

Report To: Audit Committee **Date:** 26 August 2014
Report By: Acting Corporate Director Environment, Regeneration & Resources **Report No:** FIN/36/14/JB/LA
Contact Officer: Jan Buchanan **Contact No:** 01475 712223
Subject: Targeted Follow Up to Arm's-Length External Organisations (ALEOs):
Are You Getting it Right?

1.0 PURPOSE

- 1.1 The purpose of this report is to update Committee on the findings of the 'Targeted follow up to Arm's-Length Organisations (ALOEs) – are you getting it right?'

2.0 SUMMARY

- 2.1 Audit Scotland have issued several 'are you getting it right?' reports in recent years and have asked the Council's external auditors: Grant Thornton, to undertake a review of how the Council has responded to the report issued in June 2011 titled Arm's-Length Organisation: are you getting it right?
- 2.2 Appendix 1 contains the report issued by Grant Thornton and highlights their assessment of how the Council has performed in line with the Audit Checklist on the Governance and Accountability arrangements of ALEOs recommended in the original report.

3.0 RECOMMENDATIONS

- 3.1 It is recommended that the Audit Committee consider the contents of the Grant Thornton report and thereafter note the update.

Jan Buchanan
Head of Finance

4.0 BACKGROUND

- 4.1 The Council's external auditors Grant Thornton have submitted a progress report on 'Arm's-Length Organisations: Are We Getting It Right?' as part of their responsibilities as the Council's external auditors.

5.0 FURTHER INFORMATION

- 5.1 Audit Scotland have issued several 'are you getting it right?' reports in recent years and in line with normal practice have asked the Council's external auditors: Grant Thornton, to undertake a review of how the Council has responded to the report issued in June 2011 titled Arm's-Length Organisation: are you getting it right?'
- 5.2 The report which is attached at Appendix 1 contains updates on the performance of the Council against the five areas on the checklist on Governance and Accountability arrangements where they have assessed the Council as basic and better practice in all areas. This is detailed at Appendix 2 of the report.
- 5.3 The Committee is asked to note that there are no specific concerns raised by Grant Thornton in this update, but that officers from Grant Thornton will be present at Committee to answer any questions.

6.0 FINANCIAL IMPLICATIONS

- 6.1 There are no financial implications arising from this report

6.2 Legal

There are no legal implications arising from this report.

6.3 Human Resources

There are no HR implications arising from this report.

6.4 Equalities

There are no equalities implications arising from this report.

6.5 Repopulation

There are no repopulation implications arising from this report

7.0 CONSULTATION

- 7.1 None

8.0 BACKGROUND PAPERS

- 8.1 None

Inverclyde Council

Targeted follow-up to Arm's-length external organisations (ALEOs): are you getting it right?

June 2014



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1. Introduction

Audit Scotland requires us to provide core information on how the Council has responded to national performance reports. To promote impact at a local level, a number of national performance reports are subject to more targeted follow up each year. For 2013-14, we have been asked to follow up the *Arm's Length Organisations: are you getting it right?* which was published in June 2011.

Arm's-length external organisations: are you getting it right?

Arm's-length external organisations: are you getting it right? was published in June 2011. The report was aimed at Councils considering setting up Arm's-length external organisations (ALEOs) to deliver services as well as those with existing ALEOs.

ALEOs are now an established part of local government in Scotland and play an increasing role in service delivery. Councils across Scotland use ALEOs to deliver a wide range of activities such as leisure services, economic development and property maintenance.

Increasing budget pressures and service demands mean that councils must review their services and consider options that may better meet the needs of service users and citizens, and offer improved value for money. ALEOs may provide an option to help reduce costs or to improve services. ALEOs may qualify for business rates relief, attract grants or may be able to trade to generate income. ALEOs can also offer different and better ways of providing services and can make services more accessible.

While the ALEO takes on responsibility for service delivery, the council remains responsible for ensuring that the ALEO uses the public funds the council provides to the ALEO properly and can demonstrate best value. It is therefore important for the council to be able to 'follow the public pound' to the point where it is spent. This requires well thought through governance arrangements from the outset and action to

ensure those arrangements are applied effectively in practice.

The work conducted by Audit Scotland in 2011 did not highlight widespread problems, but did highlight concerns over the management of ALEOs in specific cases. Some cases were found where poor governance resulted in risks to public money, service performance and the reputation of councils.

The report also noted that there is increasing public interest in ALEOs, particularly the impact on services and council finances where ALEOs fail to deliver.

The report recognised the issues highlighted and set out to promote and encourage good practice in the way ALEOs are set up. Key messages were centred around two main themes:

- Getting it right from the start
- Keeping it right.

Follow up requirements

Audit Scotland has asked us to complete a follow up review of the June 2011 report. This work has been scheduled in time to learn lessons from a recent follow up statutory report into the Caithness Heat and Power ALEO (http://www.audit-scotland.gov.uk/docs/local/2014/sr_140109_chap.pdf) where the Controller of Audit highlighted a substantial loss of public money caused by significant deficiencies in the governance of the project. This follow up review is therefore intended to provide the Commission with information on the

extent and nature of the use of ALEOs across local government in Scotland, and a review of the effectiveness of governance arrangements.

Our Methodology

For consistency, the follow up work across Scotland is targeted at companies, trusts and other bodies that are separate from the local authority, but are subject to local authority control, and will therefore normally be disclosed within the Council's group accounts.

Our follow up work has been focused on four questions based on the key issues for councils identified within the report:

- 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?

Our work was performed by interviewing officers and reviewing documentation including minutes and agenda papers. We also completed a questionnaire provided by Audit Scotland (Appendix 1), to ensure consistency of approach across councils.

Acknowledgements

We would like to record our appreciation for the assistance and cooperation provided to us during our audit by Inverclyde Council.

2. Inverclyde Council Arm's Length External Organisations

Inverclyde Council took steps to improve the governance and oversight of ALEOs in advance of the Audit Scotland national report. The Council has two ALEOs with a controlling interest, but monitors the performance of a number of bodies who receive significant financial support from public funds.

Defining an ALEO

The Audit Scotland report presented in 2011 defined an ALEO as a body that is separate from the local authority but is subject to local authority control or influence. This 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.

ALEOs are designed to deliver services, such as leisure facilities, property development and care services, on behalf of local authorities and can take many forms.

Inverclyde ALEOs

The Inverclyde Council 2012-13 accounts identify two bodies that are considered to have a 'close relationship' with the Council:

- Inverclyde Leisure Limited, and
- Riverside Inverclyde Limited.

A further company, Sail Inverclyde Limited, was dissolved in 2012-13.

Inverclyde Leisure Limited was established as a leisure trust in 2001 and involved the transfer of around 200 employees. The Council subsequently transferred community facilities to the Trust, and plans are in place to transfer outdoor leisure facilities in 2014-15. The Council currently provides funding of around £1.8 million to the Trust to deliver leisure services.

Riverside Inverclyde Limited is an urban regeneration company, established in 2006 to develop and regenerate sites blighted by heavy industry and decades of

economic decline. The company is a joint initiative between the Council, Scottish Enterprise and the private sector, with support from the Scottish Government.

A mid-term review in 2013 identified significant challenges for the company in delivering its targets, principally as a result of the economic downturn. In response, in March 2014, the Board approved a new approach to the regeneration and economic development. A joint enterprise with Inverclyde Council's Regeneration Team was approved, based on closer partnership working, shared priorities and objectives, pooling resources and efforts to maximise the economic potential of the area, and achieve better outcomes for the community.

Council members also form a joint committee with Renfrewshire and North Ayrshire Councils on the Clyde Muirshiel Park Authority. This Authority is not included within the Council's group accounts as the interest is not material.

The Council is also represented on the Board of River Clyde Homes, which was formed using a housing stock transfer in 2007. Around 300 employees from the housing and building services transferred to the new body. Four members out of twelve on the Board of River Clyde Homes are elected members from Inverclyde Council, to ensure that the organisation's strategy is consistent with the wider community planning objectives.

Three out of nine board members on the Inverclyde Community Development Trust are elected members, and the council provides funding of around £2 million per year.

3. Inverclyde Council ALEOs Governance Arrangements

In May 2011, the Council's Policy and Resources Committee adopted an approach to determine the level of scrutiny applied to each ALEO and council-funding body, based on a scoring matrix.

Officer and member governance roles have been defined, and supported by a programme of training. The Council did not directly respond to the national report, but the approach developed is in line with the key recommendations of the *Are you getting it right?* report.

The Council's ALEO governance arrangements

In October 2010, one of the Council's pre-school education providers, the Ladybird Nursery, closed suddenly as a result of financial difficulties. The Council faced a challenge in delivering nursery places for around 90 children who attended the centre, and in supporting the nursery's 26 members of staff.

The Corporate Management Team established a short-life working group to develop a Council policy on dealing with external organisations. The working group was chaired by the Chief Financial Officer and included Head of Legal and Democratic Services, the Head of Regeneration and Planning, the Head of Planning, Health Improvement & Commissioning, the Corporate Procurement Manager and the Early Years Manager.

The group met on a number of occasions to review the arm's length bodies providing services for the Council, to ensure that lessons were learned from the financial failure, and develop an action plan to ensure that service provision was not affected in the same way again.

Consideration was given to all organisations where "following the public pound" guidelines apply, not limited to ALEOs where the Council has a controlling interest.

The working group developed a scoring matrix using four indicators to evaluate the Council's required level of scrutiny:

- the level annual payment to the organisation;
- the proportion of the organisation's turnover which comes from the Council;
- the nature of the payment e.g. grant, commissioning payment or contractual payment; and
- the level of Council representation on the Board.

A scoring system was drawn up which would allow for an overall final score to be given over the need for governance oversight. The latest scoring matrix, presented to Policy & Resources Committee on 19th November 2013, is attached at Appendix 3.

The total score indicates the level of scrutiny required for each body, with minimum requirements outlined at Appendix 4.

The Council has regularly reviewed the matrix and associated governance guidelines after its initial presentation at the Policy & Resources Committee on 24th May 2011, and made minor adjustments to simplify and increase transparency.

The working group also outlined the respective governance roles of officers and members when dealing

with externally funded bodies (Table 1, below).

Table 1: Respective Member and Officer Roles relating to externally funded organisations

Members' roles	Officers' roles
<ul style="list-style-type: none"> a. To receive Committee Reports from Officers and following scrutiny and challenge, receive overall assurance that Organisations are meeting their contractual obligations and are operating within their Governance Frameworks. b. Receive assurance from Officers that payments to Organisations do not exceed approved Council Budgets. c. Supply relevant meeting papers to the key officer contact in advance of the organisation meetings to allow briefings to be prepared. d. Ensure Officers are fulfilling their Governance roles. 	<ul style="list-style-type: none"> a. To be the key contact for an Organisation and ensure that Organisation meets their Governance responsibilities. b. To ensure receipt and review of the relevant Governance information including Annual Audited Accounts, Interim Management Accounts and Minutes of Board Meetings and utilising professional support as required. c. Highlight to relevant Senior Officers if organisations are not fulfilling their Governance responsibilities d. To prepare reports to Committee in line with Council Financial Regulations and other agreed policies e. To provide briefings to Elected Members where Elected Members are on the Board of the Organisation.

Source: Inverclyde Council

In addition members will have specific responsibilities as Trustees, including legal duties under the Charities and Trustee Investment (Scotland) Act 2005 and Companies Act (where constituted as a company).

Financial monitoring

The Council's Policy and Resources Committee receives details of over 60 organisations, including the two ALEOs, who received funding and support from the Council.

Under one of the recent improvements to governance processes, where the Council's scoring matrix indicates a high level of scrutiny is necessary, an Annual Committee report will be prepared to highlight performance and quality issues associated with the body.

Our assessment of the actions taken by the Council

We have reviewed the actions taken following the Audit Scotland report against the criteria in the national report in Table 2.

We have concluded that in all instances the Council is meeting basic and better practices using the criteria within Audit Scotland's toolkit in the Are you getting it right? report.

Further detail on the evidence supporting our conclusions is included in Appendix 2.

Table 2: Our Assessment of the Governance and Accountability Arrangements

We use the table below to summarise our assessment of the Council's arrangements for the governance and accountability of ALEOs against Audit Scotland's toolkit provided in Appendix 2 of the *Are you getting it right?* report. Further detail and supporting evidence is included in Appendix 2 to this report.

How well does the Council ensure that effective governance and accountability is maintained when the council delivers services through ALEOs, including companies and trusts?			
	Basic practice	Basic and better practice	Advanced practice
1. How clear is the council about its reasons for delivering services through ALEOs?	<p>The decision to set up or engage with ALEOs is within the council's powers, follows an appraisal of options for service delivery and is linked to its strategic aims/policy.</p> <p>The council establishes from the start clear limits to its involvement, a timetable for achieving objectives and the circumstances in which the agreement will be terminated.</p>	<p>An overall statement of purpose is expressed in key documents.</p> <p>A regular review is carried out to ensure that the services provided by the ALEO remain aligned with the council's current objectives.</p> <p>The council identifies specific circumstances that will trigger a review of its involvement, eg changes in key personnel in the ALEO.</p>	<p>Where services are delivered through ALEOs, the council has a well-developed and soundly based strategy for the delivery of services in this manner which is clearly linked to the council's wider strategic objectives and priorities.</p>
2. How well does the council understand the financial commitment and risk to which it is exposed through ALEOs?	<p>The council defines the nature of the financial relationship, its commitment to the ALEO (shareholding, grant, loan, guarantee, etc) and contributions are not open ended in duration or amount.</p> <p>There is a written agreement about the transfer of public assets which safeguard their title and use.</p> <p>Minimum accounting and auditing arrangements are stated in the agreement.</p>	<p>Before entering into an agreement with an ALEO, the council assesses risks and documents the results.</p> <p>Service Level Agreements or equivalent are in place which specify the financial arrangement.</p> <p>A corporate register of all financial commitments to ALEOs allows the council to assess its overall commitment to its ALEOs.</p>	<p>Risk assessment extends beyond financial risks to other areas, eg reputational risk.</p> <p>The council identifies specific governance, finance and performance indicators that give early warning of potential problems and acts when required.</p> <p>Contingency plans are in place to ensure that service delivery is maintained if the agreement ends.</p>

How well does the Council ensure that effective governance and accountability is maintained when the council delivers services through ALEOs, including companies and trusts?

	Basic practice	Basic and better practice	Advanced practice
<p>3. How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and ensuring audit access?</p>	<p>The council stipulates how and at what intervals it intends to monitor financial and service performance.</p> <p>The council has identified members of staff who will monitor the ALEO's performance.</p> <p>The council ensures its external auditors have right of access to key records of the ALEO and to any explanations they consider necessary from representatives of the ALEO.</p> <p>There are no significant performance or financial concerns about the ALEO that are not being actively managed.</p>	<p>Targets (SMART) and methods of measurement are agreed and documented at the start.</p> <p>Monitoring reports provide timely and good-quality information about the ALEO's performance in delivering services and impact.</p> <p>The council scrutinises monitoring reports and follows up where performance does not meet agreed standards.</p> <p>Staff of the council responsible for monitoring the ALEO are clear about their role and are supported in it; those involved in monitoring financial performance are suitably qualified.</p>	<p>Monitoring extends beyond financial and service performance to employment practices, equality requirements, purchasing policies and sustainability.</p> <p>The council receives and scrutinises forward plans. The council takes a risk-based approach to monitoring and targets resources accordingly.</p> <p>Where the council is one of a number of public organisations involved in the ALEO, it ensures that liaison and monitoring of the ALEO is coordinated.</p> <p>The reasons for providing services through an ALEO and the impact are clear in reports to stakeholders, including the public.</p>
<p>4. Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?</p>	<p>The council has considered the question of representation and is clear about why it wants representation and is transparent in its decision about which members or senior officers will be involved and why.</p> <p>The council has a clear policy for any payments to board members.</p> <p>Members and senior officials are properly advised of their responsibilities to the council and the ALEO, including questions of declaration of interests. They exhibit this understanding through their behaviour and performance.</p>	<p>Training and support is provided to council representatives so they are clear about their responsibilities to the council and the ALEO.</p> <p>The council has a register of interests which records potential conflicts of interest that may arise from member or senior officer involvement in the ALEO.</p> <p>Members and senior officials are effective in performing their role as board members.</p>	<p>The council safeguards itself from risks incurred by members/senior officers in their dealings with the ALEO, eg liability insurance.</p> <p>Specialist training is provided to members/senior officers, eg on company or trust law. Training continues over the period of the member/ senior manager involvement and impact of training is measured.</p> <p>The council reviews representation in ALEOs, makes changes in light of experience and considers rotating representation.</p>

Appendix 1: Details of Inverclyde Council ALEOs

Name of ALEO	Legal status	Services delivered	Turnover	Net assets	Workforce	Source of data
Associates						
Inverclyde Leisure	Private Limited Company	Fitness/Recreation	£5,486,985	£(352,873)	245	2012-13 Accounts
Riverside Inverclyde	Private Limited Company	Urban Regeneration	££2.756m	£9,380,664	9	2012-13 Accounts

Appendix 2: Audit Checklist Governance and Accountability

Overall Arrangements

	Sub-question	Evidence	Our Conclusion
1	Has the council formally considered the Commission's How Councils Work report on ALEOs. If so did it develop an action plan and have also actions been addressed?	The national report was not formally presented to Committee. However, the Council had already taken steps to improve arrangements for the governance of their external organisations. A plan was put in place to enhance their arrangements. This included the Council formally undertaking meetings with major external service providers and developing a scoring matrix to identify the influence of the Council on bodies.	Basic and better practice: the action plan has helped deliver a comprehensive monitoring framework. The approach has been reviewed and the scoring matrix has been refined since its initial development.
2	How clear is the council about its reasons for delivering services through ALEOs?	There is a clear rationale for the two ALEOs that the Council currently has in place. Each of the ALEOs is reviewed to ensure that they continue to perform effectively, and that the services remain aligned with the Council's objectives. Riverside Inverclyde was subject to an external review commissioned by the Council, which gave rise to further consideration of the operating plan and working relationship between the ALEO and the Council.	Basic and better: A regular review is carried out to ensure that the services provided by the ALEO remain aligned with the Council's current objectives.
3	How well does the council understand the financial commitment and risk to which it is exposed through ALEOs?	3 of the 4 matrix measures adopted by the Council directly consider the Council's financial involvement in external organisations. Key indicators include the annual payment to the organisation, proportion of turnover funded by Council and the nature of the payment to organisation. Council officers review ALEO financial statements as part of the governance arrangements. Finance Services have provided significant input within the CHCP governance, which included attendance at governance meetings as	Basic and better: Service Level Agreements are in place which specify the financial arrangement. The matrix system in effect records and monitors the overall commitment

	Sub-question	Evidence	Our Conclusion
		<p>required and discussing matters relating to the organisation's financial position.</p> <p>Financial information has been provided to both Commissioning and Contracts Officers regarding the financial status of organisations which, if required, has resulted in further engagement with Finance Services to ensure financial governance requirements have been achieved.</p>	<p>to ALEOs and other external organisations. This could be improved by outlining key financial performance indicators, and therefore the level of risk associated with each body.</p> <p>As a result of the external report and subsequent publicity received regarding Riverside Inverclyde, the Council has a heightened awareness of the reputational risk involved, and a stronger working partnership has been implemented to ensure quality of output.</p>
4	<p>How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?</p>	<p>The Council consider their approach to governance of external organisations to be working well. Actions have been taken to ensure that the governance arrangements approved by the Policy and Resources Committee are fully implemented. The scoring matrix model has been reviewed and simplified in order to provide greater transparency and understanding.</p> <p>Riverside Inverclyde required further scrutiny due to the level of investment and public interest, and a perception that targets were not being delivered. Following an external review, leadership changes were made at the ALEO, with Inverclyde Council's Corporate Director for Regeneration and Environment taking on the role of Interim Chief Executive and, following a report to the Board, key changes were implemented, including:</p> <ul style="list-style-type: none"> ■ Review of Riverside Inverclyde board composition 	<p>Basic and Better Practice:</p> <p>Monitoring reports provide timely and good-quality information about the ALEO's performance in delivering services and impact.</p> <p>The Council scrutinises monitoring reports and follows up where performance does not meet agreed standards.</p> <p>Staff of the Council responsible for monitoring the ALEO are clear about</p>

	Sub-question	Evidence	Our Conclusion
		<ul style="list-style-type: none"> ■ The development of a three-year Inverclyde regeneration operating plan created jointly by Riverside Inverclyde and Inverclyde Council ■ Staff working more closely between Riverside Inverclyde and the Council's economic development service ■ The management structure of Riverside Inverclyde would be reviewed, and ■ A common monitoring and review process would be implemented. 	<p>their role and are supported in it; those involved in monitoring financial performance are suitably qualified.</p>
5	<p>Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?</p>	<p>Support and guidance for roles is provided through a comprehensive members training programme. This has included a specific training session with Grant Thornton on partnership working to elected members.</p> <p>The Inverclyde Council Governance Group also provided guidance on the different roles and responsibilities of Members and Officers in 2011.</p>	<p>Basic and Better practice:</p> <p>Training and support is provided to council representatives so they are clear about their responsibilities to the Council and the ALEO.</p> <p>The Council has a register of interests which records potential conflicts of interest that may arise from member or senior officer involvement in the ALEO.</p> <p>Members and senior officials are effective in performing their role as board members.</p>

Appendix 3: The Council's Governance Scoring Matrix for Externally Funded Organisations

<u>Annual Payment to the Organisation (Ex-VAT)</u>	<u>Points</u>
Payment over £250k	6
Payment £50k to £250k	4
Payment £20k to £49,999	2
Payment £19,999 and below	0
<u>Proportion of turnover funded by Council</u>	<u>Points</u>
51% to 100%	8
26% to 50%	6
10% to 25%	4
Below 10%	2
<u>Nature of Payment to Organisation</u>	<u>Points</u>
Grant-No SLA	8
Grant-With SLA	6
Commissioned-No Tender	6
Tendered	4
<u>Council Representation at Meetings</u>	<u>Points</u>
No Council Presence	6
Member on Board	4
Officers attendance allowed	2

Appendix 4: Governance Oversight Requirements

Points Total	Minimum Governance Requirements
20+	<ol style="list-style-type: none"> 1. Annual Accounts received by Service and reviewed by Finance 2. Briefing prepared where appropriate for Council Board Member in advance of any Board Meetings 3. Post Board meeting briefing notes prepared by attendee for Corporate Director, Head of Service, Finance and Procurement 4. Half-yearly documented Governance meetings with organisations 5. Annual Committee report covering performance and quality issues
16-19	<ol style="list-style-type: none"> 1. As above 2. Optional 3. Optional 4. Annual documented Governance meetings 5. As above
0-15	No action