be financed by means of the Fund.

Source of loans

3. The National Loans Fund is designated as the source of issues to the Fund by way of loan.

Assets, liabilities, reserves and public dividend capital

4.-(1) The Crown assets and liabilities set out in Schedule 2 shall be appropriated as assets and liabilities of the Fund.

(2) £4,500,000 of the amount by which the values of the assets of the Fund exceeds the amounts of the liabilities shall be treated as a revaluation reserve in the accounts of the Fund, and the reserve so treated shall be maintained as a revaluation reserve.

(3) £14,000,000, being part of the amount by which the value of the assets of the Fund exceeds the amount of the liabilities of the Fund, shall be treated as public dividend capital of the Fund.

Maximum borrowing etc

5. The aggregate of the following shall not exceed £30,000,000:

- (a) the total outstanding at any given time in respect of amounts issued to the Fund under section 2B of the Government Trading Funds Act 1973 (other than as originating debt) and,
- (b) the total at that time constituting public dividend capital issued to the Fund under section 2A(2A) of that Act.

Signed by authority of the Secretary of State

23rd March 1999

Nick Raynsford
Parliamentary Under Secretary of State,
Department of the Environment,
Transport and the Regions

We concur,

24th March 1999

Jane Kennedy
Bob Ainsworth
Two of the *Lords* Commissioners of
Her Majesty's Treasury

The Funded Operations

1. All the operations of Ordnance Survey including in particular: maintaining and enhancing the National Topographic Database; delivering survey and mapping activities in the national interest; providing national coverage of medium and small scale maps; making available a range of products, licences and services to meet the needs of customers in the United Kingdom, in Europe and world-wide; providing survey, mapping and geospatial information products and services in support of broader government policies; developing, maintaining and enhancing other geospatial datasets; contributing to any government policy to develop partnerships with other public and private sector bodies; and providing advice to government on all survey, mapping and geographical information matters.
2. Operations incidental, conducive or otherwise ancillary to these operations.

SCHEDULE 2

Article 4

Assets and Liabilities Appropriated to the Fund*Assets*

Equipment and facilities (including the management system of the national topographic database), fixtures and motor vehicles, as at 1st April 1999 used or allocated for use in the operations of Ordnance Survey.

Current assets as at 1st April 1999 used or allocated for use in or arising from the funded operations as carried on up to that date.

Liabilities

Creditors and accruals as at 1st April 1999 in relation to the funded operations.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order provides for the setting up as from 1st April 1999 of a fund with public money under the Government Trading Funds Act 1973 ("the 1973 Act") for the operations of the Ordnance Survey (Article 2). It designates the National Loans Fund as the authorised lender under the fund (Article 3).

The Order specifies the assets and liabilities which are to be appropriated to the fund, and requires £4,500,000 to be treated and maintained as a revaluation reserve. It also provides for £14,000,000 (part of the difference between the value of the assets and the amount of the liabilities of the fund) to be treated as public dividend capital of the fund (Article 4).

The maximum borrowing of the fund, being the total outstanding of the amounts issued to the fund under section 2B of the 1973 Act plus the total of the fund's public dividend capital, is not to exceed £30,000,000 (Article 5).

EXAMPLE OF A TREASURY MINUTE SETTING OUT THE FINANCIAL OBJECTIVE

Drafting note: this wording is typical of that used in most Minutes, but it may need to be amended to reflect any particular circumstances of a specific trading fund.

[NAME OF] TRADING FUND

TREASURY MINUTE dated[*date of laying before Parliament*]

1. Section 4(1) of the Government Trading Funds Act 1973 provides that a trading fund established under the Act shall be under the control and management of the responsible Minister; and in the discharge of his functions in relation to the fund it shall be his duty:

- a. To manage the funded operations so that the revenue of the fund -
 - (1) consists principally of receipts in respect of goods and services provided in the course of the funded operations, and
 - (2) is not less than sufficient, taking one year with another, to meet outgoings which are properly chargeable to revenue account; and
- b. To achieve such further financial objectives as the Treasury may from time to time, by minute laid before the House of Commons, indicate as having been determined by the responsible Minister (with Treasury concurrence) to be desirable of achievement.

2. The trading fund for the [name of body] will be (or was, if this is a renewal of an existing minute) established on [date of establishment] under the [name of body] Trading Fund Order [year and SI reference].

3. The [departmental Minister], being the responsible Minister, has determined (with Treasury concurrence) that a further financial objective desirable of achievement by the [name of body] for the period from .. to ... [agreed period] shall be to achieve a return, averaged over the period as a whole, of at least [agreed] per cent a year in the form of a surplus on ordinary activities before interest (both receivable and payable) expressed as a percentage of average capital employed. Capital employed shall consist of the capital (PDC and long-term element of loans) and reserves.

4. [If relevant] This minute supersedes that dated [date of previous Minute].

5. Let a copy of this Minute be laid before the House of Commons pursuant to Section 4(1) of the Government Trading Funds Act 1973.

Examples of Treasury Minutes can be seen in the annual accounts of trading funds as there is a requirement to reproduce them in the accounts.

EXAMPLE OF A DIRECTION RELATING TO THE VALUATION OF ASSETS AND LIABILITIES

Drafting note: this wording is typical of that used in many Directions, but it may need to be amended to reflect any particular circumstances of a specific trading fund, in particular the categories of assets and liabilities to be appropriated to the fund.

[NAME OF] TRADING FUND

TREASURY DIRECTION ON THE VALUATION OF ASSETS AND LIABILITIES

The Treasury, in exercise of the powers conferred by Section 2(1) of the Government Trading Fund Act 1973, as amended, hereby direct that the values at which assets and liabilities attributable to the [name of body] operations are appropriated to the [name of] trading fund, shall be determined as follows:

Tangible Fixed Assets

2. Tangible fixed assets should be valued at the lower of replacement cost and recoverable amount. Recoverable amount is defined as the higher of net realisable value and value in use.

Freehold and Leasehold Land and Buildings

3. Operational land and buildings will be valued on the basis of existing value use with the addition of directly attributable acquisition costs where material. Specialised properties or properties not traded on the open market should be valued on the basis of depreciated replacement cost.

4. Properties surplus to requirements should be valued on the basis of open market value, less any directly attributable selling costs where material. This method of valuation over-rides the valuation criteria at paragraph 2.

Other (non-property) operational assets

5. Other (non-property) operational assets should be valued using market value where possible. Where market value is not obtainable, these assets should be valued on the basis of depreciated replacement cost.

Debtors and Creditors

6. Debtors and creditors will be as at 31 March [year]. Due allowance will be made for any bad debts, actual or potential. Appropriate provision will be made for accrued expenses as at 1 April [year].

7. Where firm values of any assets or liabilities (on the basis required by the preceding paragraphs of this Direction) are not available when the draft Order establishing the fund is laid before the House of Commons, the best available estimate of value (on such basis) as at 31 March [year] should be used.

Dated:

Signed:

Head of the XYZ Spending Team, Her Majesty's Treasury

TIMETABLE FOR CONVERTING AN AGENCY INTO A TRADING FUND

NB:

1. This assumes that the overall time from start to finish is 24 months; in practice this can be shortened if there are no major problems, although at least one year should be allowed for the process. The steps are not in any particular chronological order within each section. Nor should the steps be taken as a comprehensive checklist; not all will be relevant in some cases, and there may be aspects peculiar to a particular candidate which are not covered.

2. In the Responsibilities ("Resp") column, references to "Dept" should be taken to be to the department and the trading fund candidate.

INITIAL STAGES – APPROXIMATELY 6 MONTHS

No	Task	Resp
01	Confirm (if necessary, seeking legal advice) that TF meets statutory criteria, in particular, the need to demonstrate efficiencies	Dept
02	Prepare preliminary and outline business cases as part of submission to Ministers for "approval in principle" to proceed with trading fund status. This may involve early consultation with internal/external auditors on systems/procedures	
03	Establish Steering Group – to include HMT and NAO	Dept and HMT
04	Confirm with ONS that proposed trading fund will satisfy classification as a public corporation eg whether there are any problems with types of income and expenditure which can be dealt with through the TF (e.g. where TF is acting as an agent for e.g. court fines). This should be done in liaison with HMT. It is important to get ONS approval at an early stage.	Dept
05	Prepare Action Plan - setting out responsibilities and target dates.	Dept
06	Agree target date for laying of Order establishing the fund	Dept
07	Determine with HMT the arrangements for agreeing financial and quality services targets	Dept and HMT
08	Consider (perhaps in conjunction with NAO) whether any improvements to management accounting and information systems are needed. Consider changes to framework document – see also point 25 below.	Dept
09	Consider with parent department and HMT whether any areas of responsibility need to be delegated to the Agency before it becomes a TF (e.g. functions exercised within a central division)	Dept and HMT
10	Parent department to prepare submission for departmental Ministers seeking approval in principle to establish trading fund	Dept
11	Secure agreement in principle from CST that TF should be introduced. This is the culmination of the initial discussions between the department, HMT and National Audit Office to establish whether there is a prima facie case for trading fund status. The department should seek the approval of its Minister who, in turn, will seek CST's approval. Sufficient time should be allowed for Ministerial consideration of the issues	Dept and HMT

SECOND PHASE - REFINING BUSINESS CASE AND MORE DETAILED NEGOTIATION – APPROXIMATELY 12 MONTHS

No	Task	Resp
12	Prepare full business case. Note HMT's requirement for this to be independently verified – this will mean arranging tenders, scoping the work and agreeing terms of reference	Dept
13	The business case will include financial forecasts covering the first 5 years of the	Dept

trading fund's operations. This will involve the identification of the assets and liabilities to be appropriated to the trading fund and, if considered necessary, whether any different methods of valuation are required. The financing of the opening balance sheet will also have to be agreed with HMT – ie the split of loans, PDC and reserves.

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|----|--|-----------------------------|
| 14 | HMT to issue valuation direction, setting out (in broad terms) how assets/liabilities are to be valued (see Annex G and 3.9.2) | HMT |
| 15 | If necessary, introduce and test shadow trading arrangements. This will be necessary where the agency currently does not trade and trading arrangements are being introduced as part of the move to trading fund status. Sufficient time should be allowed for this process to ensure that any problems arising can be addressed. The shadow trading arrangements should be as realistic as possible, eg they should cover all the services, take place over a sufficiently long period and involve as a high a number of transactions as possible. | TF
candidate |
| 16 | Consider timetable for separate VAT registration and any changes required to existing financial systems. | TF
candidate |
| 17 | Consult interested parties, ie (a) decide which parties to consult (external and governmental); (b) prepare consultation documents and consult interested parties; (c) consider results and (d) publish and lay results before Parliament. NB: Cabinet Office guidance requires a minimum consultation period of 12 weeks. It is as well to start the consultation process earlier rather than later in case there are any fundamental objections to trading fund status which require resolution. The results of the consultation process must be presented to Parliament before the draft trading fund Order is laid, but there is no indication of how far in advance the results are to be laid. | TF
candidate |
| 18 | Consider the impact of trading fund status on the format of the accounts and to the accounting policies, if necessary seeking advice from NAO | TF
candidate |
| 19 | Discuss monitoring arrangements with department and establish HMT requirements with the spending team. | Dept and
HMT |
| 20 | Identify services currently provided by parent department without charge and establish arrangements for billing (trading funds must pay for all goods and services consumed.) It may be appropriate to consider de minimus limits where the value of the services provided does not justify the effort in introducing charging arrangements | TF
candidate |
| 21 | Confirm arrangements for payment of interest and dividends | |
| 22 | Determine banking arrangements and (if necessary) discuss with HM Paymaster General and HMT | TF
candidate |
| 23 | Confirm the “funded operations” of the trading fund – these are normally those of the existing agency but there may cases where it is desirable for more or fewer activities to be taken on by the trading fund | Dept |
| 24 | Discuss with department and HMT the implications of moving away from the Supply-process. The time to be taken for this step should not be underestimated especially if the department is to become a customer of the trading fund. The terms of any Service Level Agreement or Memorandum of Understanding will need to be agreed and the financial consequences considered | Dept and
HMT |
| 25 | Prepare the revised TF framework document | Dept and
TF
candidate |
| 26 | Agree any changes to organisational structure (e.g. staffing levels and possible appointment of Treasury manager). This will probably be necessary as part of the process of agreeing the financial forecasts as changes in staffing levels will affect salary costs and possibly incur redundancy costs | TF
candidate
and dept |
| 27 | Agree arrangements for insurance | TF
candidate |
| 28 | Confirm basis of paying accruing superannuation liability contributions (nb. This is something covered in the 1973 Act, but in practice there should be no difference from the arrangements applying as an agency) | TF
candidate |
| 29 | Agree pricing policy – this should form part of the work on agreeing the financial forecasts | TF
candidate |
| 30 | Discuss delegations on e.g. staffing complement with HMT | Dept and
HMT |
| 31 | Determine maximum borrowing limit for inclusion in the Order | TF
candidate |
| 32 | Determine terms of initial debt, i.e. repayment terms, interest rates – this work will be necessary as part of the work on preparing the financial forecasts | TF
candidate |

33	Provisionally determine financial targets (ROCE) and performance (e.g. unit costs). HM Treasury to draft Treasury Minute setting out financial target and obtain approval from department, trading fund and National Audit Office. Department may wish to seek Ministerial approval to agreed target-	Dept and HMT
34	Discuss how financing arrangements will be accommodated within Spending Reviews etc	Dept and HMT
35	Consider whether TF status will affect financial and contractual delegations	TF candidate
36	Start drafting the trading fund Order, seeking advice from departmental lawyers. Lawyers in the Treasury should also be consulted	Dept
37	Discuss with HMT the appointment of the Accounting Officer	Dept and HMT
38	Once agreement has been reached at official level that trading fund status is appropriate, the department should seek formal approval from its Minister to proceed with the necessary Parliamentary procedures. In turn, the Minister will seek approval from the Treasury to lay the trading fund Order. Sufficient time should be allowed for this exchange especially if it coincides with Parliamentary recesses or at busy times for Ministers	Dept and HMT

FINAL STAGES – FORMAL APPROVAL BY DEPARTMENT, H M TREASURY AND PARLIAMENT – APPROXIMATELY 6 MONTHS

No	Task	Resp
39	Obtain formal approval from departmental Ministers and the CST	Dept and HMT
40	Ensure all necessary formalities have been agreed for opening debts, especially if there is a need for an initial injection of working capital	Dept
41	Finalise the trading fund Order	Dept
42	Department and trading fund candidate to promulgate announcement of trading fund status	Dept
43	Department to submit draft Order to the Joint Committee on Statutory Instruments for formal laying	Dept
44	Department to arrange date of Parliamentary debate and prepare briefing for Ministers	Dept
45	HMT to seek CST approval to Treasury minute and arrange for it to be laid before Parliament – this cannot be completed until the Parliamentary debate has been held	HMT
46	HMT formally appoints TF Accounting Officer once Parliamentary debate has been held	HMT
47	After Parliamentary debate has been held, HMT to prepare guardsheet for the Order and arrange for it to be signed by two Lords Commissioners	HMT

LIKELY CONTENT OF A BUSINESS CASE

J.1 INTRODUCTION

H.1.1 Guidance on business cases is available from the Office of Government Commerce (<http://www.ogc.gov.uk/sdtoolkit/workbooks/businesscase/index.html>). In broad outline, there should be three stages – a preliminary business case, an outline business case and full business case.

J.2 PRELIMINARY BUSINESS CASE

J.2.1. The aims of the **preliminary business case** are to put up a “marker” to inform departmental planning and budgeting and to:

- confirm the business need and contribution to the business strategy;
- secure commitment of stakeholders and senior management;
- ensure consideration of a number of options at an early stage;
- define the scope of the project; and
- seek approval to go forward to the next stage – feasibility.

J.3 OUTLINE BUSINESS CASE

J.3.1 This builds on the preliminary business case by:

- rigorously appraising the options to support the selection of a preferred option;
- providing robust estimates of costs, benefits and risks;
- demonstrating that the preferred option is likely to achieve value for money, is achievable and affordable; and
- seeking senior management commitment and funding to develop the full business case.

J.3.2 It is likely that submissions to Ministers to seek approval in principle to going ahead with the trading fund proposals would be made at this point.

J.4 FULL BUSINESS CASE

J.4.1 The **full business case** is accurate, complete and provides the information required to make an informed business decision. Its aims are to:

- verify the continued need for investment in business change;
- demonstrate that the preferred option represents value for money;
- establish that the supplier is capable of delivering the business change;
- confirm that the planned investment is affordable;
- demonstrate that the organisation is capable of making a successful implementation and subsequently sustain progress;

- Provide an essential audit trail for decisions taken;
- Identify how benefits will be realised and monitored;
- Confirm the investment decision.

J.5 EXAMPLES

J.5.1 Each business case will be different and the following guidance is intended to be only an aide-memoire when preparing the **outline business case**. Further more detailed work may be necessary for the purposes of the final business case. It is for each candidate to consider how best to present its case especially where there are issues peculiar to the candidate. The following points are not intended to be a checklist and may not be comprehensive. As noted in 3.4.2 above, the final business case and financial forecasts are to be subject to independent verification – National Audit Office may be considered for such work.

J.6 GENERAL BACKGROUND INFORMATION

J.6.1 This section may include:

- Background to the case, including rationale for trading fund status and evidence of Ministerial agreement;
- Justification for trading fund status, including evidence that statutory and administrative tests have been satisfied. This should include evidence that alternative arrangements have been considered and that they offer less good value for money than trading fund status;
- The mission statement – strategic aims and goals;
- An indication of the economic and financial benefits accruing from trading fund status. These will vary from case to case, but the underlying principle is that there should be evidence that trading fund status will lead to more commercially-focussed with emphasis on greater awareness of the interests of the customer, and to more efficient and economical ways of working. Although not relevant in all cases, benefits may accrue from identifying ways of developing the customer base. In many ways, this area is similar to the statutory test of ensuring that trading fund status will lead to greater efficiency and economies in the management of the operations;
- Evidence that Office for National Statistics has agreed to the trading fund being classified as a public corporation.

J.7 STRATEGIC POSITIONING

J.7.1 This section considers aspects which are a guide to the long-term success of the trading fund candidate (some of the points may be less relevant to trading funds engaged in regulatory or statutory functions).

- Identification of customers and consideration of likely development of customer base;
- Market for the goods or services;
- SWOT analysis (strengths, weaknesses, opportunities and threats);
- Identification and assessment of likely competitors;

- Are there any unique selling propositions;
- Condition of asset base and likely cost of replacement or update;
- Are the accounting and other systems capable of supporting a self-standing organisation;

J.8 INTERNAL ENVIRONMENT

J.8.1 This section may include:

- Evidence that the structure of the organisation is aligned to customer needs;
- Confirmation that the organisation has the necessary leadership and management skills;
- Evidence that the management structure reflects the nature of strategic and business goals?
- Clear identification of the roles of CE and senior management in the management structure;
- Evidence that staff are commercially aware and willing to work in a more commercial environment;
- Confirmation that adequate training has been carried out by those who may be affected by the implications of applying the provisions of the 1973 Act and other legislation;
- Details of and any planned improvements to current management information systems, financial and non-financial;
- Details of how management of change will be addressed;
- Details of the arrangements for internal audit and the audit committee;
- Discussion of research and development issues
- Consideration of how the freedoms of trading fund status interact with the overall objectives of the department – in other words if the department is both owner and customer, might there be an issue over the respective interests of the department

J.9 FINANCIAL ENVIRONMENT

J.9.1. The business plan should include financial forecasts and information regarding the assumptions made in its preparation:

- Planned efficiency gains;
- Management accounting arrangements;
- Staff training and resources;
- Financial accounting arrangements, systems, controls, training and resources;
- Asset base identification and management of surplus assets;
- Assumptions made on predicted activity levels and financing arrangements;
- Insurance arrangements;
- Performance targets – setting and measurement against outturn figures;
- Scenario modelling;
- Banking arrangements;
- Cash management;
- Corporate Governance issues;
- VAT issues;

- Changes in salary payment procedures (if any);
- Monitoring arrangements required by sponsoring department;
- Agreement of ROCE targets;
- Consideration of opening loan(s) position, repayment and interest rates;
- Arrangements for any initial working capital loans;
- Arrangements for the transfer of any surplus assets;
- Consideration for the update of Framework document;
- Identification of goods or services currently provided by the department free of charge, and implementation of hard charging regime;

J.9.2 The forecasts should also include sensitivity analyses to show the effects of changes in the key assumptions.

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