

# Perth & Kinross Council

## Arm's-length external organisations – are you getting it right?: A follow-up report



Prepared for Perth & Kinross Council  
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# Executive summary

## Background

1. In 2011, the Accounts Commission published *Arm's-length external organisations (ALEOs): are you getting it right?* in its "how councils work" series of reports. The purpose of these reports is to stimulate change and improve performance. The ALEOs report was designed to promote and encourage good practice in the way ALEOs are set up and operated.
2. Councils are increasingly using arm's-length organisations as an alternative way of delivering services. Frequently, ALEOs provide recognised 'council services' for example leisure services, but they can also manage commercial operations. While the ALEO is responsible for services, the council remains responsible for the public money it gives to the ALEO and the quality of services the ALEO provides.
3. As part of the 2013/14 audit local government auditors are carrying out targeted follow up work on ALEOs in each council. The aim of this work is to provide a position statement on councils' use of ALEOs and in particular, on progress since the 2011 report was published. For the purposes of this review, we have considered the arrangements in place for Horsecross Arts Ltd (Horsecross) and Live Active Leisure Ltd (LAL).

## Key findings

4. Overall the Council demonstrated that elements of good or best practice are evident in the governance arrangements in place for ALEOs. Areas of good practice identified included:
  - the Council explored alternative service delivery models for culture and leisure provision resulting in sole member status for Horsecross and LAL being agreed in June 2013
  - the Council's Local Code of Guidance for Funding External Bodies & Following the Public Pound (the Code) outlines the governance arrangements that are required for funding of external bodies
  - the Council has standard SLA templates ensuring agreements with ALEOs cover the required governance arrangements, the Council's commitment, indemnity and insurance cover and circumstances that will trigger a review of its involvement with the organisation
  - a corporate register of financial commitments to ALEOs is maintained and reported to the Council annually
  - the Council's compliance with the Code was reviewed by internal audit in May 2013
  - SLAs for Horsecross and LAL for the two years to March 2015 have been agreed. The service specification provides a clear link to the Council's strategic objectives and priorities and outlines key targets, outcomes and performance measures
  - performance and financial monitoring is undertaken regularly by officers
  - the Council's induction process for members included presentations on membership of outside bodies

5. It was highlighted however that the Council did not formally consider the national report *Arm's-Length External Organisations: Are you getting it right?* issued in June 2011 although in its review of ALEOs the findings have been considered. Further improvements have been highlighted to strengthen the Council's approach including:
- implementation of actions agreed with internal audit including updating the Code, updating standard SLAs and improvements to information reported in the central register of funding to external bodies
  - continued involvement in Horsecross to ensure the recovery plan is implemented and the intended impact on the longer term transformation of the organisation is realised
  - ensuring that the Code is complied with including ensuring that members have considered half yearly or annual reports on these ALEOs
  - agreeing a criteria set for the skills and expertise required of members being appointed to ALEO boards
  - ensuring written agreements with the ALEOs where the Council participates as a decision maker are in place
6. We will continue to monitor and report on the Council's progress in this area.

## Acknowledgements

7. The contents of this report have been agreed with relevant officers in terms of factual accuracy. The assistance and co-operation received from officers during the course of our audit work is gratefully acknowledged.

# Introduction

## Background

8. Arm's-length external organisations (ALEOs) are companies, trusts and other bodies that are separate from the local authority but are subject to local authority control or influence. Control or influence can be through the council having representation on the board of the organisation, and/or through the council being a main funder or shareholder of the organisation.
9. Councils are increasingly using ALEOs as an alternative way of delivering services. Frequently, ALEOs provide recognised 'council services' such as leisure services, but they can also manage commercial operations, for example exhibition facilities and commercial properties. While the ALEO is responsible for services, the council remains responsible for the funds used and ensuring value for money. Arrangements can be complex and good governance is crucial.
10. In 2011, the Accounts Commission published *Arm's-Length External Organisations: Are you getting it right?* The report highlighted good practice in the way ALEOs are set up and managed, including arrangements for performance monitoring. The report also included a checklist and key points for action, intended for use by councillors and officers.
11. The report's key messages included the following:
  - ALEOs can offer the potential for reduced costs, new sources of income and greater flexibility. However, there may also be increased risks. The 'following the public pound' principles continue to provide the basis for sound governance of ALEOs.
  - Any decisions to use an ALEO to deliver services should involve an appraisal of the options available and a sound business case, using expert advice when necessary.
  - Governance for ALEOs can be complex; strong and effective governance is required from the outset. Councils should specify the business practices and standards they expect the ALEO to observe. Clarity about roles and responsibilities is vital.
  - Monitoring of ALEOs should be risk-based and proportionate. Councils need good-quality monitoring information on ALEOs so they are aware of their finances, risks and performance. Information should be current to allow prompt action to be taken.
  - Councils should periodically review their ALEOs to ensure they remain the best option for service delivery, and to ensure effective governance is in place. Councils should decide the trigger points for reviewing or terminating the delivery agreement, and take prompt action where required.
  - Ongoing training and guidance should be provided so that councillors and officers involved in any capacity with ALEOs have the skills they need to undertake their duties.

12. More recently the Accounts Commission's Chair wrote to all councils highlighting the serious financial consequences of weak governance in the arrangements for overseeing ALEOs. The Chair took this opportunity to remind councils about the Commission's "*how councils work*" report. The Commission's ongoing interest in ALEOs reflects its role in ensuring effective governance of public finances and service performance regardless of the way services are delivered.

## Audit scope and objectives

13. As part of this year's audit a follow-up review is being carried out across all Councils in Scotland to assess progress since the 2011 report was published. The '*Toolkit for improving the governance of ALEOs*' set out in the national report is the basis for this work. The checklist contains five questions based around both the 2011 report and Audit Scotland's Best Value toolkit on ALEOs:
- Has the council formally considered the Commission's "*how councils work*" report on ALEOs. If so did it develop an action plan and have these actions been addressed?
  - How clear is the council about its reasons for delivering services through ALEOs?
  - How well does the council understand the financial commitment and risk to which it is exposed through ALEOs?
  - How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?
  - Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?
14. The toolkits set out four descriptors which capture levels of development or performance.

Does not meet basic practice requirements	An organisation may not yet demonstrate the basic practice level in any particular category.
Basic Practice	Minimum acceptable standards, which would be sufficient to allow an organisation to demonstrate sound performance.
Better Practice	As basic, with some elements of good or even best practice, but not on a consistent basis.
Advanced Practice	Consistently demonstrating good or best practice and contributing to innovation.

15. The Council should not necessarily set out to achieve the highest level of best practice ('advanced practice') as set out in the report. Instead, the Council should set out which level of maturity it wants to achieve, based on the size, complexity and materiality of its ALEOs.

16. Appendix 2 contains details of the Council's ALEOs including name, legal status, services delivered and some contextual information. For the purposes of this review, we have considered the arrangements in place for Horsecross Arts Ltd (Horsecross) and Live Active Leisure Ltd (LAL). Tayside Contracts Joint Committee has been excluded from this review as no funding is made to this body other than through contracts for services provided. The minute of agreement between the three constituent councils and Tayside Contracts Joint Committee is also currently being reassessed.
17. Although this report identifies certain risk areas, it is the responsibility of management to decide the extent of the internal control system appropriate to the Council. We would stress, however, that an effective control system is an essential part of the efficient management of any organisation. The risk areas highlighted in this report are only those that have come to our attention during our normal audit work in accordance with our Code of Audit Practice and therefore are not necessarily all of the risk areas that may exist.
18. The action plan included as Appendix 1 to this report details the areas where continued risk exposure requires management action.



# Main findings

## Council's response to 'Arm's-Length External Organisations: Are you getting it right?'

19. The national report *Arm's-Length External Organisations: Are you getting it right?* published in June 2011 has not been formally considered by members. The toolkits for checking progress and improving governance were not formally reported to allow appropriate consideration of the Council's position. Henderson Loggie's annual report on the audit of the Council in 2010/11 highlighted the national report and that the report findings were being considered as part of the governance and accountability arrangements of Horsecross and LAL within the Council's review of *Securing the future for culture and leisure services*.

### Action point 1

20. Internal audit conducted a review of following the public pound which covered the arrangements in place for ALEOs and reported their findings in May 2013. Internal audit's objectives were to ensure that:
- the Council has adequate arrangements in place to ensure compliance with the Code of Guidance on Funding External Bodies & Following the Public Pound.
  - arrangements are in place within Services for monitoring ALEOs to ensure efficient, effective and economic use of Council resources in meeting agreed objectives
21. Internal audits report *Following the Public Pound* issued in May 2013 highlighted that the internal control arrangements were moderate or moderately weak and resulted in twenty-one agreed actions including updates to the Code, improving information in the central register and revisions to the standard SLAs.

## Clarity about the reasons to use ALEOs

22. Councils, generally, need to assess the options for delivery of services that best meet their objectives. This requires an understanding of the options available, including in-house, partnership and contracting opportunities, as well as the potential to use an ALEO.
23. Both of the ALEOs reviewed have been in operation for a number of years therefore our review concentrated mainly on whether the service provided remained aligned with the Council's objectives.
24. The Council's *Securing the Future Towards 2015 and Beyond* outlines programmes of redesign, efficiency, and targeted savings included delivering savings and explore alternative service delivery models for culture and leisure provision. As part of the wider proposals of *Securing the Future for Culture and Leisure Services* an option appraisal of service delivery resulted in sole member status for Horsecross Arts Ltd and Live Active Leisure Ltd being agreed in June 2013.

25. The services provided by Horsecross and LAL are outlined in the SLAs with the service specification providing a clear link with the Council's strategic objectives and priorities. These SLAs are for the period up to 31 March 2015 and this will allow any revisions to realign the service provision with the Council's current requirements and the Community Plan/Single Outcome Agreement 2013-2023.
26. Overall we have assessed the Council as demonstrating **advanced practice** in this area although the Council should evaluate on an on-going basis whether providing services through ALEOs continues to be the preferred option.

## Financial commitment and risk

27. The Council's Local Code of Guidance for Funding External Bodies & Following the Public Pound (the Code) outlines the governance arrangements that are required for all funding of external bodies. The Code has been the subject of an internal audit review in 2013 and is currently being redrafted to incorporate improvements in the arrangements. The Code arrangements include:
  - funding agreements including the requirements for Service Level Agreements (SLAs)
  - arrangements for the termination of the agreement
  - monitoring arrangements covering areas of review and timescales
  - requirements for representation on outside organisations covering written agreements, induction etc.
28. The Council maintains standard SLA templates ensuring agreements cover the required governance arrangements, the Council's funding commitment, indemnity and insurance cover and circumstances that will trigger a review of its involvement with the organisation. This standard SLA documentation was used in agreeing SLAs for Horsecross and LAL.
29. The Council also maintain a register of all funding to external bodies which is reported annually to the Strategic Resources & Policy Committee.
30. Following internal audit's report *Following the Public Pound* issued in May 2013 the Code and standard SLAs are in the process of being updated and a commitment has been agreed to improve the information within the central funding register.
31. Horsecross Arts Ltd highlighted material uncertainty surrounding solvency of its operations in 2013. The Council worked with Horsecross to resolve the uncertainty around its financial position including agreeing accelerating payments of grants to Horsecross on the agreement of certain conditions. Due to identified issues the Council exercised its sole member powers to intervene in Horsecross in October 2013 whereby the Council has the powers of appointment and removal of directors, as well as to direct the board. Further to this the Executive Sub-Committee of the Strategic Policy & Resources Committee in November 2013 agreed to provide additional funding to stabilise Horsecross's cash flow position in the short to medium term while a recovery plan was implemented. This recovery plan included a number of conditions in relation to the longer term transformation of the organisation.

32. Since July 2013 the Council have continued to require headline performance information from Horsecross which is reported to the Council. The primary focus of the Council has been to ensure tight monitoring of Horsecross's financial management and to ensure the required improvements in relation to financial management and control are being implemented. In the intervening period Council officer liaison with Horsecross has been more frequent to allow an assessment of the wider performance requirements contained within the SLA.
33. Overall we have assessed the Council as demonstrating **better practice** in this area. The implementation of agreed actions in internal audit's report together with the improvements being implemented as a result of the difficulties encountered by Horsecross would result in an assessment of advanced practice.

## Monitoring and performance management

34. Councils should set clear objectives and agree performance indicators for services delivered through ALEOs and mechanisms should be in place to identify and act upon under-performance. By formally reviewing information relating to these external organisations on a regular basis, members can identify and act upon any early warning signs relating to specific governance, financial or performance aspects. Effective monitoring is especially important where quick action may be required to protect services and the council's interests and reputation.
35. The SLAs detail the service specification required from the ALEOs. The Council's objectives and priorities are linked to service activity and responsibilities which are measured through key performance indicators and targets/outcomes to demonstrate service delivery. The Council has delegated responsibility for monitoring the performance of its ALEOs to specific officers. Quarterly SLA/Liaison meetings are held for Horsecross and LAL where finance and performance is monitored.
36. As part of the conditions whereby the Council provided additional funding to Horsecross financial updates are now provided to the Council on a monthly basis. The Council's intervention in Horsecross has resulted in:
- regular financial management monitoring
  - a review of governance arrangements
  - a review of the senior management structure
  - a review of health and safety policy and practices
  - transformation of the business model for Horsecross
37. Officers are working with Horsecross on a regular basis to support the development of the operating model and in the interim are only seeking performance information required for the Council service's Business Management Improvement Plan.
38. The Code also notes that a half yearly report and annual report on the ALEOs should be considered by the appropriate Committee. Officers have highlighted that as both sole member companies were established in June 2013, the scrutiny process did not take place for the 2012/13 Annual Reports but is built into the scrutiny programme for future meetings of the Scrutiny Committee.

39. Internal audit reviewed ALEOs performance management arrangements and agreed a number of actions in its report in May 2013. An area relevant to Horsecross and LAL was that the standard SLAs paragraphs in relation to access rights for external audit required to be updated. The Code and standard SLA documentation is currently being updated with the next review of LAL and Horsecross SLAs is due by April 2015.
40. Overall we have assessed the Council as demonstrating **better practice** in this area even though improvements in member's involvement could be instigated. To achieve advanced practice the Council may also wish to consider its approach to:
- monitoring ALEOs beyond financial and performance areas to cover areas such as employment practices, equality requirements, purchasing policies and sustainability
  - demonstrating a risk based approach to monitoring and target resources accordingly
  - demonstrating to stakeholders through public performance reporting the reasons for providing services through an ALEO and the impact this has had

## Role of members and officers

41. It is generally regarded as good practice to ensure that an ALEO board has an appropriate composition to bring the mix of skills and experience required to govern the organisation. Setting criteria for the level of skills and experience required as council representatives will help ensure that the appointment process to ALEO boards is transparent, and support clarity about roles and responsibilities.
42. The ALEOs Memorandum and Articles of Association provide for the Council to nominate three members to serve as Directors and be members of the Board. The ALEOs Articles of Association highlight that directors are not given any remuneration. Currently three elected members sit on the Boards of Horsecross and LAL with the appointments agreed by the Council. The Council's register of interests for these six members appropriately records the individuals' involvement in the ALEO.
43. Setting criteria for the level of skills and experience required as Council representatives would help to ensure that the appointment process to ALEO boards is transparent. We have been unable to obtain evidence that the appointment process sets any criteria.

### Action point 2

44. The Council's induction process for members in May 2012 included presentations on membership of outside bodies covering areas such as charities acts, companies acts, codes of conduct, conflicts of interest etc. Officers have highlighted that members are reminded of their respective responsibilities to the Council and to the outside organisation prior to holding any discussion on these ALEOs.
45. The SLAs require that ALEOs have appropriate indemnities and insurance cover to safeguard the Council from risks incurred through member's involvement with the ALEO.

46. The Council's Code highlights that where it participates as a decision-maker, adviser or observer that it will enter into a written agreement with the body. Currently the Council does not have any written agreement for Horsecross or LAL.

**Action point 3**

47. Overall we have assessed the Council as demonstrating **better practice** in this area even though transparency of the roles and responsibilities of members appointed to the ALEOs could be improved. To demonstrate advanced practice the Council would have to improve the transparency of appointments, consider instigating the written agreements with the ALEOs and provide and evaluate ongoing specialist training to those involved in ALEOs.

# Appendix 1: Action plan

## Key risk areas and planned management action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	19	<p><b>National report</b></p> <p>The Audit Scotland report <i>Arm's-Length External Organisations: Are you getting it right?</i> published in June 2011 was not formally considered by members.</p> <p><b>Risk: The findings of national reports, which are of relevance to the Council, are not fully considered.</b></p>	Officers maintain a record of national reports identifying the lead officer and what action has been taken to respond to the report. Services are required to present national reports to themed committees.	Acting Partnership and Improvement Manager	In place
2	43	<p><b>Board member selection</b></p> <p>There is no evidence that criteria is set for the level of skills and experience required as Council representatives to ensure that the appointment process to ALEO boards is transparent.</p> <p><b>Risk: The appointment process is not transparent, and board members are not selected on the basis of the skills or experience required to discharge their responsibilities.</b></p>	It is the responsibility of the ALEO to complete a skills matrix to ensure their Board contains the appropriate skills. Thereafter it is the responsibility of both the ALEO and the Council to ensure that Members appointed by the Council have the correct skills and training.	Head of Democratic Services (on behalf of the Council)	31 Dec 2014

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3	46	<p><b>Board members roles</b></p> <p>The Council's Code requires a written agreement with the ALEO where the Council participates as a decision maker. No written agreements are in place for Horsecross or LAL.</p> <p><b><i>Risk: The roles and responsibilities of Council representation is unclear and therefore individuals are unable to act in the best interest of the Council and the board.</i></b></p>	In line with the Council's Code a formal written agreement will be implemented setting out roles and responsibilities.	Head of Legal Services	30 Sept 2014

# Appendix 2: ALEO data

ALEO/Legal status	Services delivered	Turnover	Net assets	Workforce
Live Active Leisure Limited is a private company, limited by guarantee. It has charitable status (Registered Charity No. SC000175).	To provide and to assist in providing, in the interests of social welfare, recreational facilities and leisure time occupation for members of the public with the object of improving the condition of life of the inhabitants of Perth and Kinross.	£10.5 million	£16.8 million	238 FTE
Horsecross Arts Ltd is a sole member company, with Perth & Kinross Council the sole member of the company. Horsecross has charitable status (Registered charity no SC022400)	To advance performing arts, and arts education, in Perth and elsewhere.	£4.5 million	£0.04 million	152 (headcount)

Source data: 2012/13 financial statements