

A

ANNEX 7.3 TRADING FUNDS

This annex discusses how sponsor departments should assess proposals for trading fund status, control and monitor their trading funds, and deal with public dividend capital (PDC).

Proposals for trading fund status

A.7.3.1 Bodies seeking trading fund status will usually need two years or so to get their proposals agreed. They will need to demonstrate that their income will largely sustain their operations and that they have the capacity to control and manage their business effectively. It is usual to establish a trading fund to begin on 1 April with a trading year to coincide with the government's financial year, ending at end March. The key steps are set out in box A.7.2A.

A.7.3.2 Further guidance may be found in the Treasury's *Guide to the Establishment and Operation of Trading Funds* (www.hm-treasury.gov.uk/mediastore/otherfiles/guideto_tradingfunds.PDF)).

Public dividend capital

A.7.3.3 Trading funds are normally established with deemed capital in the form of public dividend capital (PDC) though often no cash transaction takes place. PDC may include an allowance for working capital. Once established, the trading fund should pay a dividend on the PDC and to service any loan capital from the NLF.

A.7.3.4 Under resource budgeting arrangements, sponsor departments score their trading funds' PDC as an asset. They also incur a cost of capital charge on the value of the net assets of bodies in which they have an investment, including trading funds. This charge is offset by the receipt of dividends on the PDC and interest on any loan capital. So if the trading fund is unable to pay a dividend, the sponsor department may need to find offsetting savings.

Monitoring and control

A.7.3.5 Sponsor departments should monitor the performance of their trading funds, as any other part of their departments or ALBs. They should take an active part in assessing the (annual) corporate plans prepared by their trading funds, which should be agreed with the relevant departmental minister.

A.7.3.6 The trading fund's corporate plan should be supplemented by a more detailed annual business plan against which the sponsor department should measure performance monthly. In some cases, the Shareholder Executive may act for or advise the sponsor department.

A.7.3.7 The Treasury takes a strategic role. It needs to be confident that the department has adequate procedures for monitoring and controlling its trading funds. It may take a more direct role if particular questions or problems arise.

box A.7.3A main steps in processing applications for trading fund status

Any body proposing to become a trading fund should be part of a department or a department in its own right.

Sponsor departments should:

- consider whether the body really will get most of its income from trading;
- assess whether trading fund status will improve the body's efficiency and effectiveness in managing its activities;
- obtain the agreement of both departmental ministers and the Chief Secretary to the body's outline business case;
- prepare a detailed business case, including financial forecasts, financing arrangements (eg loans or PDC), valuation of specialised assets, and determination of financial targets;
- arrange independent assessment of the business case (perhaps by private sector consultants), including a fitness to trade review where goods or services are not currently charged for. The review will need to confirm that the systems are adequate to identify costs of goods or services provided, make necessary charges to customers, control debtors, manage incoming cash, and maintain adequate accounting and reporting systems;
- consult and advise customers, staff and other stakeholders about the proposal to establish a trading fund (the results of the consultation will eventually be laid before Parliament);
- consult the Treasury about:
 - the capitalisation of the trading fund, eg a cash injection, NLF loans or PDC
 - arrangements for monitoring the financial performance of the trading fund
 - financial targets
 - appointment of the Accounting Officer for the trading fund
 - the Framework Document
 - the draft Trading Fund order;
- seek final approval of both departmental ministers and the Chief Secretary;
- arrange the necessary Parliamentary debate.

The Treasury

- agrees the basic business case and capitalisation of the trading fund;
- issues a direction under the Government Trading Funds Act 1973 setting out how the assets and liabilities to be appropriated to the trading fund are to be valued;
- directs the trading fund to be guided by the FReM and by standard directions on its report and accounts.