

OFFICIAL

AUDIT GLASGOW

PROVISION OF AUDIT SERVICES TO THE PUBLIC SECTOR

Perth and Kinross Council

ALEO Transformation Review

The Terms of Reference for this review is provided at appendix 2.

1. Background

1.1 Perth and Kinross Council (PKC) has three Arms Length External Organisations (ALEOs):

- Live Active Leisure (LAL),
- Culture Perth and Kinross (CPK), and
- Perth Theatre and Concert Hall (PTCH).

| ALEO | Established | Structure | Key Purpose |
|------|-------------|---|--|
| LAL | 1965 | Wholly owned by PKC Registered charity | To provide health and fitness opportunities for the local community. |
| CPK | April 2016 | Wholly owned by PKC Registered charity | To deliver museums, libraries, archives, family and local history and creative learning. |
| PTCH | 2005 | Wholly owned by PKC Registered charity | To operate both Perth Theatre and Concert Hall. |

1.2 Each of the ALEOs has a Service Level Agreement (SLA) with PKC which details the core activities that the ALEO is expected to deliver along with key performance indicators against which the ALEO will be measured. The SLAs were last updated in 2023 and also include the level of service fee that the ALEOs will receive from PKC in that financial year.

1.3 Audit Scotland published its report *ALEOs: Are you Getting it Right?* in 2011 and a subsequent report on Council's Use of Arms Length Organisations in 2019. The key messages from the reports are:

- Oversight, accountability, and good management are essential.
- In managing ALEOs, Councils should continue to apply the principles in the Following the Public Pound Code. This includes overseeing the performance, financial position, and associated risks of ALEOs.
- There is a need to set clearer criteria for how councillors and officers are involved with ALEOs and demonstrate more clearly how ALEOs secure Best Value.

OFFICIAL

OFFICIAL

- 1.4 What this means is that Councils must be clear on the reasons for the ALEO being in existence and the benefits that having the ALEOs bring including being able to demonstrate how the use of ALEOs improves outcomes for people.
- 1.5 As each ALEO is a registered charity, it is bound to comply with the requirements of the Office of the Scottish Charity Regulator (OSCR). The Charities (Regulation and Administration) Bill was passed by the Scottish Government in June 2023 and will increase the powers of OSCR and improve transparency and accountability of charities. The ALEOs will also be required to comply with this.
- 1.6 PKC commenced a review of its ALEOs in the summer of 2023, the purpose of which is to review the Council's arms-length delivery models for culture and leisure and recommend any structural/wider changes required to maximise Council investment in culture and sport services.
- 1.7 The purpose of our part of the review was to support the financial analysis and options for change element of the ALEO Transformation Review. In addition, a critical friend role will be undertaken using the experiences of undertaking similar reviews at Glasgow City Council's ALEOs over the last few years.
- 1.8 The future model of service provision needs to consider a number of factors when assessing any options and recommendations. Clearly financial savings will be a key driver, but the following should also be considered by the Council and the ALEOs when making their final determinations:
 - Greater resilience - ability to easily transfer resources across the Council Family;
 - Improved governance – consistent approaches to risk management, systems of internal control and governance will enhance assurance;
 - Direct and indirect costs, including support;
 - Strategic alignment – e.g., ICT systems and medium / longer term planning;
 - Local suitability and needs - potential requirement for adapting current working practices.

It may be that one part of the Council Family has to adopt a change that may be sub optimal for that organisation but has greater and wider benefits from a Council Family perspective. This would need to be carefully considered and mitigated where possible, but a Group-perspective is important when assessing potential options.

2. ALEO Governance

- 2.1 The ALEOs all came about for different reasons and at different times. The governance arrangements for the ALEOs have therefore evolved over time. All have an SLA with the Council, which details, amongst other things, the specification of services that each must deliver and the corresponding key performance indicators (KPIs).
- 2.2 Each of the three ALEOs currently reports into the PKC Scrutiny and Performance Committee. Reporting to the Committee is generally on an annual basis, however they can also be called to Committee on an ad-hoc basis. The most recent reports from the three ALEOs submitted to the Scrutiny and Performance Committee were in April 2023 and there was an inconsistency in the level and types of information contained within each report. We have observed that the reports do not focus on the services that the ALEOs are to deliver under the SLA.

OFFICIAL

OFFICIAL

- 2.3 A robust ALEO governance framework includes how the Council’s Scrutiny Committee holds ALEOs to account for the services they are contracted to provide under the SLA, and how these contribute to the Council Plan. Specific financial monitoring should also be reported at a reasonable frequency by the Council for the purposes of monitoring the impact on the General Fund (*recommendation 1*).
- 2.4 All three ALEOs are dependent on Council funding for significant elements of their revenue. They are also deemed to be subsidiaries and therefore consolidated within the Council’s Group financial statements, as required by proper accounting practice. It is therefore important that all parties are clear that opportunities for savings (or other improvements) are considered in terms of benefit to the wider Council Group family. Our observation from our review is that this culture is not currently as evident as it could be (*recommendation 5*).
- 2.5 The Board of Directors and governance structure within each of the ALEOs differs. Each of the ALEOs has a Chief Executive and Senior Management Team, with the Chief Executive also being present on the Board. There are three Elected Members appointed to each Board by PKC.

| ALEO | Size of Board | Meeting Frequency | Sub Committees |
|------|---------------|---------------------------------|---|
| LAL | 11* | Approximately 7 times per annum | Sub committees covering HR, Property & environment, Finance & governance, and Service delivery. |
| CPK | 11 | Quarterly | Sub committees covering Finance and Resources, Nominations, Strategy & Development and Audiences & Marketing. |
| PTCH | 12 | Quarterly | Sub committees covering Finance and Governance, People and Nominations |

* 2 vacancies on Board

- 2.6 The total Board resource is therefore significant across the three ALEOs and we are recommending a review to consider optimum Board size and composition. We were also advised that the Articles of Association for the ALEOs have not been recently updated (*recommendation 3*).
- 2.7 There is currently no Internal Audit service covering the ALEOs. This is not in keeping with best practice and is exposing the Council Group to risk. Internal Audit provides a vital role to those charged with governance by evaluating the effectiveness of governance, risk management and internal control arrangements and playing a key role in promoting good corporate governance. The Chartered Institute of Public Finance and Accountancy (CIPFA) published its Statement on the Role of the Head of Internal Audit in 2019 which is considered as best practice for all public sector organisations. We recognise the severe resourcing pressures faced by the Council and its ALEOs, but we are recommending budget is identified to provide a rolling framework of assurance covering key processes and controls. As noted at 1.8, if these processes and controls are more closely aligned, then it would be easier to provide a lean audit and assurance framework. Ideally this would be provided by the Council’s Internal Audit team (*recommendation 4*).

OFFICIAL

3. ALEO financial arrangements

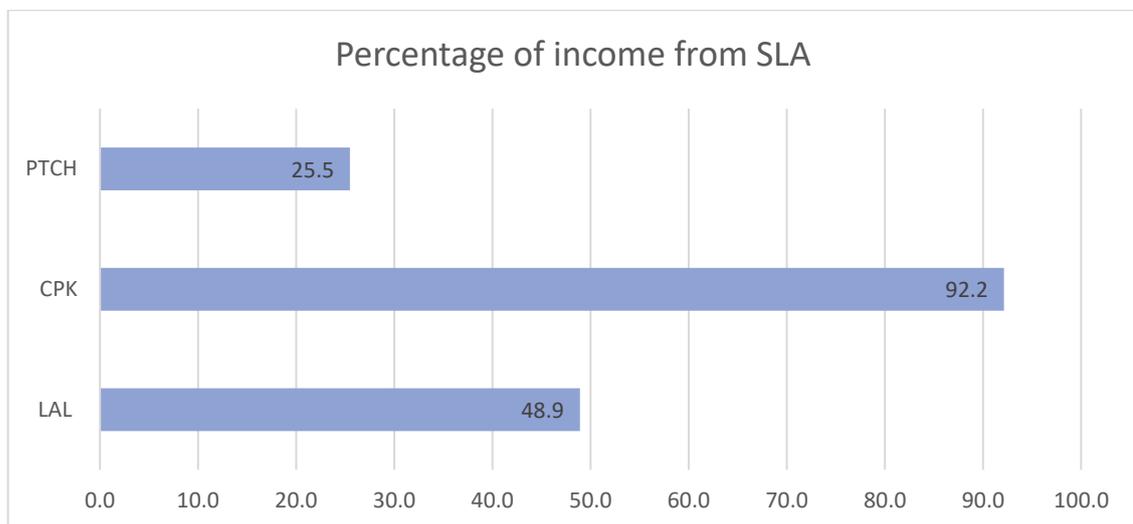
3.1 The three ALEOs operate their own standalone financial systems. CPK and PTCH both use *Xero* financial system and LAL uses *SAGE* financial system. It may be more beneficial for the 3 ALEOs to utilise the same system as the Council with a separate module. This may generate savings and also allow for staffing flexibility and resilience across the Council Group as there would be corporate familiarity with the system. It would also enable a consistent internal control framework to be deployed for common systems, which would enhance assurance for the Boards and management. It is noted that CPK currently has a vacancy in the finance team and is having to buy in assistance from its External Auditors, Azets (*recommendation 6*).

Income

3.2 As part of the SLA, PKC provide £8.717m funding to the ALEOs annually, split as follows for 2023/24:

| ALEO | Service fee (£m) |
|--------------|------------------|
| LAL | 4.263 |
| CPK | 3.392 |
| PTCH | 1.062 |
| Total | 8.717 |

The SLA income contributes to the overall revenue funding of each organisation and is more significant to CPK due to both LAL and PTCH having the ability to charge for the majority of services delivered. The following chart provides detail on the percentage of overall income that comes from the SLA service fee.



OFFICIAL

- 3.3 Over the last 3 years, there has been no uplift to the service fee for the ALEOs to reflect inflation or pay awards. Whilst no additional savings have been applied to the ALEO service fees as yet, this has resulted in a pressure on the ALEO revenue budgets. We understand that it's likely that ALEOs will be subject to savings in future financial years. LAL have used reserves to fund the deficit, however this is unsustainable in the medium/long term. CPK received one off funding from PKC to ensure a balanced budget. This was following a library review which recommended the closure of some libraries, which the CPK Board supported but was rejected by the Elected Members of PKC. PTCH has used trust and foundation and ticket sales monies to contribute to core costs, whilst also reducing staff numbers.
- 3.4 Gross income budgets for 2023/24 are set out below:

| Gross Income Budget (2023/24) | LAL (£m) | CPK (£m) | PTCH (£m) |
|-------------------------------|--------------|--------------|--------------|
| P&K service fee | 4.263 | 3.392 | 1.062 |
| Fees and Charges | 4.670 | 0.128 | 1.182 |
| Grant income | 0.570 | - | 0.734 |
| Investment income | 0.029 | - | - |
| Rental income | - | - | 0.300 |
| Fundraising | - | 0.032 | 0.087 |
| Other income | 0.236 | 0.128 | 0.787 |
| TOTAL | 9.768 | 3.681 | 4.152 |

- 3.5 Currently when submitting grant funding applications, each of the ALEOs does this independently. However, often the applications are going into the same body such as the Gannochy Trust, and the ALEOs are unaware of the applications being submitted by the other two. Whilst there is recognition that some funders will only deal with the specific ALEO, there may be opportunities to learn from each other and as a minimum through better communication and collaboration ensure that the ALEOs are not competing for the same funding from the same funder (*recommendation 13*).
- 3.6 Both LAL and PTCH have conference facilities that are hired out. There is currently no joined up working on this, therefore it may be that both are competing for the same business (*recommendation 14*).

Expenditure

- 3.7 Due to all ALEOs having charitable status, they receive rates relief for the properties that they either own or are leased to them from the Council. This equates to approximately £1.7m per annum. They are also exempt/partially exempt from VAT. Both are key considerations for any proposed reform that could result in this charitable status being removed.
- 3.8 The total gross expenditure budget for the three organisations for 2023/24 is £18.2m, broken down under subjective headings is as follows:

OFFICIAL

| Gross Expenditure Budget (2023/24) | LAL (£m) | CPK (£m) | PTCH (£m) |
|------------------------------------|---------------|--------------|--------------|
| Employee costs | 6.787 | 2.920 | 2.290 |
| Property costs | 1.203 | 0.082 | 0.073 |
| Supplies and Services | 1.032 | 0.419 | - |
| Utilities | 1.304 | - | 0.400 |
| Cost of Sales | 0.071 | - | 0.792 |
| Fleet | - | 0.115 | - |
| Miscellaneous | - | 0.050 | 0.672 |
| TOTAL | 10.397 | 3.586 | 4.227 |

- 3.9 Employee costs are the most significant item of expenditure. The staffing establishment for each ALEO is:

| ALEO | Employees (FTE) |
|--------------|--------------------|
| LAL | 195 |
| CPK | 71.1 |
| PTCH | 78.5 |
| Total | 344.6 |

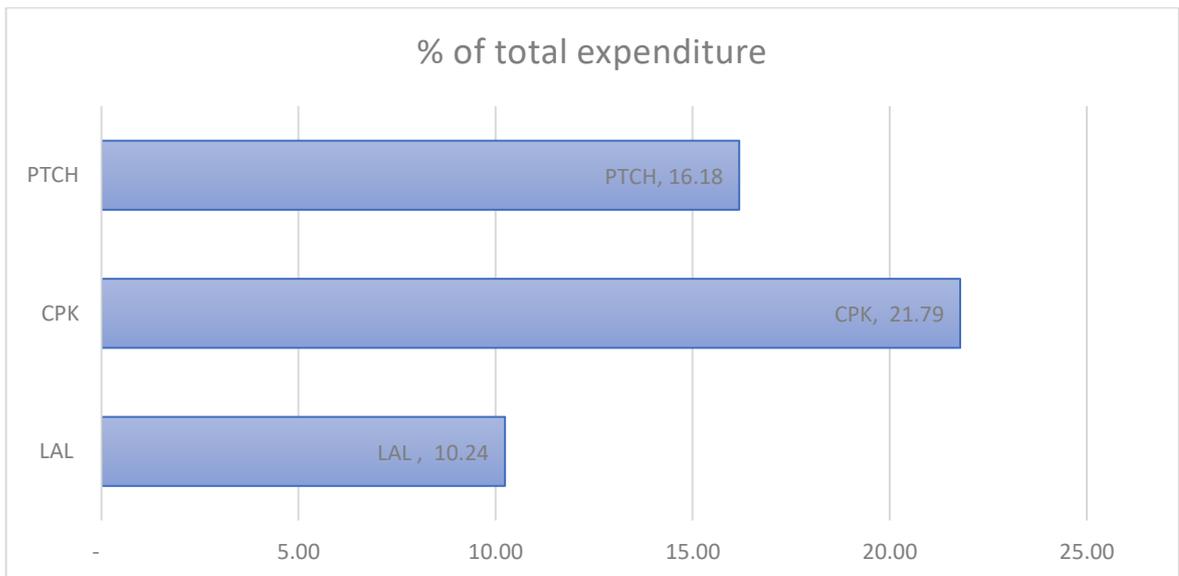
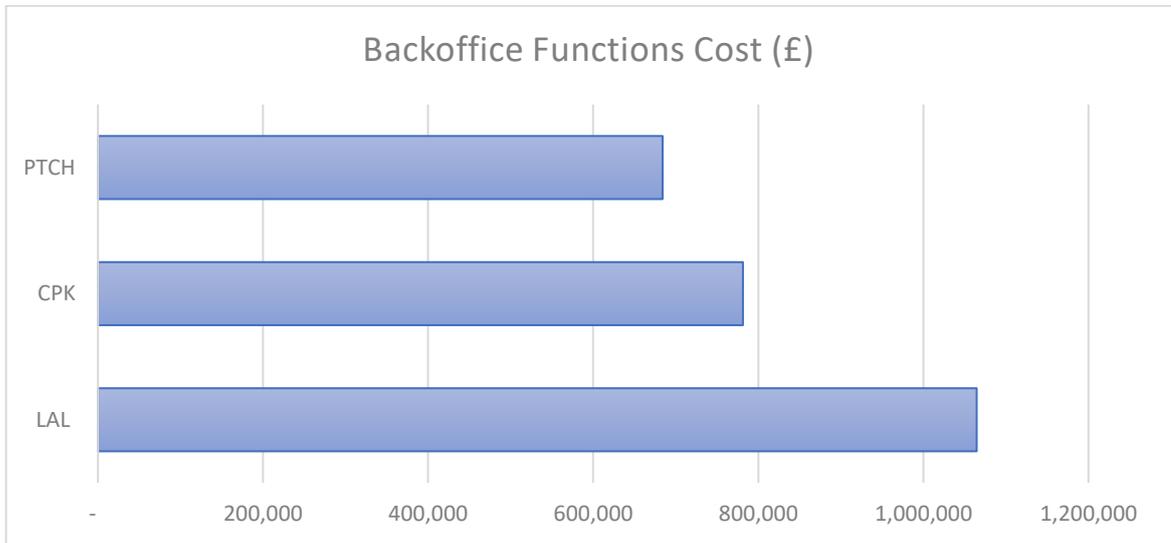
- 3.10 In terms of procurement and non-employee expenditure, none of the ALEOs have a specialised procurement resource. As subsidiaries of the Council, there is a need to demonstrate compliance with public sector procurement regulations, and the absence of a formal procurement compliance framework gives rise to potential risk in this area. There may also be opportunities for joint procurement of certain commodities across the Council Group (*recommendation 12*).

Support costs

- 3.11 Each ALEO has its own Chief Executive, Senior Management Team and back-office functions in addition to the front-line service delivery staff. Back-office services include finance, HR, marketing, ICT and admin.
- 3.12 Salary structures and payroll arrangements are also unique to each organisation. It is noted that not all the ALEOs pay staff the real living wage, which should be considered by the Council as part of this review as a potential risk. The payroll arrangements for CPK have changed in the recent past and are now provided by an external provider and not PKC. This costs approximately £11k for delivery of this service from the external provider. LAL and PTCH both operate their own payroll (*recommendations 10 and 11*).
- 3.13 Within the back-office teams in each of the ALEOs there is potential duplication and opportunities for efficiencies. For example, management should explore whether LAL could provide payroll services to CPK, keeping the money within the Council group and making a net saving or other benefit (para 1.8). We are recommending that each support function is reviewed across the Council Group to identify any potential efficiencies or improvements through a shared service model (*recommendation 7*).

OFFICIAL

The chart below provides detail of the current cost of back-office functions to each of the 3 organisations.



Property

3.14 The ALEOs deliver services from a variety of venues, including ones that are wholly owned by the individual ALEOs and ones that are owned by PKC. The table below provides some further detail in relation to the properties from which each of the ALEOs operates.

| ALEO | Number of properties services delivered from | Ownership of properties | Other information |
|------|--|--|--|
| LAL | 6 main venues plus 4 campuses and | In the main properties owned by LAL with exception of: | LAL responsible for repairs and maintenance and investment in the 6 main venues. |

OFFICIAL

| ALEO | Number of properties services delivered from | Ownership of properties | Other information |
|-------------|---|---|--|
| | 8 community halls | - campuses from which services delivered; and - community halls. | |
| CPK | 17 | All properties owned by PKC | All planned repairs and maintenance and compliance work undertaken and funded by PKC. |
| PTCH | 2 | PKC | PKC responsible for the fabric of the properties and PTCH responsible for the specific arts related fixtures and fittings. |

3.15 The costs associated with the properties are most significant for LAL due to it being responsible for repairs and maintenance of the 6 main buildings that it operates from, including Perth Leisure Pool.

3.16 The usage figures for the properties from which each of the ALEOs delivers services are detailed in the table below:

| ALEO | Area | Usage (2022/23) |
|-------------|-----------------------------------|------------------------|
| CPK | Museums | 44,045 |
| | Libraries | 7,132 |
| LAL | Dry Sports | 310,922 |
| | Perth Leisure Pool | 354,546 |
| | Community Campuses | 274,255 |
| | Other venues | 79,448 |
| PTCH | Audiences | 133,151 |
| | Participants | 18,613 |
| | Delegates (conference and events) | 13,654 |
| | Other footfall | 278,034 |

Further work is required to determine if best use is being made of the Council family assets, through trend analysis and benchmarking with other similar organisations (*recommendation 8*).

3.17 PKC currently provides some services to each of the ALEOs, to varying extents. It is unclear why these arrangements differ, and a review should be undertaken to ensure all parties are clear on baseline numbers and the rationale for services provided and associated recharges (*recommendation 2*).

| ALEO | Services provided by PKC | Total recharge (£m) |
|-------------|---|----------------------------|
| LAL | - IT infrastructure/telephones | 0.118 |
| CPK | - Property maintenance and repairs - Buildings Insurance | Not yet provided |

OFFICIAL

| ALEO | Services provided by PKC | Total recharge (£m) |
|------|--|---------------------|
| | <ul style="list-style-type: none">- IT support (network and hardware)- Treasury- Utilities- Waste Management- Fleet management | |
| PTCH | <ul style="list-style-type: none">- Property maintenance and repairs | Not yet provided |

3.18 Although PKC provides some ICT services to two of the ALEOs, each also arranges elements of their own ICT arrangements and one is solely responsible for all ICT arrangements. It is not clear how the Council group ICT risks are currently documented and mitigated due to the current fragmented arrangements. There is currently a real risk that should one of the ALEOs not follow Council ICT strategy that they could put at risk other parts of the ICT arrangements. It is important that the ICT Strategy, hardware and software, ICT security and network are understood by all parties and aligned to the Council's strategic ICT arrangements (recommendation 9).

4. Recommendations

4.1 The Council and the three ALEOs should consider the content of this report and specifically the recommended actions outlined in Appendix 1 as part of the Council's review of the ALEO structures.

OFFICIAL

5. Appendix 1

Recommendations for PKC to consider for action

| Ref | Recommendation |
|-----|---|
| 01 | Scrutiny A formal ALEO governance framework should include how the Council's Scrutiny Committee holds ALEOs to account for the services they are contracted to provide under the SLA, and how these contribute to the Council Plan. Specific financial monitoring should also be reported at a reasonable frequency for the purposes for monitoring the impact on the General Fund (suggested quarterly). |
| 02 | Services from PKC A review should be undertaken to ensure all parties are clear on the rationale for services provided by PKC and the associated recharges. Recharges should be based on proper accounting practice, and any changes in service / recharges may need to be reflected through corresponding SLA financing changes. |
| 03 | Board Size The Council should review of the current size of the Boards in conjunction with ALEO senior management to determine if they are appropriately sized. A skills needs assessment should also be considered. |
| 04 | Internal Audit Management should appoint an Internal Auditor for each ALEO. This could be provided by PKCs Internal Auditors. |

Recommendations for PKC and ALEOs to consider for action

| Ref | Recommendation |
|-----|---|
| 05 | Culture and Relationships Clear messaging should be used going forward so that all parties are clear that they are part of the wider Council Group. This perspective is important when assessing options for changes to services and structures. |
| 06 | Finance System Consideration to be given to streamlining the finance arrangements by the utilisation of the one financial system for all ALEOs with separation between the 3 organisations using different company codes. Ideally this would align with the PKC system. This would reduce maintenance and support costs for the current three separate systems that are in operation and also provide some resilience with staff able to support the other organisations if required. |

OFFICIAL

| Ref | Recommendation |
|------------|--|
| 07 | <p>Support Services</p> <p>A full review of all back-office services provided by each of the ALEOs to be undertaken to seek opportunities for more joint working or creation of a hub of excellence that could deliver a specific function to all 3 ALEOs.</p> <p>As a minimum when one of the ALEOs recognises the need for a additional help with a support service, the first port of call should always be PKC and the other 2 ALEOs before going out to the market.</p> |
| 08 | <p>Property</p> <p>A full review of all properties from which the ALEOs currently deliver services from. The review should include the following:</p> <ul style="list-style-type: none"> - condition and suitability of each property; - the annual repairs and maintenance costs for each property and whole life costing of the assets, including information on whole life costing; and - the usage of each property. <p>This information should then be used to determine if best use is being made of the joint assets and inform decision making as part of any options appraisals for future transformation / service reform of all the property assets. This review should take account of the work currently ongoing in relation to properties including LAL/sports properties and the previous work in relation properties including the library property review. There are examples in other authorities of a variety of services being delivered from the same properties, e.g., libraries incorporating access to jobs, skills and benefits advice.</p> |
| 09 | <p>ICT</p> <p>A review of the ICT arrangements across the ALEOs should be undertaken to map out the current arrangements for:</p> <ul style="list-style-type: none"> - Networks and server estate - ICT security - Applications & currency - Service desk - End User Computing <p>Thereafter work should be undertaken to ensure the ICT related risks are managed appropriately from a group perspective.</p> |
| 10 | <p>Payroll</p> <p>Management should review the arrangements for delivery of the payroll services at each of the ALEOs. As part of this the option for having a payroll hub which delivers the payroll services to all three of the ALEOs thereby keeping the money within the Council group and making a net saving should be explored. As a minimum the options for one of the other two ALEOs to provide the payroll services to CPK should be explored. The wider principles at para 1.8 should be applied in this assessment.</p> |
| 11 | <p>Salaries</p> <p>A review of the salary structures should be undertaken to determine if harmonisation of similar roles can be undertaken. Discussions should also be undertaken with regards the real living wage.</p> |

OFFICIAL

| Ref | Recommendation |
|-----|--|
| 12 | Procurement A review of the procurement arrangements across the ALEOs should be undertaken to determine the most effective procurement arrangements to be put in place to ensure compliance with the public sector procurement regulations and where joint procurement arrangements for particular commodities may bring financial savings to the Council group. |

Recommendations for the ALEOs to consider for action

| Ref | Recommendation |
|-----|---|
| 13 | Grant Funding A review of the arrangements for the ALEOs applying for grant funding should be undertaken to determine if there are any opportunities to undertake joint working/joint funding applications, particularly to those funders that all of the ALEOs receive funding from. |
| 14 | Conference Facilities LAL and PTCH to undertake a joint piece of work to determine where more joint working could be undertaken in relation to conference facilities. This could include aligning conferencing strategies; joint marketing of the conference facilities; signposting to the others' facilities where one ALEO is unable to meet the needs of the customer; joint team leading the marketing and promotion of conference facilities. |

OFFICIAL

OFFICIAL

Appendix 2: Terms of Reference

The purpose of the review is to support the financial analysis and options for change element of the ALEO Transformation Review.

The scope of the audit will cover:

1. Financial Analysis – what does the Council currently pay each of the 3 organisations to deliver and what is delivered for this service fee; and what Council services does each ALEO use (back office).
2. Critical friend role – support management as the Transformation review progresses. This will include sharing methodologies and approaches used in Glasgow City Council where useful.
3. Options for change – ad hoc ongoing high-level support to Council project group on the options for change and the sustainability of these including attendance at working groups/meetings.

OFFICIAL