
Report To:	Policy & Resources Committee	Date:	26 May 2009
Report By:	John Mundell, Chief Executive	Report No:	CE008/09/JWM
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Subject:	Outstanding Audit Actions – Significant Trading Operations		

1.0 PURPOSE

- 1.1 The purpose of this report is to provide an update on the outstanding audit action, which has now been allocated to the Chief Executive, that relates to the Council's three Significant Trading Operations (STO's):

Environment and Community Protection – Roads
Environment and Community Protection – Fleet Management
Regeneration and Resources – Building Services

The outstanding action is as follows:

- 1.2 *“The Council will carry out a fundamental review of its arrangements for the Council's Significant Trading Operations with a view to maximising operational performance further. Appropriate evidence will be retained of this review and all subsequent reviews.”*
- 1.3 A number of further action points exist which also relate to the STO's, however these remain the responsibility of the relevant directorates and will be progressed accordingly.
- 1.4 A short life working group has been established to consolidate the required work for the STO's as a group of activities and it is expected that all remaining actions will be co-ordinated and concluded via this group.

2.0 SUMMARY

- 2.1 The background to the establishment and evolution of the current trading accounts within the Council can be found in section 4 of this report. The policy framework to assist councils in identifying and assessing trading operations was set out in guidance provided by CIPFA and also through Best Value guidance.

- 2.2 This Framework outlines the current test as to whether an activity should be operated as an STO. It is as follows:

“Where a service operates in a competitive market and derives income from customers outwith the Council, and this accounts for 10% of the revenue and has a value of £100,000 or more per annum, then the presumption should be in favour of the maintenance of published accounts.

Otherwise, the presumption should be against the activity operating as an STO.”

- 2.3 There has been no overall review of the three existing STO's in Inverclyde since the Bishop Report in August 2005 (see section 6.5), a number of individual reports have been brought forward relating to each of the STO's. A summary of these can be found in sections 6.2 – 6.20.

- 2.4 This report presents the journey which the Council has taken to identify and evaluate on an ongoing basis, its STO's.
- 2.5 The duty of Local Authorities to deliver and demonstrate Best Value extends across all Council services. An additional exercise is planned to extend "competitiveness testing" that is usually carried out on behalf of STO's, to all services. This type of assessment can fit into the current Directorate Planning framework. A further report will be prepared and brought to committee providing greater detail.

3.0 RECOMMENDATIONS

That Committee:

- 3.1 Note the contents of this report in relation to the Council's STO's.
- 3.2 Agree with the proposal to alter the policy framework by which STO's are identified, considering a low end threshold of £1m income from external sources per annum for classification as an STO.
- 3.3 Request a further report on the development of an assessment / test of competitiveness for all Council services. This should, in turn, be reflected in the preparation of future Directorate Plans for 2010 and beyond.
- 3.4 Concur that the consolidated content of this report satisfies the outstanding audit requirement as outlined in section 1.2 of this report.

John W Mundell
Chief Executive

4.0 BACKGROUND

Best Value Legislation

- 4.1 The Local Government in Scotland Act 2003 revised the previous 1980 and 1988 Acts. In addition it repealed the Compulsory Competitive Tendering Provisions under which certain activities were undertaken.
- 4.2 The 2003 Act also provided a framework to enable the delivery of better, more responsive public services. The Act has been a key aspect of Local Government modernisation. The specific provisions relate to:
- A duty to secure Best Value in local government services.
 - A statutory underpinning of the community planning process.
 - A power to advance wellbeing to enable local authorities to work in a more innovative and creative way.

The key aim of the act is that all Councils should continuously improve their performance and ensure they secure services of the highest quality, at a cost that is acceptable, in the local communities. It also seeks to increase the role of local people in deciding priorities for local services. It is in this context that “competitiveness” must be viewed, as opposed to a narrow competitive tendering exercise.

- 4.3 The 2003 Act imposed a duty on Local Authorities to maintain trading accounts for certain activities whilst allowing Councils to enter into different trading agreements as follows :
- Trading with another local authority, by building capacity to support such trading agreement
 - Trading with other public authorities or bodies where the provision supports services through pre-existing contract
 - Trading with bodies with a public purpose in support of that purpose
 - Trading with other trading partners (e.g. Private sector)

The Act also imposed certain restrictions on the trading activities; in particular, it restricted income generation from other trading partners.

- 4.4 Councils were given the responsibility of identifying STO's which were to be operated on the basis of a financial break even position over a three year rolling period. Trading Accounts are required to demonstrate this.
- 4.5 A policy framework for assessing and reviewing trading operations was set out in guidance provided by CIPFA which was adopted and used by Inverclyde Council in 2006. The Policy Framework identifies an acid test as to whether an activity should be operated as an STO.

“Where a service operates in a competitive market and derives income from customers outwith the Council, and this accounts for 10% of the revenue and has a value of £100,000 or more per annum, then the presumption should be in favour of the maintenance of published accounts.

Otherwise, the presumption should be against the activity operating as an STO”

This Policy Framework now needs to be reviewed in the context of the current climate to establish a more coherent approach and proportionate threshold relative to the assessed

level of material risk to the Council. It should be noted that a decision to alter the policy framework will most likely result in two of the existing services ceasing to be considered as STO's. A more workable framework will enable clearer and more meaningful fiscal and performance accountability for those Council services which operate as a financial risk to the organisation.

- 4.6 Since the introduction of the 2003 Act and the practical establishment of STO's, a number of reports have been conducted, reviewing trading operations within the Council which are summarized in sections 6.2 – 6.20 of this report.
- 4.7 Progress towards Best Value has been a critical issue for all local authorities since the legislation was enacted and key to this is effective performance management and planning frameworks. A fundamental part of the delivery of Best Value is to review services through an appropriate framework which should ensure that all local authority activities are subject to the test of the "five Cs":
- **Challenge** of current policies and approaches either to identify alternatives or to justify their retention
 - **Compare** with other providers to identify and stimulate best practice
 - **Consult** with other stakeholders to identify issues of concern and to influence future approaches
 - **Compete** demonstrating the competitiveness of existing approaches or providers and assessing future options for service management and delivery
 - **Collaborate** working with strategic partners to deliver services
- 4.8 In the past, it is clear that much of the focus of detailed work within Inverclyde Council relative to specific assessments or reviews of a service's competitiveness, has only been focused on the former DSOs/DLOs. Within these service areas there have been varying degrees of competition whether on a compulsory or voluntary competitive basis for many years. In addition, benchmarking and comparative information also varies and as a consequence, the Council has been unable to objectively demonstrate competitiveness in the broadest sense.
- 4.9 The Roads STO is subject to continuous challenge and benchmarking through comparative reviews via the inter-authority NESI group, along with the 3 Ayrshire authorities. This situation is not standardised however.
- 4.10 It should be noted that the decision to designate any service as an STO should not be restricted purely to those services which were formerly DLOs/DSOs. Furthermore, the duty to deliver and demonstrate Best Value extends across all Council services. Therefore, any framework that is developed to achieve Best Value must recognise the need for **competitiveness** of all Council services, such as Homecare and Pre-school services is a key factor. The test / assessment of competitiveness cannot be limited only to former trading activities and should apply irrespective of whether a service is provided in-house or externally (e.g. via Inverclyde Leisure etc.).
- 4.11 Best Value requires a balance to be struck between economy, efficiency, effectiveness and continual improvement in relation to each service. As a consequence, the "compete" element of a Best Value review, whilst historically being interpreted as implying a range of things from tendering of work to price benchmarking, now requires a move from crude market rate comparators to a range of measures that are likely to provide a sustainable basis for improved value for money.

5.0 Key Consideration

- 5.1 A report submitted by the Chief Financial Officer to the Policy & Resources Committee on the 31 March 2009 recommended the continued classification of all existing STO's for the financial year 2009/10. The report referred to the Audit Scotland's Members letter for the 2007/08 Accounts which included the need for the Council to carry out a fundamental review of its arrangements for Significant Trading Operations with a view to maximising

operational performance. Whilst this is important, far greater benefits can be achieved by introducing the necessary step change required to demonstrate the Council's plans for improved management of competitiveness across all services.

6.0 Trading Operations

6.1 In respect of trading operations, the Council has undertaken a great deal of work in the past. As mentioned earlier in this report a decision was made at the Policy & Resources Committee of 31 March 2009 to retain all three current STO's for the 2009/10 financial year. These services are:-

- a) Building Services
- b) Roads Maintenance
- c) Vehicle Management

A resume of the reports prepared on the STO's over the last few years is shown below.

April 2005 – Report to Council's Policy & Strategy Committee

6.2 A report was submitted regarding trading operations. At that time, there were 8 services operating under this categorisation. An options appraisal was requested to review the future of Trading Operations, emphasising a need to focus on Best Value considerations.

6.3 The notion of reducing the number of STO's from 8 to 3 was proposed at that time.

May 2005 – Audit of Best Value and Community Planning

6.4 This exercise was carried out early in 2005 and reported by Audit Scotland in May of that year. It was an assessment of the Council's ability to deliver Best Value based on the structures, skills, use of resources and overall strategic direction. A number of recommendations were made within the report which relate to the assessment of Council services, and these can be directly related to the assessment and consideration of STO's within the Council:

- The Council should undertake a fundamental review of its management and service structure arrangements based on a clear and logical analysis of customer need as well as organisational efficiency
- The Council should undertake a performance review of all services, focusing on the identification of customer needs and the establishment of a clear performance baseline for all services from which targets can be set and against which future performance can be measured

6.5 Points noted specifically in relation to STO's in the Audit of Best Value & Community Planning are as follows:

- Service activities that were previously subject to Compulsory Competitive Tendering (CCT) do not have effective performance management systems in place. They have not been reviewed or subjected to market testing for several years - in one case since 1988
- The Council was the subject of statutory reports in 2000 and 2001. These reports identified problems with financial management and accounting arrangements, and the failure of certain DLO's/DSOs to make their statutory financial target. Over the years DLO's and DSOs in Inverclyde have struggled, and still do so in the case of building services and roads

6.6 A section of the Audit of Best Value & Community Planning 2005 also focused on competitiveness, referring to the duty held by the Council to conduct its business in a manner which demonstrates appropriate competitive practice. The following points were made:

- Inverclyde Council currently operates eight DLO/DSOs and it is not clear that the working arrangements have changed significantly since the moratorium on CCT was introduced in 1995 and Best Value was introduced in 1997
- There are indications that the current arrangements do not demonstrate Best Value
- Client services are not charged on the basis of demonstrably up to date schedules of rates or bills of quantity tested against external sources
- Contracts are of a considerable age, generally dating back to before local government re-organisation and the moratorium and repeal of CCT
- The Council has identified the need to review trading accounts as part of the new service review schedule. This should be done as a matter of urgency to ensure that the Council can demonstrate competitiveness in these areas. Services use benchmarking information to varying degrees to compare services and costs, but it is not clear that this is systematic and sufficiently robust to demonstrate competitiveness

The operation of the (then 8) STO's was noted as an indicator of how the Council approaches its duty to demonstrate competitiveness in all services.

August 2005 – Bishops Report

- 6.7 This report was commissioned from external consultants in order to provide an objective judgement on the competitiveness of the Council's 8 STO's. It was recommended that these be reduced from 8 to 3, and that this be achieved mainly by synergising complementary services, such as refuse collection and street cleaning.
- 6.8 There was no scope within the report to review the nature and purpose of activities that may have brought some of them back into the mainstream fold, neither was there a consideration of links between trading and non-trading operations (i.e. the links between school janitorial and school cleaning services).

February 2006 – Report to Council's Policy & Strategy Committee

- 6.9 A further report was submitted, referring to Audit Scotland's November 2005 report which outlined a number of findings and improvement actions relating to trading accounts:
- Council should draw up a robust plan for STO's with milestones and timescales
 - A new approach to Business Planning should be adopted via a reformed Budget Process
 - Explicit statements should be made about new management arrangements – Core of Statutory Duty / Duty of Best Value etc.
 - Core improvements – develop a clear approach to demonstrate Value for Money and Competitiveness in former Compulsory Competitive Tendering services
- 6.10 This report ultimately resulted, early in 2006, in the reduction from 8 STO's to the current 3. It was generally acknowledged, within the report that the designation of an activity as an STO brings about additional accountancy requirements and associated costs – therefore that fewer STO's was more in line with Best Value. The guiding principle should be that, as the purpose of an STO is to generate income through provision of a service on a commercial basis, then the public accounting of this provides assurance that this activity is not being subsidised by the taxpayer.
- 6.11 It was also stated within this report that Trading Operations should be part of a wider, Corporate Performance Management System.

**Regeneration and Resources – Property Services
September 2008**

- 6.12 This plan is subject to annual review and outlines the operational model and financial projections for the BSU, within Property Resources and Facilities Management. Income projections for the 3 year period covered by the plan are as follows:

Year	Income (£)
Yr 1	2,523,100
Yr 2	2,715,000
Yr 3	2,910,000

Principles of Full Cost Recovery have been applied to each business component within the unit, ensuring that every project contributes to the overheads of the unit.

**Environment and Community Protection – Roads
March 2009**

- 6.13 The Roads STO carry out works directly for the Council. Roads income is generated predominantly through direct charges to the Roads Client, with additional income being generated through other Council services and external customers.
- 6.14 The Roads STO income is around £2,266,000 per annum subject to capital availability. This is broken down as:

Client income	£ 2,105,000
Other Council services	£ 109,000
External customers	£ 52,000

The majority of revenue is generated internally through other services. Externally generated income is £52,000 which accounts for approximately 2.3% of revenue generated.

- 6.15 Taking this into consideration the Roads STO falls short of the current Trading Activity Policy Framework test and does therefore not meet the criteria to be operated as an STO.

**Environment and Community Protection – Fleet Maintenance
March 2009**

- 6.16 The Vehicle Maintenance STO carries out works for the Council along with a service level agreement with Port Glasgow Transport. Income generated from internal Council sources for vehicle maintenance is around £960,000 per annum
- 6.17 Income generated from Port Glasgow Transport equates to £21,000 per annum, again well below the £100,000 threshold identified in the Trading Activity Policy Framework.

**Policy & Resources Committee
31 March 2009 – Significant Trading Operations 2009/10**

- 6.18 This report was brought forward by the Chief Financial Officer to seek approval (which was granted) to retain all 3 current STO's for the duration of financial year 2009/10.
- 6.19 Within this document, a status report was provided on the financial performance of each of the services, in terms of their achievement or otherwise of a break even position over a 3-year rolling period. This showed that Building Service and Roads had achieved a cumulative surplus in the last three audited financial years, but that the Vehicle Maintenance STO had a cumulative deficit over the same period. It was further indicated, however, that there was an expectation that all 3 services would break even, taking financial year 2008/09 into account.

6.20 The 31st March report also points to the submission of this subsequent report, bringing together the previous work that had been done in review and consideration of STO's.

7.0 PROPOSALS

7.1 It is proposed that alterations be made to the policy framework by which STO's are identified within the Council, based on the fact that the £100,000 threshold for acceptability is, in itself too small to be significant within the context of the Council / Service budgets. It is proposed that the threshold should be adjusted to a more realistic and appropriate level of £1million of income.

7.2 It is proposed that, from April 2010, both the Fleet Maintenance and Roads services no longer be considered as Significant Trading Operations of the Council, due to their no longer meeting either the existing or proposed criteria used to identify an STO.

7.3 With regards to the Building Services Unit, it is proposed that the existing Business Plan continue to be the guiding operational document for the continuation of this service as an STO due the significant proportion of income derived from external sources. This will require appropriate accounting and annual review of the plan as outlined within the document, and in accordance with CIPFA guidance.

7.4 It is also proposed that a further report be compiled for consideration by this committee outlining a policy framework and action plan to address the need for competitiveness assessment across all Council services as an ongoing consideration of Best Value and ongoing efficiency.

8.0 IMPLICATIONS

8.1 Legal

There are no legal implications, specific to Inverclyde Council at this time, within this report

Personnel

There are no personnel implications, specific to Inverclyde Council at this time, within this report

Financial

Financial implications relate to the accounting practices and requirements relating to the services alluded to within this report. Any decisions taken regarding the status of services should be communicated with the Chief Financial Officer to ensure that appropriate actions are taken for future reporting and allocation of resources to the services in question (either ceasing to be STO's or coming on board as new STO's).

Action to achieve competitiveness will provide a significant conduit to demonstrate effective use of resources and address future years' budget gaps.

Equalities

There are no equalities implications, specific to Inverclyde Council at this time, within this report