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**East Dunbartonshire Council**

[www.eastdunbarton.gov.uk](http://www.eastdunbarton.gov.uk)

## **FOLLOWING THE PUBLIC POUND**

### **LOCAL GUIDANCE NOTE**

**November 2011**

## **INTRODUCTION**

East Dunbartonshire Council has funding agreements in place with Arms-Length and External organisations (ALEO's) for a range of purposes which relate to Council services and the achievement of corporate objectives. To ensure that public funds are used properly, to maintain accountability, and to ensure that Best Value is secured, it must be possible to trace the funds from the point at which they leave the Council to the point at which they are ultimately spent by the receiving organisations. In other words, it is important to be able to "Follow the Public Pound" across organisational boundaries.

## **SCOPE OF "FOLLOWING THE PUBLIC POUND"**

"Following the Public Pound" principles do not apply to conventional contracts which involve Councils purchasing goods or services. Nor do they apply to funding of statutory public bodies such as police and fire joint boards, or where Councils administer funds on behalf of other agencies, such as in distributing locally, financial assistance provided by the Scottish Executive.

In practice, Council support for ALEO's ranges from relatively small grants for voluntary organisations and small community organisations, to payments to trusts set up by Councils to manage particular functions. Whatever the nature of the relationship, there are responsibilities and requirements for both parties.

## **ACCOUNTS COMMISSION/COSLA GUIDANCE**

In response to concerns about Councils' increasing use of ALEO's and the need to maintain control and accountability over public funds, the Accounts Commission published the "Code of Guidance on Funding External Bodies and Following the Public Pound" jointly with COSLA's Operational Guidance. A copy of this is attached as Appendix A to this document.

In addition in 2011 the Accounts Commission published a report entitled *Arm's-Length External Organisations (ALEOs): are you getting it right? Which*, highlights good practice in the way ALEOs are set up and managed, such as arrangements for performance monitoring. It includes a checklist and key points for action, intended for use by councillors and officers. This is attached as Appendix B and includes a checklist.

The guidance is based on 6 principles of good practice which are as follows:

- **Purpose** – the Council is clear about its reasons for transferring funds to the ALEO;
- **Financial Regime** – the Council has a clear and robust financial management regime in place;
- **Monitoring** – the Council has robust arrangements for monitoring its relationship with an ALEO;

- **Representation** – the council is clear about the purpose of any officer or member representation on ALEO's, and representatives discharge their responsibilities with due regard to the objectives of the Council and recognising the importance of avoiding conflict of interest;
- **Limitations** – in entering into a substantial funding commitment with an ALEO, the Council sets a timetable for the achievement of its objectives;
- **Accountability** – the Council makes arrangements for suitable access by external audit.

The guidance recognises that Councils will wish to have their own rules setting out procedures appropriate to their local circumstances but advises that those rules should be based on the Code of Guidance.

## **PURPOSE & SCOPE OF LOCAL FOLLOWING THE PUBLIC POUND GUIDANCE**

The purpose of this document is to provide a general guidance note which sets out a series of requirements for Council services when funding is to be given to an ALEO. Services should determine their own detailed procedures, which suit their particular circumstances but they must be able to demonstrate that they have complied with the requirements of this guidance note and in turn the Code of Guidance itself.

The Code of Guidance states that it should apply to “any substantial funding relationships entered into by Councils and to existing substantial funding relationships at the earliest possible review date.” For the purposes of the local guidance, substantial will be taken to mean in excess of £10,000. However it is also recommended that appropriate arrangements are put in place to comply with the Code where a grouping of similar grants exceeds this value. For example, although the majority of grants to community organisations are small, in total they represent a substantial financial commitment by the Council.

For ease of reference to the Code of Guidance, this local guidance note has been structured in line with the six principles of good practice.

### **Principle 1 – PURPOSE**

When agreeing to transfer funds to an ALEO, the Council must be clear about its reasons for doing so and these should be in accordance with the Council's overall objectives. There needs to be a very clear statement which sets out what the funding will be used for and how this relates to the stated objectives of the Council. In order to demonstrate this, reference should be made to documents such as the Community Plan, Corporate Plan and Service Plans. The statement also needs to be definitive in terms of targets and timescales.

### **Principle 2 – FINANCIAL REGIME**

A detailed checklist is available in the COSLA Operational Guidance and use of this is recommended. Further guidance can also be obtained from Finance & ICT. In

general the most important aspects which must be considered prior to approving funding are:

- Financial assessment of the organisation to demonstrate the funding need, with particular reference to levels of reserves, and financial stability to ensure ultimate delivery of the purpose for which the funding is being given;
- The full value of the financial commitment by the Council, referring also to timescales;
- The nature of the financial relationship, e.g. loan, grant, shareholding;
- Criteria for making (and receiving) payments;
- Details and value of any transfer of assets and the destination of those assets;
- Accounting and reporting procedures to be adopted, including confirmation of a robust system of internal control and external audit arrangements;
- Criteria and arrangements for terminating the funding.

A risk assessment must be carried out. A template with guidance on this is contained in Appendix C. Further advice is available from the Audit & Risk Manager.

Statutory Accounting guidelines stipulate that the Council must account for certain ALEO relationships within its Group Accounts, the determining factor being the level of interest and control which the Council has within the relationship. Therefore, for all new ALEO relationships, please contact the Corporate Finance Manager to discuss the nature of the relationship in more detail, to establish whether the accounts of the ALEO will require inclusion within the Council's Group Accounts.

### **Principle 3 – MONITORING**

The Council must set out any requirements which it has of ALEO's and how the relationship will be monitored to ensure these requirements are being met. This is best served by the existence of a written agreement. The written agreement may take the form of a "Conditions of Grant" document where the funding relates to a specified grant or donation, or a more complex document where the ALEO has a more integral relationship with the Council. It is for services to determine what type of written agreement is appropriate. Appendix D contains a list of issues which should be considered for inclusion within the written agreement.

Arrangements should be made to submit regular monitoring reports to the appropriate Committee or designated officer in accordance with the Scheme of Delegation.

For each ALEO, a link support officer should be identified, with responsibility for overseeing adherence to the written agreement and monitoring arrangements.

### **Principle 4 – REPRESENTATION**

The Council must consider carefully the question of representation on the boards of ALEO's which are subject to its control and bodies which are not subject to its control. It is therefore essential to ensure that officers and Members who are selected to represent the Council meet the criteria set out in Appendix E. Further advice can be obtained from the Head of Legal and Administration.

Once appointed it is essential that officers and Members and members are properly informed as to their legal, financial and insurance requirements, with clarity as to roles, conflicts of interests, additional obligations and potential liability associated with the representation. The Head of Legal and Democratic Services maintains a register of interests for officers and Members and must be notified of all appointments or changes in appointment as they arise.

### **Liability Insurance Cover**

The Council provides indemnity in the following limited circumstances:

- Where the individual acts solely on behalf of the Council, within the terms of reference laid down by the Council and solely in pursuance of the Council's statutory powers;
- Where an individual acts solely in an advisory capacity in connection with the local authority's functions;
- Where the individual occupies an observational role on the board or committee of an outside organisation, representing the Council's interests;
- Where the individual acts on behalf of a joint committee established by two or more local authorities.

Where the individual acts in a decision making capacity or in any respects outside the four categories specified above, no Council insurance cover would be in place and the ALEO has the responsibility for ensuring appropriate insurance. Accordingly, those officers and Members who are appointed to outside bodies should make sure that appropriate insurance cover is in place and should ask to see the policy documents. Further guidance on this issue can be obtained from the Audit & Risk Manager.

### **Principle 5 – LIMITATIONS**

This principle should be satisfied by having a suitable written agreement in place, as set out earlier. The agreement must address limitations in relation to timescales, funding, interest and representation, and arrangements for review and termination.

### **Principle 6 – ACCOUNTABILITY**

This principle is basically to ensure that the Council's auditors can access the key records of the ALEO, are able to seek explanations from representatives of the ALEO, and have access to the ALEO's auditors. These arrangements should therefore be included within the written agreement referred to earlier.

### **COMPLIANCE WITH CODE OF GUIDANCE**

This is a local guidance to services but ultimately the Council must comply with the Code of Guidance on Funding External Bodies and Following the Public Pound. The Head of Finance & ICT is required to ensure that appropriate arrangements are in place to support compliance and this is therefore included within the Financial Regulations of the Council. Failure to comply can result in disciplinary action.

How councils work:  
an improvement series for councillors and officers

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# Arm's-length external organisations (ALEOs): are you getting it right?



Prepared for the Accounts Commission  
June 2011



# The Accounts Commission

The Accounts Commission is a statutory, independent body which, through the audit process, requires local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has four main responsibilities:

- securing the external audit, including the audit of Best Value and Community Planning
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- carrying out national performance studies to improve economy, efficiency and effectiveness in local government
- issuing an annual direction to local authorities which sets out the range of performance information they are required to publish.

The Commission secures the audit of 32 councils and 45 joint boards and committees (including police and fire and rescue services).

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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## About our 'how councils work' series

The Accounts Commission seeks to support improvement in best value and resource management, recognising these as two key components vital to the successful delivery of council services.

The purpose of the 'how councils work' series of reports is to stimulate change and improve performance. We select topics based on the recurring themes and issues from our Best Value audit work, the work of local auditors and our annual overview report. We draw mainly on our existing audit work but supplement it with new audit work and other information.

This is the second report in the series. The first report examined roles, responsibilities and working relationships of elected members and council officers in achieving best value.



## What have auditors found?

These boxes appear throughout this report and represent case studies from individual councils. They have been drawn from Audit Scotland audit reports. They are not key findings for all councils.



# Introduction



ALEOs are arm's-length external organisations that can be used by councils to deliver services.



**1.** Increasing budget pressures and service demands present risks and challenges to councils and the services they provide. This requires councils and councillors to review their services and consider options that may better meet the needs of service users and citizens, and offer improved value for money.

**2.** One option may be to set up and fund an arm's-length external organisation (ALEO). Currently, councils use ALEOs to deliver a wide range of activities such as leisure services, economic development and property maintenance.

**3.** ALEOs may offer an alternative to more traditional 'in-house' or contract-based service delivery and usually take the form of companies or trusts. They are 'arm's-length' because the council retains a degree of control or influence, usually through a funding agreement, and 'external' because they have a separate identity to the council.

**4.** ALEOs by their nature are one step removed from council control and, as a result, governance and financial arrangements can be complex. There is a risk service users and citizens have less input and influence over how services are provided. There is also the potential for conflicts between the interests of the council and the ALEO.

**5.** ALEOs are now an established part of local government in Scotland and play an increasing role in service delivery. In the past decade, for example, the number of ALEOs set up to deliver leisure services has almost doubled.

**6.** The main drivers for using ALEOs are to reduce costs or to improve services. ALEOs may qualify for business rates relief, attract grants or may be able to trade to generate income. However, it is not just about money. ALEOs may offer

different and better ways of providing services and can make services more accessible. It is important that councils and councillors are clear about the anticipated benefits from using an ALEO to deliver services.

**7.** 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. In other words, the council remains accountable for the funds used to deliver public services, regardless of the means by which the service is delivered. Consequently, it is 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.

**8.** Strong governance requires clear roles and responsibilities, both for those at the council responsible for monitoring the ALEO and for those asked to be a representative on the board of the ALEO. Representation in particular requires careful consideration. Councillors and officers serving on ALEO boards face challenges in finding an appropriate balance between their responsibilities to the council and to the ALEO.

**9.** Pressures on budgets mean that councils are looking at alternative ways of delivering services. This may lead to further and more innovative use of ALEOs and, for that matter, decisions to withdraw funding from existing ALEOs and to bring services back into council control. At the same time, ALEOs themselves face a challenging financial and operating environment. Councils need good information so they have early warning of difficulties and are ready to deal with any financial and service risks that may arise.

**10.** To date, our audit work has not highlighted widespread problems. But it has highlighted concerns over the management of ALEOs in specific cases, including situations where poor governance has resulted in risks to public money, service performance and the reputation of councils. There is also increasing public interest in ALEOs, particularly the impact on services and council finances where ALEOs fail to deliver. There has also been interest in staff recruitment practices in ALEOs and in payments to councillors who have taken up roles on the boards of ALEOs. These factors, along with the quickly changing local government context, confirm that the time is right for this report.

### About our report

**11.** This is the second report in our 'how councils work' series. It is aimed at councils that are considering setting up ALEOs to deliver services, as well as those with existing ALEOs. It is designed to promote and encourage good practice in the way ALEOs are set up and operated. Our report will be of particular interest to officers and councillors who are responsible for monitoring ALEO performance or who serve on ALEO boards.

**12.** Our report sets out good practice in the way councils deliver services through ALEOs. It focuses on how councils establish ALEOs and maintain governance and accountability for both finance and performance. It highlights areas that work well and where improvement may be required.

**13.** Our report draws on our audit work across all 32 councils, including our Best Value audit work and reports that have highlighted particular concerns or issues arising from the use of ALEOs. We have reviewed council documentation and have drawn on survey work conducted in councils as part of recent performance audits.

**14.** We hope this report will stimulate discussion among councillors and officers that will lead to change and improvement. The report aims to support all councils by signposting readers to sources of information and guidance, and by providing examples from our audit work. We have also included checklists and other self-assessment tools that councillors and officers may find helpful.

# Part 1. Setting the scene



ALEOs are an established part of local government. The principles of openness, integrity and accountability apply equally to ALEOs as to council-run services.



## Key messages

- Councils are increasingly using ALEOs as an alternative way of delivering services at a time of significant budget reductions.
- Where appropriate, 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.

## ALEOs are now an established part of local government

**15.** Councils decide the best way to deliver services to meet the needs of the communities they serve. Most commonly, councils provide services 'in-house' through their own departments and employees or through contracts with other public, private and third sector or voluntary suppliers. Councils can also create separate organisations to deliver services. The term, arm's-length external organisations, or ALEOs, is often used to describe such organisations.

**16.** ALEOs deliver council services, but do not operate within traditional council structures. They are 'external' because they have a separate identity to the council, and are 'arm's-length' because the council retains some control or influence, usually through a funding agreement ([Exhibit 1](#)).

**17.** Under an arm's-length arrangement, the delivery of a service or activity becomes the responsibility of a separate organisation. As such, the council loses direct control over the day-to-day management of the service. However, it remains

accountable for how public money is spent and the quality of services delivered. This association also means that there are ongoing financial and reputational risks for the council if things go wrong.

**18.** Public funds and assets may also move from the direct control of the council to the control of the ALEO. This can range from relatively small sums or, where an ALEO manages an entire service, large-scale payments and asset transfers. Council support for ALEOs ranges from grants to third sector organisations to payments to trusts set up by councils to manage all of their leisure and cultural facilities, for example. The ALEO may be a one-off to deliver a particular project or may be part of a large group involving holding companies and complex structures.

**19.** We have not sought to quantify the current number of ALEOs and what they spend because of the time and cost to councils and to us. However, a brief review of councils' accounts shows that the majority of the 32 Scottish councils operate ALEOs and that there are currently

around 130 major ALEOs in total. Councils typically operate between one and four ALEOs, although three councils operate 14 or more ALEOs. These figures do not include the many smaller organisations that receive some level of council funding which are otherwise independent of the council.

**20.** Councils consider alternative ways of providing services and ALEOs continue to feature strongly in the range of options considered. Our audit work indicates that the numbers and variety of ALEO arrangements has continued to grow. For example, our 2010 performance audit report, *Physical recreation services in local government*,<sup>1</sup> found that the number of ALEOs set up to provide leisure services has almost doubled in the last decade ([Exhibit 2](#)).

## ALEOs can offer financial and other benefits

**21.** ALEOs can offer financial and operational advantages. Under current arrangements, charities, for example, can qualify for business rates relief. ALEOs can also have greater freedoms to trade, for example, by offering

## Exhibit 1

### What are ALEOs and what do they do?

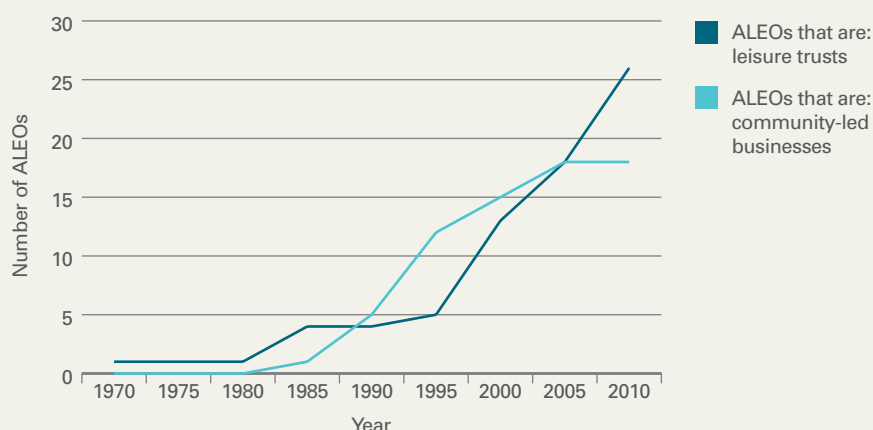
We define arm's-length external organisations as companies, trusts and other bodies that are separate from the local authority but are subject to local authority control or influence. Control or influence can be through the council having representation on the board of the organisation, and/or through the council being a main funder or shareholder of the organisation.

ALEOs can take many forms including companies limited by guarantee or shares, community enterprises, such as industrial and provident societies, trusts and Scottish Charitable Incorporated Organisations. Examples of the services they deliver include leisure, transportation, property development, and more recently, care services. ALEOs are often set up as non-profit making organisations such as charities to promote public benefit in areas such as health, education, recreation and equal opportunities.

Source: Audit Scotland

## Exhibit 2

### Growth in the use of leisure ALEOs



Source: Audit Scotland

services to other public and private sector organisations and this can help them to attract grants and private sector investment. ALEOs can have more flexibility in deciding employee terms and conditions to meet their business needs. The financial and tax implications of ALEOs are complex and specialist advice is essential. Councils also have to be aware that the tax position may change if central government policy changes.

**22.** Councils have used ALEOs to deliver more routine activities, as well as more innovative projects. Examples include transport services, energy schemes, and property development companies. These can offer new sources of income but there can be related risks. There have been cases where councils have had to provide unplanned financial support to ALEOs and, in more extreme cases, have had to wind-up ALEOs and take responsibility for their services and financial commitments.

**23.** Councils should be clear about their aims before choosing the most suitable option for delivery. All delivery models have advantages and

disadvantages and councils should choose the optimum arrangement to meet their needs. Councils should be risk aware, but not risk averse; this requires them to be clear about the risks involved and to have a coherent strategy for managing them.

**24.** Exhibit 3 (overleaf) provides examples of different delivery approaches including the potential advantages and disadvantages commonly associated with them. In practice, combinations of these options are often used. For example, ALEOs can have trading companies as subsidiaries, or can contract areas of activity to private sector providers. Partnership working can also be a feature of all these delivery approaches.

**25.** In summary, ALEOs can bring financial and operational advantages. However, it is not always clear whether these are realised in practice or if they are sustainable over time. Councils need to review whether their ALEOs have achieved their intended benefits such as cash savings or improved customer satisfaction and, overall, assess whether they can

demonstrate value from the money and other resources provided to the ALEO.

### The 'following the public pound' principles provide the basis for sound governance

**26.** ALEOs are not new and are an established part of local government. In 1996, the Accounts Commission and the Convention of Scottish Local Authorities (COSLA) published a Code of Guidance<sup>2</sup> in response to growing concerns about the implications for control and accountability arising from the use of ALEOs. The focus was on self-regulation and based on the premise that, to ensure public money is used properly, it must be possible to 'follow the public pound' across organisational boundaries.

**27.** The Code was published some time ago and since then there have been important developments in governance and professional practice – we refer to this elsewhere in this report. There have also been significant changes in local government legislation, including councils' responsibilities for Best Value and Community Planning.<sup>3</sup> However, the six principles in the Code are as relevant today as they were when the Code was first published (Exhibit 4, overleaf).

**28.** The Following the Public Pound Code aims to ensure that the principles of openness, integrity and accountability apply equally to funds or other resources that are transferred to ALEOs. The Code received statutory backing in 2005<sup>4</sup> and, as a result, councils are required to comply with the Code when they establish and deal with ALEOs.

**29.** The Code continues to provide the foundation for how councils should manage their relationships with ALEOs. Our *Following the Public*

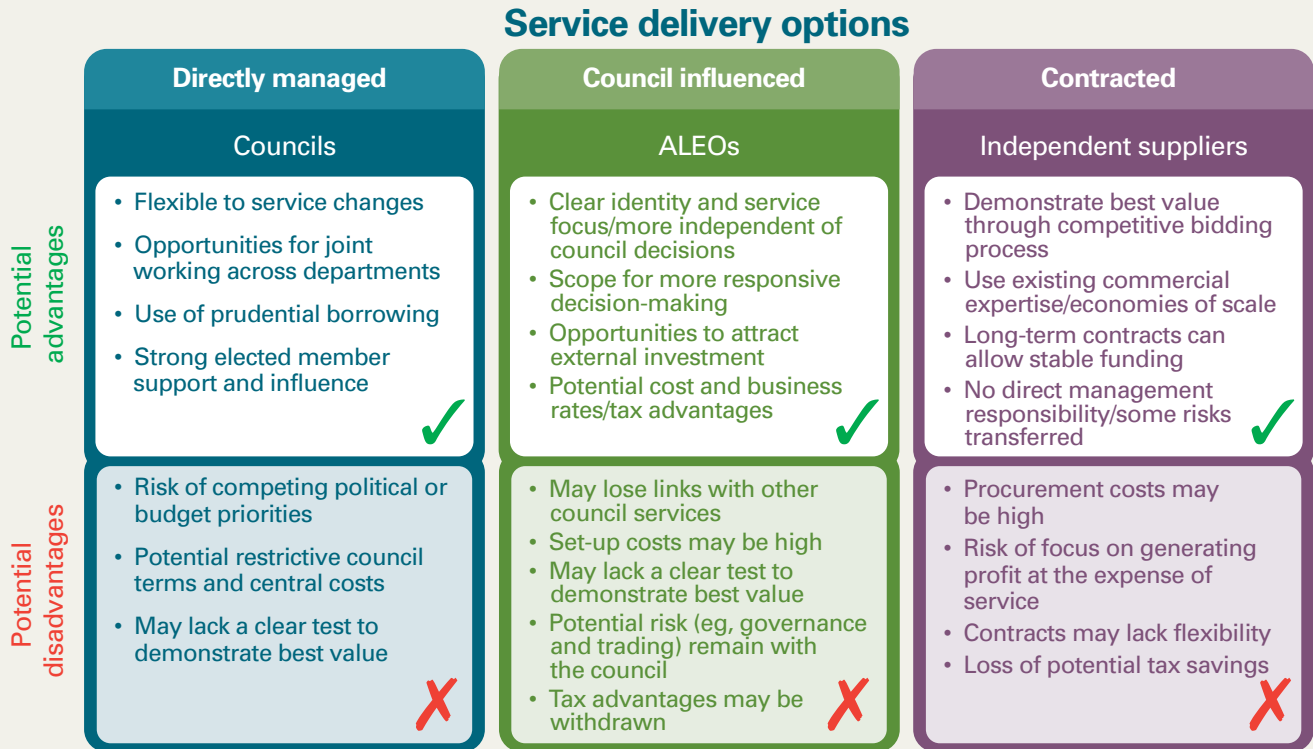
<sup>2</sup> Code of Guidance on Funding External Bodies and Following the Public Pound, Accounts Commission/Convention of Scottish Local Authorities, 1996.

<sup>3</sup> The Local Government in Scotland Act 2003.

<sup>4</sup> Direction by Scottish ministers under section 51 of the Local Government in Scotland Act 2003, June 2005.

### Exhibit 3

Overview of delivery options and their potential advantages/disadvantages



Source: Audit Scotland

*Pound* report of 2005<sup>5</sup> found that no council fully complied with the Code. The report recommendations included councils putting in place better monitoring of their ALEOs that is proportionate to the risks involved.

**30.** Our report explores what councils need to do to get this right from the start. We then go on to consider the steps councils need to take on an ongoing basis to keep things right, ie to ensure that ALEOs remain the best option and that governance remains fit for purpose. Keeping it right applies to new ALEOs and those where councils have an ongoing involvement.

### Exhibit 4

#### Following the public pound principles

The principles of openness, integrity and accountability apply to councils in their decisions on spending public money. These apply equally to funds or other resources which are transferred to ALEOs. The Code sets out six principles that require councils to:

1. have a clear **purpose** in funding an ALEO
2. set out a suitable **financial regime**
3. **monitor** the ALEO's financial and service performance
4. carefully consider **representation** on the ALEO board
5. establish **limits** to involvement in the ALEO
6. maintain audit access to support **accountability**.

Source: Audit Scotland



# Part 2. Getting it right from the start



Councils must have clear reasons for using ALEOs. They must understand the impact on people who use services. Clear roles and responsibilities and effective monitoring are essential.





### Key messages

- 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.

### Decisions to use ALEOs should be based on an options appraisal and sound business case

**31.** Best Value requires councils to make the best use of the resources available to them. This includes identifying the best way of delivering services. It follows that councils should be able to demonstrate the benefits of any decision to create an ALEO, or to continue service provision through an existing ALEO.

**32.** Councils need to assess the options that best meet their objectives. This requires an understanding of the options available including in-house provision, partnership and contracting options, as well as the option to use an ALEO if appropriate. It also requires rigorous analysis and understanding of the pros and cons of each option.

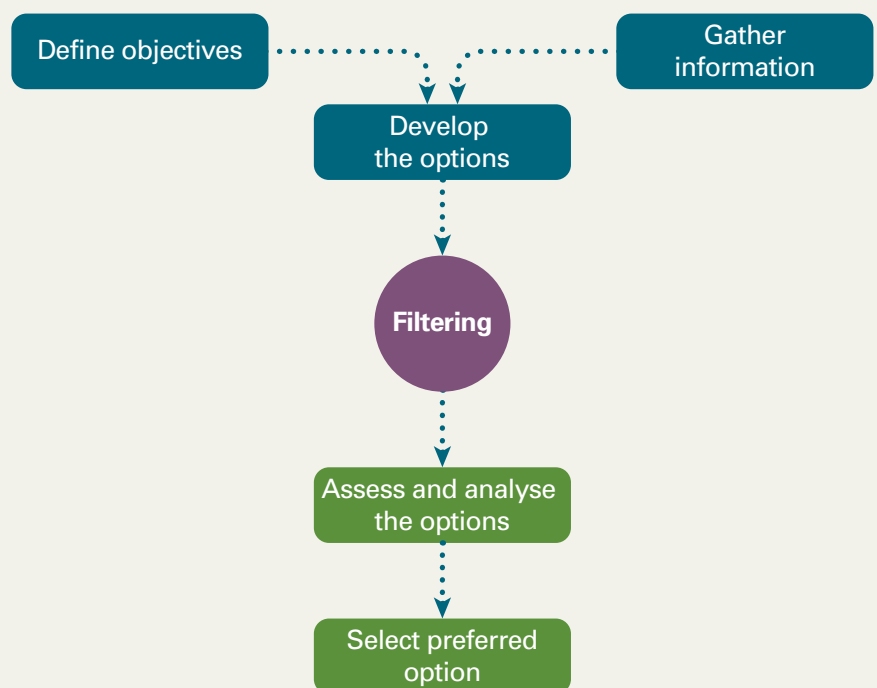
**33.** Any decision to set up an ALEO should flow from an options appraisal. However, our Best Value audit work has shown that many councils do not have a well-developed approach to options appraisal.

**34.** There is a considerable amount of guidance available on options appraisal and this report does not attempt to cover the process in detail. [Exhibit 5](#) sets out the basic stages of a typical options appraisal; these principles apply equally when considering new ways of service delivery that may include delivery through an ALEO.

**35.** Options appraisal should consider the risks involved, the financial implications and governance arrangements. Having good-quality information on costs that allows valid comparisons between the options is essential.

### Exhibit 5

#### Basic stages of an options appraisal



Source: *Capital Planning and Option Appraisal – A Best Practice Guide for Councils*, CIPFA Local Government Directors of Finance, October 2006



### What does it look like in practice?

- Being clear what your aims and objectives are.
- Knowing the market and identifying all the options.
- Involving stakeholders such as service users and the local community.
- Being clear about the risks associated with each option, both long and short term.
- Being objective and impartial when assessing the options.

**36.** Options appraisal also requires good information about what service users and communities need and the potential impact on them if there is a change in how services are delivered. The ability of citizens and service users to influence the way councils provide services flows from good community engagement and is a fundamental principle of Best Value. This is particularly important in the case of core services such as social care on which vulnerable people are dependent.

**37.** Councils considering the use of ALEOs should assess the impact of ALEOs on service users and citizens in general. This includes how community views are represented, including the role of councillors.

**38.** Councillors need to oversee options appraisals that involve potential major shifts in how services are provided. They have a key role, for example, in agreeing the broad objectives of the options appraisal, in the appraisal process itself or in scrutinising the process and emerging proposals.

**39.** Rigorous options appraisal requires expertise in legal, business and operational matters and the process can be expensive and time-consuming. Councils need to consider whether they have sufficient expertise in-house and may need specialist consultancy support, eg in relation to charity law and tax-related matters, such as VAT. Councils should also learn from their own and other councils' experience of using ALEOs and factor that in to the options appraisal.

**40.** Exhibit 6 provides examples of the governance and operational questions that councils need to ask when considering service delivery options and preparing a detailed business case for their preferred option.

## Exhibit 6

Examples of governance and operational issues to consider in options appraisal

Legal and governance	Business and operational
Is there a clear statutory basis for undertaking the activity?	Does the activity fit in with the council's objectives?
How will governance work – including the means of council control and representation?	What are the service implications, eg quality, access, marketability, pricing?
How will the ALEO be accountable to the community and the service user?	How will services users be involved and customer satisfaction measured?
How will the council demonstrate that the ALEO offers best value and assure that it accounts for all public money provided to the ALEO?	What are the financial implications, eg taxation, treatment of profits, ability to attract investment and residual liabilities for the council?
What are the implications of EU and other procurement law, for example on the award of the contract or service delivery agreement?	What is the payback time, allowing for initial set-up costs?
How will obligations including equal opportunities, best value and sustainable development, data protection and freedom of information be observed?	Are there benefits in sharing services with other councils or partners?
How will the delivery method be reviewed, and what is the basis for withholding funds or terminating the arrangement?	What will be the impact on demand, including the council's ability to subsidise any increase?
How will council employees and assets be treated including transfer arrangements and pensions?	How will flexibility or changes to delivery be allowed for?
What are the statutory financial reporting and auditing requirements?	What are the operational risks, including future changes in legislation or the marketplace?
	What management information will be shared by the ALEO to demonstrate financial control and best value?

Source: Audit Scotland



### Want to know more?

- *Healthy Competition – How councils can use competition and contestability to improve services* (Audit Commission)  
<http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/healthycompetition.aspx>
- *The Green Book Appraisal and Evaluation in Central Government* (HM Treasury)  
[http://www.hm-treasury.gov.uk/d/green\\_book\\_complete.pdf](http://www.hm-treasury.gov.uk/d/green_book_complete.pdf)
- *Improving strategic commissioning in the culture and sport sector: Guidance paper 2 Options appraisal, the business case and procurement* (Local Government Improvement and Development – formerly IDeA)  
<http://www.idea.gov.uk/idk/aio/19049726>
- *Making Choices: Volume 2: A Practice Guide to Best Value, Procurement and Competitiveness* (Scottish Government)  
<http://www.scotland.gov.uk/Resource/Doc/158566/0042999.pdf>

- How will we safeguard our interests such as assets and other resources made available to the ALEO?
- How will we know how well the ALEO is doing, through our scrutiny of both service and financial performance?

**43.** While the use of arm's-length arrangements can offer innovative ways of delivering services, strong governance arrangements need to be in place to ensure that ALEOs contribute effectively to the delivery of the council's corporate objectives and priorities. It is vital to establish sound governance from the outset. We have seen councils struggle to exert good and effective governance well after the ALEO was set up and, as a result, services and public funds were exposed to risk. This is particularly important where ALEOs are set up to deliver fast-moving, innovative projects.

**44.** The fact that an ALEO may be a separate organisation from the council is unlikely to be at the forefront of service users' and taxpayers' minds. One consequence of using more complex delivery structures involving ALEOs is that the public may be less clear about who is responsible for services and, for example, who they should complain to if they are unhappy with the services they receive. Maintaining transparency is a key objective in good governance.

### Conditions attached to the use of public funds should be clear

**45.** The funding relationship between councils and ALEOs is typically set out in a service or management agreement. These should set out what is expected from the arrangement, specifying the money and other resources the council will provide and what it expects from the ALEO in return. The agreement should include criteria for the council withholding its funding, or for terminating its relationship with the ALEO.

## Exhibit 7

### What do we mean by governance?

Governance is about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, and cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and, where appropriate, lead their communities.

Source: *Delivering Good Governance in Local Government*, SOLACE/CIPFA, 2007

### Sound governance is needed from the outset

**41.** Governance is about clear direction and control and is central to the success of all organisations. It is important that councils meet good governance standards, for example, by demonstrating strong leadership, effective community engagement and robust scrutiny (**Exhibit 7**).

**42.** Delivering projects or services through ALEOs is likely to make governance more complex. However, the same principles of good governance apply and councils will be best placed to safeguard their interests where they ask fundamental

questions and act on them at the outset. Key questions which councils and councillors need to ask themselves include:

- Are we clear about our overall expectations of the ALEO?
- How well do we understand the financial commitment and risks flowing from the decision to set up and support the ALEO?
- How do we ensure that governance arrangements in the council and the ALEO are sound and that those with an active role receive adequate training and advice?

**46.** The written agreement should also cover the accounting and audit requirements. Accounting must follow the legal requirements for company or charity financial reporting, and the agreement should state the arrangements for audit access to records held by the ALEO. Many ALEOs include an audit committee as part of their internal governance structure. These should be chaired by a non-executive member and ensure that the board is aware of, and acts on, risks, and other financial and performance information.


**47.** As part of the annual audit, external auditors appointed by the Accounts Commission review compliance with accounting standards and the Commission/COSLA Code. The Commission cannot appoint auditors to ALEOs but the auditors the Commission appoints to councils have the right of access to information for the purpose of their audit.

**48.** Beyond finance, there is also scope for the agreement to cover other aspects, to ensure that business practices and standards councils expect in the direct delivery of services are observed by ALEOs in spending public money ([Exhibit 8](#)).

**49.** ALEOs are seen as an extension of the council and there are potential reputational risks to the council from its association with the ALEO. Consequently, where business practices in the ALEO fall below the standards expected from the council itself, or where there are significant governance failings, this has the potential to affect stakeholders' views about the council as a whole.

### Councils should set a clear policy for any payments to board members

**50.** We consider the question of representation on boards in the following section. However, in attaching conditions to funding at the outset, councils should also set a clear policy and rationale for any payments to board members. The payment of councillors as board members can be a contentious issue, and there have



### What have auditors found?

Two examples of what the auditors found in individual councils:

- The council did not establish any clear limits for its involvement in the project and did not appear to have developed any contingency plans to be used in the event of a significant change in circumstances.
- Corporately, the council did not establish effective governance. As a result, it was not well placed to deal with key issues when they emerged and was not aware of the significance of the company's decision to pursue a high-risk service-delivery option.



### What does it look like in practice?

Auditors have noted good practice where a council put restrictions on the payment of council officers or elected members who are non-executive directors of arm's-length companies or trusts. Its policy states that such duties should generally be regarded as part of their role of office and will not entitle the post holder to additional payment other than appropriate expenses incurred in the course of board business.

## Exhibit 8

### Attaching conditions to the funding arrangements

In agreeing funding arrangements, councils should consider conditions for the ALEO that align with their own legal requirements and policies. As a minimum, they should address:

- equalities
- sustainability
- recruitment and employment practices
- data protection and handling
- freedom of information principles
- standards and behaviour
- arrangements for engaging with citizens and service users.

Source: Audit Scotland

been examples where ALEOs have faced criticism for amounts paid to councillors to attend board meetings.

**51.** There is potential conflict of interest, or the appearance of a potential conflict, if councillors receive payments directly from ALEOs. In

such circumstances it can be difficult to demonstrate the principles of good governance.

**52.** Whether councillors receive payments from the council as a result of their role on ALEO boards is a policy matter for councils to



## What have auditors found?

An example of what the auditors found in a council:

- There are no criteria set for the selection of individuals to sit on company boards. It is not clear how the council, on an ongoing basis, decides whether this representation fulfils the council's objectives.

decide. However, in terms of good governance, the determining factors should be the substance of the councillors' role rather than the fact that the position happens to be on an ALEO board as opposed to, for example, a council committee.

**53.** We note that a similar point was made by the Scottish Local Authorities Remuneration Committee (SLARC), an independent advisory body responsible for making recommendations to Scottish Ministers on the salary and allowances paid to councillors. As part of its 2010 review<sup>6</sup> SLARC considered the appointment of elected members to the boards of companies or to organisations established, owned or funded by local authorities. SLARC noted that additional payments from arm's-length organisations to councillors for sitting on a board undermines the principles of the existing remuneration scheme for councillors. It has set out a number of recommendations including that no additional remuneration other than that provided in the current remuneration scheme should be paid to councillors for serving on such bodies.

### Clarity on roles and responsibilities is vital

#### Representing the council's interests

**54.** It is common practice for councils to nominate councillors or officers for positions on the boards or governing bodies of ALEOs. Councillors or officers as board members can have

an important role in the governance of the ALEO, for example, in overseeing how the ALEO is managed. Where this works well, it can provide important links between the council and the ALEO and can help ensure that the board acts in the interest of the council as major shareholder, for example. It also recognises the importance of the council's community leadership role and provides an opportunity for council representatives to ensure the ALEO is being properly run and that council funds are being used effectively.

**55.** Councils should set clear criteria for the skills and experience required of board members. They should also have a clear and transparent selection process to make appointments to boards.

**56.** Councils need to consider very carefully the question of representation. Having established that they want representation, councils need to assess the advantages and possible risks. They then need to consider the skills, expertise and qualifications required to carry out the representation role effectively. Depending on the services that the ALEO will provide, it may be appropriate for the ALEO board to reflect specific interests. For example, councillors with a background in sport or leisure may be well placed to represent their council on the board of a leisure trust. Specifying criteria will help ensure that the appointment process is transparent and will help support clarity about roles and responsibilities.

**57.** Taking on a direct role in the ALEO brings with it new responsibilities, including legal duties. For example, councillors and officers serving as directors of an ALEO that is constituted as a company assume personal responsibilities under the Companies Acts. They owe a duty to shareholders and creditors of the company and may be personally liable if the company engages in wrongful trading or if any other offence arises in the company. As we say in our report on physical recreation services,<sup>7</sup> the companies' legislation was not framed specifically to the circumstances of ALEOs and councillors, but it still applies.

**58.** Similarly, councillors and officers serving as trustees on charities must observe the legal provisions which apply to charities and trusts. Crucially, officers and councillors need to be aware of the risks and where to get advice if they need it. The Office of the Scottish Charity Regulator (OSCR) *Who's in Charge* guidance<sup>8</sup> sets out the duties of charity trustees including the need for clear responsibilities and behaviours to ensure the charity has the required degree of independence and provides public benefit through its activities.

**59.** Councils must consider representation and take steps before the ALEO is established. Key issues are:

- to ensure the appropriate composition of the board to bring the mix of skills and experience required to govern the organisation
- to set out why the council will be represented on the ALEO board and what is expected of individuals from the council who are asked to sit on the ALEO board
- to make clear how those individuals will be supported in the role.

<sup>6</sup> 2010 Review of Remuneration for Local Authority Councillors, SLARC, March 2011.

<sup>7</sup> Physical recreation services in local government, Audit Scotland, October 2010.

<sup>8</sup> Who's in Charge, The Office of the Scottish Charity Regulator, March 2011.



- to consider how service users and communities will be represented, including the role of councillors

### Managing potential conflicts of interest

**60.** Representation on the boards of ALEOs by its nature introduces the potential for conflict of interest for individuals who have roles in both

the ALEO and the council. Members and officers who act as directors of companies have difficult obligations to balance. For example, councillors have a duty under the Code of Conduct to act in the interests of the council. However, at the same time, as company directors they are required to act in the interests of the company. It is important that potential conflicts

are thought through at the outset, in particular to avoid any situation where conflicts become irreconcilable ([Exhibit 9](#)).

**61.** Some roles may be incompatible or can pose real risk to governance and accountability. For example, a councillor or officer who scrutinises an ALEO on behalf of the council, or makes funding decisions affecting an ALEO, should not be a board member of the ALEO. More generally, the dual roles may mean that individuals have access to council information that may not be appropriate to disclose at ALEO board meetings – and vice versa, in respect of commercially sensitive information that is available as a board member of an ALEO. Councils may avoid this situation by specifying the information they require, as part of the funding agreement established at the start.

**62.** In practice, this heightens the need for councillors to be aware of the potential for conflicts of interest. Where councillors also serve as members of the ALEO they should be clear that they continue to have a responsibility to the council. This goes beyond simply declaring an interest and withdrawing from council discussions about the ALEO; they need to anticipate the nature of the agenda item and likely deliberations and decide what action they should take, seeking advice from officers where appropriate.

### The councillor role

**63.** Councils often nominate councillors to contribute to the work of ALEOs. This can involve councillors taking a position on the board of the ALEO, so it is important that he or she is clear from the start what this different dimension means.

**64.** The first report in our 'how councils work' series<sup>9</sup> explored roles and responsibilities in councils in the widest sense, but also reflected on

## Exhibit 9

### Competing responsibilities

#### The Councillors' Code

Duty – You have a duty to act in the interests of the council as a whole and all the communities serviced by it.

Appointments to partner organisations – If you become a director of a company as a nominee of the council you will assume personal responsibilities under the Companies Acts. It is possible that a conflict of interest may arise for you as between the company and the council. In such cases it is your responsibility to take advice on your responsibilities to the council and to the company. This will include questions on declarations of interest.

Source: *The Councillors' Code of Conduct*, Scottish Government, December 2010

#### Guidance for Charity Trustees (OSCR)

Where a charity trustee is faced with a conflict of interest between the interests of the charity and those of a person or organisation responsible for their appointment as a charity trustee, the interests of the charity must come first. The charity trustee must act in the interests of the charity to which they have been appointed, not in the interest of the person or organisation which appointed them, for example a local authority or another charity.

If in relation to a particular issue the conflict of interest is irreconcilable, then the charity trustee in question must make this known to the other charity trustees, and not take part in any discussion or decision-making on the issue.

Source: *Guidance for Charity Trustees*, OSCR, June 2009

#### The Companies Act

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This applies in particular to the exploitation of any property, information or opportunity.

Source: *The Companies Act 2006*



### What do councillors say?

Councillors serving on the boards of ALEOs gave different views about the role involved, pointing to the need for more clarity:

"My role is to see where the council money is going, what it's used for, and to ensure that policies are followed."

"I'm there to represent the council – to take the line of the council – I'm not there in my own right."

"I am representing the council to make sure that things are done in accordance with council policy and to make sure that the money is spent as it should."

Source: *Roles and working relationships: are you getting it right?*, Audit Scotland, August 2010



### What have auditors found?

Three examples of what the auditors found in individual councils:

- The main concern arising relates to the actions taken by council staff following the resignation of the management committee. While this may have been in good faith and in the interests of maintaining the service which the ALEO was set up to deliver, they effectively assumed management responsibility for the ALEO. This was a wholly inappropriate role for council officers to adopt. It is important that councils and their officers are clear about their respective roles and responsibilities in dealing with any ALEO.
- Officers were not clearly aware of their responsibilities and relevant monitoring procedures. Where specific responsibilities were assigned, including maintaining a watching brief to represent the council's interest, there is little evidence to suggest that these roles were delivered effectively.
- There was a potential for conflict of interest arising from a lack of appropriate separation between the responsibilities of council officers and the advisers to the company. For example, an officer became involved in the financial affairs of the company and was appointed company treasurer, resulting in conflict of interest and blurring the boundaries between the council's finances and those of the company.

the specific circumstances which apply when councillors and officers are required to become board members of ALEOs.

**65.** As part of that work, we spoke to a sample of councillors from across six councils. Most of those we spoke to who are appointed to an external body said they felt confident in their role, through experience or by drawing on support from council officers and other board members.

**66.** Despite this confidence, councillors said they were on the board to represent the council and its best interests, which suggests they may not be clear about what the role fully involves, such as the new and additional responsibilities attached to being a trustee or a member of a company board.

**67.** Those who did not feel confident in the role said they were unsure about what is expected of them when they were first appointed. [Part 3](#) of

our report considers the need for ongoing advice and training for council representatives working with ALEOs.

**68.** Elected members have a unique perspective and can draw on their deep understanding of the needs of the communities they serve in their work with ALEOs. This can help ensure that services provided by the ALEO are consistent with the council's overall aims, and align with local need. However, it may be possible to bring these advantages into the ALEO without the legal responsibilities attached to being a director, trustee or member of a board. Councillors could, for example, serve on a subcommittee of the ALEO, in an advisory capacity, or take on the role as an observer or adviser that would not require formal membership of the ALEO. Where councils pursue this option they should ensure that responsibilities are clear and seek advice about any wider implications arising from such a role.

### The officer role

**69.** Statutory officers in councils have specific duties as set out in legislation and discharge their role as part of wider responsibilities in their councils. They have an important, independent role in promoting and enforcing good governance and for making sure that councils comply with legislation. In summary:

- The Head of Paid Service (the chief executive) is responsible for all aspects of the management of the council. Together with councillors, he or she is responsible for promoting good governance.
- The Chief Financial Officer (the director of finance or equivalent) is responsible for the financial affairs of the council.
- The Monitoring Officer (the head of legal services or equivalent) is responsible for advising the

council about the legal position of proposed actions.

**70.** Each of the statutory officers' responsibilities extends to cover their council's governance arrangements for its interests in an ALEO, in setting up the ALEO and monitoring its performance. Guidance on the Chief Financial Officer's role, for example, sets out what is expected of him or her in relation to ALEOs (Exhibit 10).

**71.** Lines of accountability can become less clear where an officer is involved with an ALEO. Where council officers take an executive, or operational role in an ALEO such conflicts can be avoided by using secondments. The officer will then be an employee of the ALEO and responsible solely to the ALEO board. In the specific case where a senior officer is appointed to the board of an ALEO he or she will assume new responsibilities that change the nature of his or her ongoing working relationship with the council's chief executive.

**72.** Council officers are often required as part of their duties in the council to oversee the council's interests in the ALEO or to provide support in other ways. This can help to safeguard the council's interests and to share expertise. However, officers need to be clear about the role and its limitations. In particular, they must avoid becoming too close to the ALEO or finding themselves in a position where their responsibilities to the council are compromised. For example, an officer who oversees the ALEO's finances on the council's behalf should not take on a formal financial management function in an ALEO.

**73.** Liaison involving officers may provide the opportunity for oversight without the need for direct representation on the ALEO's board. Some councils use designated officers to manage and maintain their relationship with ALEOs. As these officers are not board members they can protect the council's interests

**Exhibit 10**  
The role of the chief financial officer in relation to ALEOs

"Consistency of standards and transparency in financial activities are essential. In this context, CIPFA's view is that the statutory role of the chief financial officer does not stop at the boundaries of the local authority but extends into its partnerships, devolved arrangements, joint ventures and companies in which the authority has an interest."

Source: *The role of the chief financial officer in local government*, CIPFA, 2010



### What does it look like in practice?

An example of good practice from an individual council:

- The council has decided that no officer should hold a trustee or directorship position with any of the ALEOs the council engages with. This was based on the potential for conflicts of interest to arise between an officer's responsibilities to the council as an employer and that officer's responsibilities and personal liability when appointed to an outside body. The council saw a continued role for councillors on the boards of ALEOs, but recognised that councillors must be very clear in their responsibilities.



### Want to know more?

- *Code of Guidance on Funding External Bodies and Following the Public Pound* (Audit Scotland)  
[http://www.audit-scotland.gov.uk/docs/local/2003/nr\\_040311\\_following\\_public\\_pound.pdf](http://www.audit-scotland.gov.uk/docs/local/2003/nr_040311_following_public_pound.pdf)
- *Code of Conduct for Councillors* (Audit Scotland)  
<http://www.scotland.gov.uk/Publications/2010/12/10145144/12>
- *Delivering Good Governance in Local Government* (SOLACE/CIPFA)  
[http://www.cipfa.org.uk/panels/corporate\\_governance/good\\_gov\\_briefing.cfm](http://www.cipfa.org.uk/panels/corporate_governance/good_gov_briefing.cfm)
- *Guidance for Charity Trustees* (Office of the Scottish Charity Regulator)  
<http://www.oscr.org.uk/CharityTrusteeDuties.stm>

without any potential conflict of interest. The officers have a monitoring role and attend company or board meetings as observers, keeping up to date on company operations and performance. These link officers should be sufficiently

senior to highlight significant risks and issues to the council and to ensure that appropriate action is taken. However, arrangements such as these do not replace the need for effective performance reporting to the council.




### Performance monitoring should be clear from the start, risk-based and proportionate

**74.** Performance management is the process of managing and improving activities using good management information in areas such as customer satisfaction, risks, and costs. Councils should consider the arrangements for performance monitoring before the ALEO is operational. Our audit work has found scope for improvement in performance management in councils generally. This includes the way councils monitor services delivered through ALEOs.

**75.** Councils should set clear objectives for services delivered through ALEOs and put appropriate monitoring systems in place, including tailored performance indicators. The council should have an overview of how well ALEOs are meeting their objectives, while the ALEOs themselves should also monitor more detailed day-to-day operational issues. Mechanisms should be in place to identify and act on under-performance including trigger points to review the delivery agreement.

**76.** Performance monitoring should be proportionate to the scale of the activity and the risks involved. Our audit work found that councils tended to focus on the financial position of ALEOs, often relying on annual audited accounts. However, these are often available long after a matter of interest to the council has emerged. We have recommended that councils do more to monitor performance, including regular financial reporting, and service outcomes.


**77.** Councils are required under the Accounting Code to produce group accounts, which draw together the council's financial interests in organisations in which it has interests and control. The Code sets out the circumstances when the degree of influence or control requires organisations to be included in the




### What does it look like in practice?

As an example of good practice, one council requires its ALEOs to:

- provide the council with appropriate information and assistance to monitor service performance including risks
- provide quarterly reports on financial and operational performance to council-nominated officers
- provide a twice-yearly performance report to council dealing with Key Performance Indicators (KPIs)
- submit annual performance report to council on financial and operational performance, service satisfaction and board member training
- annually review and agree KPIs and performance measurement framework.

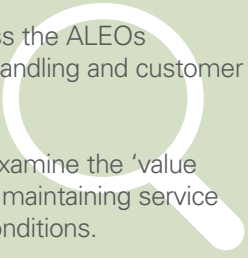




### What have auditors found?

An example of good scrutiny practice in one council:

- The council has an external governance and scrutiny committee that is responsible for scrutinising the performance of the council's ALEOs.
- The committee's scrutiny activity includes performance, risks, financial management, partnership working, contractual compliance and compliance with equalities obligations.
- It also receives reports on themes common across the ALEOs including service interdependencies, complaints handling and customer care, audit reporting, and absence management.
- The committee's ongoing work programme will examine the 'value added' from ALEOs and will review proposals for maintaining service performance and quality in the current financial conditions.



group; these organisations will often include ALEOs. The group accounting process aims to ensure that councils provide a true and fair picture of the extent of their activities. It also provides an opportunity to look across the group at the overall asset and liability position and at how ALEOs feature in the group.

### Risk management

**78.** Service delivery through ALEOs can involve greater risks. This can be due to more complex governance structures, the financial environment in which they operate, or because of the type of service they deliver. It is important that councils are risk aware and have systems in place to monitor and manage risks. This

includes financial, technical, business, and legal risks. Councils must also be aware that where ALEOs run into financial difficulties they may be liable for any losses incurred either as guarantors, or as a result of some other obligation.

**79.** Our work, including Best Value audits, has shown that risk management is generally not well developed in councils. We have recommended that councils regularly review their risk exposure across arm's-length organisations. Councils should be aware of the potential risk to their strategic priorities posed by each individual ALEO.

**80.** Councils' risk registers should cover all activities delivered by ALEOs. Each ALEO will have its own particular risks. These will depend on the type and size of the organisation, the level of funding, the type of service provided, and its client group. Lower levels of expenditure can be relatively high risk due to the nature of the services they provide. Conversely, higher expenditure areas may not have such high operational risks, but councils should regularly monitor them as the impact of failure on council finances and service users would be substantial.



### What have auditors found?

Good practice in one council involved putting in place increased scrutiny of a trust that was under-performing. The committee overseeing the trust was provided with additional performance information that assured it that improvements were being made. This highlights the need for councils to have a strong risk awareness and to be informed of how well ALEOs are performing on an ongoing basis.



### Want to know more?

- Audit Scotland's risk management Best Value toolkit  
<http://www.audit-scotland.gov.uk/work/toolkits/>
- A range of tools and guidance materials are available on the CIPFA website:  
<http://www.cipfa.org.uk/>
- The HM Treasury's guide to risk management principles  
[http://www.hm-treasury.gov.uk/d/orange\\_book.pdf](http://www.hm-treasury.gov.uk/d/orange_book.pdf)

# Part 3. Keeping it right



Councillors and officers must be aware of how ALEOs perform and take prompt action when required. They must ensure they have the skills and knowledge to carry out their role.



## Key messages

- Councils need good-quality monitoring information of 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.

## The principles of Best Value apply equally to ALEOs, and need to be maintained

**81.** Getting the set-up and related arrangements for ALEOs right from the start is vital. It is equally important to make sure that the arrangements remain fit for purpose and remain effective in changing circumstances. This part of our report is also relevant where councils already use ALEOs to deliver services.

**82.** As with council-run services, ALEOs should be able to demonstrate Best Value, and effective systems for performance management and review are an important part of this. The toolkit in [Appendix 2](#) brings together good management practice that applies in managing ALEOs and key steps necessary to move from basic to more advanced practices.

**83.** Councils need to be vigilant and aware of risks affecting the ALEOs that they fund. This applies equally

to members of ALEO boards and to councillors with a role in the council committees that oversee ALEOs. Councillors and officers should actively challenge how well ALEOs provide value for money and offer improved services for users. This requires them to have sufficient information on the ALEO's financial position, performance and risks.

**84.** Council representatives should also be aware of ongoing governance risks such as the potential for conflicts of interest. Conflicts are less likely where the objectives of the ALEO and the council are consistent and clearly defined. The situation can arise where these interests diverge and the actions of one organisation can be at odds with the other. For example, if an ALEO has discretion to alter the nature of the services it provides or its pricing policy, this may affect the uptake of services. Council and ALEO representatives must remain vigilant to ensure that the organisations continue to operate in line with their intended objectives.

**85.** Effective monitoring is especially important in the current financial environment where quick action may be required to protect services and the council's interests and reputation. Performance information should be current and meaningful to allow the

council providing the funding to take prompt action when issues arise. Reporting limited to annual financial statements or a narrow set of measures is not sufficient. Councillors should draw attention to any gaps in the information they receive to ensure that they can undertake their scrutiny role effectively.

**86.** Our physical recreation study found instances where councils only reported the performance of sports and physical recreation ALEOs to committee intermittently or not at all. In some cases, council officers received performance reports, but did not report performance or significant issues to committees. The study found that a significant proportion of councils monitored performance through very narrow statutory performance indicators. This is despite significant funding and the scale of the leisure activities involved.

**87.** Council nominees on boards have indicated to us that they can generally balance their roles with the council and an ALEO. However, in practice it is not always straightforward and conflicts of interest can arise that can make it difficult for councils to govern their ALEOs effectively.



## What have auditors found?

In one council the situation arose where:

- The council and its partners created an arm's-length company to manage a small group of historic properties to support tourism in the area.
- The company ran into financial difficulties and the board, which included councillors, took the decision to close down some of these tourist attractions. This decision was not reported to the council despite it being the main funder of the organisation.
- The councillors, acting as company directors, made the decision in the financial interests of the company. However, tourism is a priority area for the council, and this decision conflicted with the council and its partners' objectives to provide important tourism facilities.



## What have auditors found?

### Three examples of what the auditors found in individual councils:

- The elected member on the ALEO board could have done more at key stages to ensure the council was aware of developing problems in the ALEO. At key stages he should have reassessed the balance between his responsibilities to the company and his corporate responsibilities to the council as a whole.
- To date, the council has been reliant on board members to raise any issues with arm's-length companies. We have noted instances where relevant information has not been presented to the council on a timely basis. Having a member or officer on the board is not a sufficient monitoring mechanism in itself.
- We found that one council continued to fund an ALEO while being unaware that it was in serious financial difficulty. At the same time, another funding partner was aware of the risks faced by the ALEO and had already suspended its funding.

over the medium term where they are unclear of what level of funding they will receive. The situation can also arise where a council chooses to reduce funding in response to surpluses generated by ALEOs. However, this can be a disincentive to ALEOs achieving their objectives, such as increasing service uptake.

**93.** As with services delivered directly by a council, it is equally important that ALEOs have their own mechanisms in place to review and continually improve their services. Councillors and officers should satisfy themselves that these are effective in practice and review and update their service agreements with the ALEO accordingly. Reviews of the effectiveness of ALEOs should take into account stakeholder and service-user feedback and examine areas such as governance, financial and resource management, performance, and the capacity for future improvement.

**94.** Termination agreements should be in place for all ALEOs, setting out the circumstances that may give rise to a review and, ultimately, situations where the council may move to end the agreement with the ALEO. The trigger points to review or terminate agreements with ALEOs should be clearly understood by all parties. This should cover explicitly the arrangements for the return of any council-owned assets and the steps needed to ensure that service users' interests are protected. The implications for the workforce will be a major issue, including, for example, liabilities for pensions.

**95.** We have found that the termination process can be complex in practice. Difficulties can arise where agreements are not in place, or where councils have not made their reasons for discontinuing services through ALEOs clear. This can result in difficult negotiations and potential legal action.

**88.** Councils that have an overview of their ALEOs are better placed to demonstrate Best Value in the way they use their resources. They should also understand how ALEOs contribute to the council's overall aims, and the risks and levels of funding committed to them. Councils are better placed to do this where they disclose ALEO activities in their group accounts to give a clear picture of their activities and liabilities, including ALEOs. They should also ensure that their strategic and service plans incorporate ALEO activity. Councils should be able to identify and review or wind-up ALEOs that are dormant or ineffective. Maintaining a register of ALEOs can help councils to achieve this.

**89.** Councils should regularly review their ALEOs to ensure they continue to meet their objectives and remain the most appropriate option for service delivery. Scrutiny procedures should be in place to identify and act on under-performance including trigger points to withhold funding or to review the activity.

**90.** Councillors and officers should be alert to issues affecting service users. They should review customer satisfaction information and check that ALEOs are effectively undertaking any requirement to engage with service users and citizens. They should also be aware of how any changes to their policy on pricing and concessions impact on target client groups.

**91.** Councillors should be aware of how their spending decisions affect both council-run services and services delivered through ALEOs. ALEOs are vulnerable to reduced funding from councils and other partners. Situations can arise where ALEOs need to make difficult budget decisions such as reducing service levels or increasing prices.

**92.** Council officers and councillors need to consider the impact of their funding on the ability of ALEOs to plan their business. ALEOs that are more dependent on council funding will find it more difficult to manage budget reductions. ALEO boards find it difficult to plan their activities

## Councillors and officers require ongoing advice and training

**96.** Council representatives should not underestimate the commitments involved and responsibilities associated with a board position. Previous audit work<sup>10</sup> noted that on average boards required 30 per cent more time of members than expected. Councillors and officers working in connection with ALEOs need to ensure they are competent to undertake the role.

**97.** Officers and councillors should be supported with guidance and training. Our audit work suggests that one in four councillors had not received training and support and did not feel clear of their role on external bodies. There are many issues that need to be understood including effective governance and the legislation covering companies, charities, and employment law, for example. We

would expect basic training to be compulsory for any councillor or officer who is taking up a role in an ALEO, with an annual review or update to ensure that key matters remain at the forefront of those involved in ALEOs.

**98.** We found that councillors are keen to receive training and many would have welcomed training or at least information about the organisations they were representing.

**99.** We have noted that while councils offer training in these areas, its actual uptake can be limited. Councils should monitor the effectiveness of training and its uptake. We found good practice where councillors are required to undertake a minimum period of training per year, for example as part of their continuous professional development. This may include training on the Code of Conduct for councillors, and more specific training on ALEOs ([Exhibit 11](#)).



## What do councillors say?

“At first I had no idea what was expected of me.”

“I’ve attended three meetings of the Trust and am still finding my feet.”

“There’s no support – you just get on with it.”

“There was no training provided but this would be a way to overcome the lack of clarity I felt about the role during the first few meetings.”

Source: Survey conducted as part of *Roles and working relationships: are you getting it right?*, Audit Scotland, August 2010.

## Exhibit 11

### Training – getting it right

Areas to consider include:

- directors’ and charity trustees’ duties under companies and charities legislation
- directors’ liabilities to third parties
- shareholders’ rights
- codes of conduct, registration of interest, duties of confidentiality
- health and safety
- procurement, employment and environmental law
- wrongful trading, enforcement, disqualification and sanctions
- insurance.

Source: Audit Scotland

# Part 4. Key points for action



There are a number of actions councillors and officers must take to strengthen their working practices and relationships with ALEOs.





The tables below outline key points for action for councillors and officers involved with ALEOs

### Getting it right from the start

Councils must:

- observe the Accounts Commission/COSLA Code, and other guidance to understand their responsibilities and good practice when involved with ALEOs
- base any decision to set up an ALEO on sound options appraisal and feasibility assessments including risks
- ensure that where they use an ALEO it fits their priorities or policy objectives
- consider governance at the outset to ensure the council and the ALEO can effectively:
  - scrutinise performance and be held accountable
  - monitor costs, performance, and risk
  - engage service users and citizens
- clearly understand and set out the roles of boards, committees and the council in the articles of association or other constitutional documents
- set clear criteria for appointing representatives to the boards of arm's-length organisations, their required skills and experience, and any payments to board members
- agree clauses to terminate or review the delivery arrangement at the outset, taking into account the impact on services and their users, employees, and assets.

### Keeping it right

Councils must ensure that council representatives involved in ALEOs:

- are aware of how well council objectives are being met by the ALEO
- carry out their scrutiny or management roles effectively, and take action on any shortcomings or under-performance
- are risk aware and satisfied that risks to the council and the ALEO are identified and acted upon
- act quickly on potential conflicts of interest, including declaring interests and seeking advice
- take action to withhold funding or to review or terminate the agreement, particularly where services or public money are at risk
- take action where the intended objectives of the ALEO are not being met, or diverge from council priorities
- periodically review their delivery arrangements to ensure that the best use is made of resources and that clear governance is in place
- review or wind-up ALEOs that are no longer active or effective, or contribute to the council's aims
- ensure that they have the skills and training to undertake their role.



# Appendix 1.

## A tool for checking progress

Checklist to support good management of ALEOs	Assessment	Required actions/timescale
<b>Rationale for an ALEO</b>		
<ul style="list-style-type: none"> <li>• How clear are we on the objectives we are trying to achieve?</li> <li>• Are we satisfied that these fit in with the council's priorities?</li> <li>• Are we aware of the risks of the ALEO option on services and communities, the employees and the council?</li> <li>• How well do we understand any advantages of the ALEO delivery option compared to other options?</li> <li>• How will we know whether these advantages have been achieved in practice?</li> </ul>		
<b>Governance of ALEOs</b>		
<ul style="list-style-type: none"> <li>• Are we clear how the services delivered through ALEOs are accountable to service users and citizens in general?</li> <li>• Do we understand how the money paid to the ALEO is accounted for?</li> <li>• Are we satisfied that we understand our roles on boards and committees, and know when to act on any potential conflicts of interest?</li> <li>• Are we aware of any conflicts in roles between council and ALEO representatives, for example in:             <ul style="list-style-type: none"> <li>– scrutiny</li> <li>– award of funds</li> <li>– strategic or operational decisions?</li> </ul> </li> </ul>		

Checklist to support good management of ALEOs	Assessment	Required actions/timescale
Are we aware of how well ALEOs are performing, including:		
<ul style="list-style-type: none"> <li>• How well the ALEO is meeting its objectives?</li> <li>• What areas perform well, and what needs improvement?</li> <li>• How satisfied are service users?</li> <li>• Is the ALEO providing value for money?</li> <li>• Do service levels need to be changed – and what flexibility is there to do this?</li> </ul>		
Are we aware of the risks faced by the council and the ALEO, including:		
<ul style="list-style-type: none"> <li>• Is it financially sound, eg with appropriate levels of reserves?</li> <li>• Its ability to generate income or finance its borrowings?</li> <li>• What are the risks to services and the people that use them?</li> <li>• What are the risks to the council, eg liabilities for borrowings?</li> <li>• Is there a need to withhold funding or to review or wind-up the ALEO?</li> <li>• What are the implications for services, employees and assets if this is the case?</li> </ul>		

# Appendix 2.

## Toolkit for improving the governance of ALEOs

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><b>3. How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?</b></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>Access rights for internal and external audit are covered in the agreement.</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><b>4. Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?</b></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. 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>

# Arm's-length external organisations (ALEOs): are you getting it right?

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**CODE OF GUIDANCE ON  
FUNDING EXTERNAL BODIES  
AND FOLLOWING  
THE PUBLIC POUND**

**AND  
OPERATIONAL GUIDANCE**

**COSLA**  
*Promoting Scottish Local Government*

# ACCOUNTS COMMISSION CONVENTION OF SCOTTISH LOCAL AUTHORITIES

## CODE OF GUIDANCE ON FUNDING EXTERNAL BODIES AND FOLLOWING THE PUBLIC POUND

### 1 OBJECTIVE

It is important to ensure clear public accountability for public funds at the same time as supporting initiatives for securing quality local authority services in the most effective, efficient and economic manner. The principles of openness, integrity and accountability apply to councils in their decisions on spending public money which are subject to public record and external audit. These principles should also apply to funds or other resources which are transferred by councils to arms-length bodies such as companies, trusts and voluntary bodies. This guidance is intended to ensure proper accountability for such funds and that the principles of regularity and probity are not circumvented. It has the support of the Convention of Scottish Local Authorities.

### 2 SCOPE

The guidance which follows sets out a framework for councils' relationships with bodies through which they seek to carry out some of their functions other than on a straightforward contractual basis. The principles of the guidance apply to companies and other bodies such as trusts or grant aided voluntary organisations both where such bodies are subject to local authority control or influence and where they operate at arm's length. Councils will wish to have their own rules setting out procedures appropriate to their local circumstances and internal processes, and those rules should be based on this guidance. **The guidance should apply to any new substantial funding relationships entered into by councils and to existing substantial funding relationships at the earliest possible review date.** What is "substantial" will vary according to circumstances. When interpreting "substantial" councils should have regard to the significance of the funding in relation to their own budgets and its significance in relation to the budget of the external body. We do not, for example, intend this guidance to apply to the many small revenue grants which councils make to community groups annually. "Funding" is intended to include all resources which councils may transfer.

### 3 PURPOSES

When agreeing to transfer funds to an external body a council must be clear about its reasons for doing so. Proper considerations should always apply and the prime purpose of involvement with external bodies should be the

achievement of the council's objectives in the most effective, efficient and economic manner and not the avoidance of controls or legal restrictions which are designed to secure probity and regularity in the use of public funds. The reasons should be related to a strategy or policy of the council and that link should be demonstrable. **An overall statement of purpose should be contained in any council decision to establish the funding relationship and should be expressed in any establishing documents or written agreements or understandings between the council and the body.** The council should set out its expectation of the use of the funding. This should contain a broad and general statement of aims or goals and should also contain clear targets with timescales and methods of measurement whenever possible, as well as any conditions and reporting requirements.

## **4 FINANCIAL REGIME**

The council should spell out clearly the extent of its financial commitment to the external body and the nature of the financial relationship eg shareholding, grant, loan, contractual payments. Criteria for making and receiving payments should be specified. The transfer of any assets should be clearly regulated in a written agreement and the end destination of any such assets should be specified. The council's entitlements to any financial return should be stipulated and **commitments to financial contributions by councils should not be open-ended in duration or amount.** The written agreement should refer to the minimum standard of management arrangements which need to be in place and any specific or additional responsibility and accountability which is being vested in a board or management committee. **The minimum accounting and audit requirements should also be included.**

## **5 MONITORING AGREEMENTS**

The council should make clear any requirements which it has of external bodies to operate in a particular way. This might include proper employment practices, recruitment and selection processes, equal opportunities requirements, wages and conditions of service of employees and purchasing policies. **The council should also stipulate how it intends to monitor the relationship between itself and the external body.** For example, the council may wish to stipulate that it will have appropriate access to records held by the body. The council may require the body to take appropriate advice on its actions and to make frequent monitoring reports to the council on such matters as -

- income, expenditure, profitability, liquidity and other financial matters
- achievement of targets
- future plans

Regardless of representation on committees or boards, the council should insist on regular monitoring and reporting back by such bodies. Where the council designates a member of staff in a supervisory officer or equivalent capacity it should ensure that such officers are clearly aware of their responsibilities and of the relevant monitoring procedure. It is not the intention of this guidance to try to put the external auditors of the council in the place of the auditors of external bodies. However, **the council must ensure that its external auditors are given a right of access to such records, and, if appropriate, accounts and financial arrangements of the external body so that they may follow the trail of public money from the council through the body.** They should be able to seek, through the council, any explanations which they consider necessary from representatives of the body. **The external auditors of the council should also have access, through the council, to the external auditors of the body.**



## 6 REPRESENTATION

The council should consider very carefully the question of representation on the boards of companies which are subject to its control and, to an even greater extent, on bodies which are not subject to its control. For example, members or officers who become directors will assume personal responsibilities under the Companies Acts. It is possible that conflicts of interest can arise for such members and officers as between the company and the council.

The council must ensure that members and officers are properly advised of their responsibilities to the council and to the company. This should include questions of declarations of interest.

## 7 LIMITATIONS

In entering into a substantial funding commitment with an external body the council should lay down a timetable for the achievement of the objectives. If the purpose is a continuing one then provision should be made for regular review of achievements and of the relationship between the body and the council. Arrangements should include regular reporting to an appropriate council committee, if necessary in private if issues of commercial confidentiality arise. Clear limits should be set on the extent to which the council will become involved financially with the body and its affairs. Clear rules should be laid down at the outset for terminating the funding agreement and separation of the council's interest from that of the body. Councils should consider whether particular events should trigger a review eg change of leading personnel in the external body.

## 8 ACCOUNTABILITY

The external auditors appointed by the Accounts Commission will be required to review as part of the annual audit the arrangements which councils have made for such substantial funding agreements and will measure councils' compliance with this guidance. In cases where they have concerns over issues of probity and regularity they will make these known to the council and the Controller of Audit.

# COSLA

## OPERATIONAL GUIDANCE

### INTRODUCTION

In May 1996 the Accounts Commission for Scotland and COSLA issued jointly a Code of Guidance on Funding External Bodies and Following the Public Pound. COSLA undertook to take forward with councils, and input from the Commission as required, the further development of operational guidance. A working group of officers, assisted by a process of consultation with councils, has now prepared this guidance.

The Code was not written in prescriptive terms. It is for each council to address the issues which are dealt with in the Code in the light of its own circumstances. The external auditors of councils, who are appointed by the Accounts Commission, will assess how councils have dealt with those issues, measuring councils' performance against the Code. This guidance is intended to help councils to address the issues which are dealt with in the Code and, like the Code itself, it is not intended to be prescriptive. It follows the framework of the Code.

### SCOPE

The Code was prepared because of a concern about the use by councils of trusts and companies which they set up. Such trusts and companies would characteristically be designed to carry out some function or functions of the council and would receive funds from the council. The public funds involved moved outwith the scope of the normal regime of accountability which applies to councils. Decisions on the use of the funds were no longer taken in public and were beyond the scope of public sector audit. The principal objective of the Code was to re-establish some of the normal mechanisms of accountability in relation to these funds. **When drafting the Code it became clear that the same principles should apply to other forms of financial support given by councils to partner organisations.** Many of the problems associated with council trusts and companies were also present in the relationship with grant aided organisations and voluntary bodies. The need for clear objectives, the setting of targets, monitoring, reporting and exit strategies was as great in relation to those bodies. For this reason it was agreed to extend the Code to significant funding relationships which councils set up.

Proportionality is important. There are very many funding relationships, eg annual grants to local voluntary bodies, where there needs to be accountability but it would not be appropriate to apply the full rigour of the Code. Because of the widely varying circumstances of Scottish councils, where precisely the Code should or should not apply has to be interpreted locally rather than by a national template. When considering whether a funding relationship is "substantial", therefore requiring the full application of the Code, the following factors are relevant -

- the Code does not apply to straightforward contractual relationships
- a substantial financial relationship is likely to involve council expenditure equal to the product of at least £1 on the council tax
- the significance for the external organisation of the council's financial contribution eg would its absence affect that organisation's capacity to continue? Does it represent 30% or more of the organisation's funding?

# PURPOSES

Councils need to give careful consideration to the powers which they have to establish, participate in or appoint officers to external bodies. Recent decisions of English courts on equivalent powers in England and Wales have dealt with the use of section 111 of the Local Government Act 1972, which corresponds broadly to section 69 of the Local Government (Scotland) Act 1973. The main considerations in the use of these sections are:

- they may only be relied upon in relation to functions (powers and duties) of a council
- having identified the relevant function, it must be considered whether or not the proposed course of action is calculated to facilitate or is conducive or incidental to the function
- the powers are subject to all other legislation affecting councils who may not rely upon their provisions where there are other limits imposed by statute or statutory instrument
- councils may not rely on these powers to justify doing what is “incidental to the incidental”
- councils may not rely on these powers to circumvent controls
- councils may not rely on these powers where to do so would amount to an impermissible delegation of their powers

There are differences in the statutory position in Scotland compared to England and Wales. For example, section 15 of the Local Government and Planning (Scotland) Act 1982 provides wider council powers in relation to recreational facilities than are available in England and Wales. However, the general principle of recent English decisions will apply in Scotland ie councils may not seek to circumvent statutory controls and must have a genuine statutory basis for such involvement.

Proposed changes in the law contained in the Local Government (Contracts) Bill will clarify councils’ powers to enter into contracts for the discharge of their functions. Contracts certified under the proposed legislation will still be subject to the audit regime.

# FINANCIAL REGIME

This section of the Code points to the kind of matters which should be contained in the original specification by the council when entering into the financial commitment. Councils may find the following checklist helpful when drawing that specification up.

## Checklist

- Has a financial assessment of the body/project been carried out
- Was the assessment carried out independently and objectively (normally this can be done within the council)
- Has an assessment been made of the technical aspects of the group/project
- Was that assessment independent, objective and competent
- Have any financial/technical estimates been verified
- Have any forecasts of future performance been verified as realistic
- Is there evidence of all other affected parties and contributors being appropriately consulted
- Has all available information been pooled
- Nature of council’s financial contribution - shares, grant, loan
- What is the limit of the council’s contribution

- What mechanism will trigger payments/receipts
- Assessment/valuation at each payment stage
- Assessment of management/control regime
- Special arrangements for start-up funding
- Assets/liabilities - ownership, destination
- Council's exit strategy - recurring liabilities
- What accounts will be kept - frequency, type
- Access by council officers - internal audit should be guaranteed access

## MONITORING ARRANGEMENTS

The above checklist sets out the kind of provisions which should be made about monitoring the relationship between the council and the external body. **The council should nominate, in every case, an officer who will be responsible for monitoring the relationship**

**Reports should be made to officers of the council or committee or its equivalent as appropriate, and the nature and frequency of these reports should be established at the outset.** The absolute minimum is that a formal, written report should be made to committee or its equivalent annually. This should be in advance of the budget process, to allow the council time to consider such future action as may be necessary. Reports should contain not just financial information, but also performance information covering

- the aims and objectives of the organisation and how these have been met
- whether the standards set by the council have been met
- how performance is measured against value for money indicators
- targets and future plans

## REPRESENTATION

Councils should ensure that they give proper advice to members and officers involved in external bodies on their responsibilities to the council and to the body. In particular members and officers should:

- establish whether indemnity arrangements are in place in their authority if members or officials are acting as directors or advisers
- consider whether the council should hold insurance to cover officials in the case of work done for such bodies
- establish whether the bodies in question have in place suitable indemnity insurances covering advisers and directors etc

Members and officers who act as directors of companies have extra and difficult obligations, for example in relation to conflicts of interest and the need to have regard to the national Code of Local Government Conduct. Directors must exercise due care and skill. They owe a fiduciary duty to shareholders and creditors of the company and may not participate in wrongful trading where there is no reasonable prospect of avoiding insolvency. Nominee directors have duties to the company and creditors separate from their duties to their council. Difficulties will arise if directors

act in the interests of the local authority rather than those of the company. There can be restrictions on what they may disclose to the local authority where there is a conflict of interest.

Shadow directors are not appointed to the company's board but are persons or bodies with whose directions or instructions the directors of the company are accustomed to act. These persons and bodies owe the same duties to the company and are subject to the same obligations and responsibilities as are directors. The responsibility of the elected member or officer changes once appointed to the board of a company. From then on the elected member or officer, when acting as a director, can only act in the interests of the company. This can obviously give rise to confusion of roles and conflict of interest and if wrongful trading or any other offence occurs, the director may be personally responsible financially and otherwise (possible prison sentence etc). If the council effectively controls the company, the council can put itself in the position of a shadow director and can be liable for debts or responsible for offences. This effective control can arise where the council appoints a majority of directors and tells them what to do. Even if no directions are appropriate, the council can have effective control if it normally tells the company what to do.

It appears to be improper for the council to insure elected members and officers against their liabilities. The company should effect a directors and officers liability insurance policy.

## ACCOUNTABILITY

The Accounting Code of Practice (ACOP), in dealing with council related companies, provides that the following information should be disclosed in notes to the consolidated balance sheet of the council.

“Details of the name, business, percentage of total shareholding, the degree of commitment to meet accumulated deficits or losses of subsidiary or associated companies, net assets and results of operations and other financial transactions of any related companies, including reference to those which are consolidated in the group accounts, where the accounts of the related companies may be acquired and whether there has been any qualification to the audit opinion in respect of those accounts.”

Councils should disclose similar information in respect of any substantial interest which they have in external bodies governed by the Code. The intention is to make sure that any contingent liability of the council is clearly understood and expressed and that any material financial obligations or risks are disclosed.

## CONCLUSION

When the Code was issued it was made clear that it would be reviewed in the light of experience. Some councils have already embarked on a detailed examination of their position, and those who have not should do so as soon as possible. External auditors will report on how councils are responding to the Code. COSLA and the Accounts Commission will continue to discuss areas of common interest and seek to keep the guidance contained in the Code and these operational guidelines up-to-date.

## Statements of good practice

There are six principles collecting covering 22 good practice statements.

Principle	Statement
<b>1. Purpose:</b> the council is clear about its reasons for transferring funds to the ALEO.	<p>1. The council operates within its statutory powers.</p> <p>2. The prime purpose of involvement with an ALEO is the achievement of the council's objectives in the most effective, efficient and economic manner.</p> <p>3. Council policy sets out procedures covering funding of an ALEO.</p> <p>4. The council sets out its expectations on the use of funding.</p>
<b>2. Financial regime:</b> the council has a clear and robust financial management regime in place.	<p>5. Before entering into an arrangement with an ALEO, the council conducts a risk assessment of it (the assessment extends well beyond financial risk to areas such as reputational risk).</p> <p>6. The council defines the extent and nature of its involvement with an ALEO.</p> <p>7. A written agreement between the council and an ALEO refers to the minimum standard of management arrangements which the organisation needs to have in place and any specific or additional responsibility and accountability which is being vested in a board or management committee.</p> <p>8. At the outset of a new relationship with an ALEO, the council specifies minimum arrangements for accounting and audit purposes.</p>
<b>3. Monitoring:</b> the council has robust arrangements for monitoring its relationship with an ALEO.	<p>9. The council makes clear any requirements which it has of ALEOs to operate in a particular way, eg in relation to policies on personnel and environmental issues.</p> <p>10. The council stipulates how it intends to monitor the relationship between itself and an ALEO.</p> <p>11. Monitoring reports on an ALEO are regularly submitted to the council (or a committee or its equivalent as appropriate), which takes appropriate action.</p>
<b>Principle 4. Representation:</b> the council is clear about the purpose of any officer or member representation on ALEOs, and representatives discharge their responsibilities with due regard to the objectives of the council.	<p>12. The council appoints members or officers to sit on ALEOs where this is necessary and appropriate.</p> <p>13. The council ensures that any officers or members selected to represent the council on an ALEO are suitable for the positions they are to hold.</p> <p>14. The council ensures that all members and officers involved in an ALEO understand their respective responsibilities to the council and to the ALEO.</p> <p>15. The council has a register of declarations of interest which includes potential conflicts of interest that may arise from officers and/or members being involved with an ALEO.</p> <p>16. The council has taken steps to safeguard itself from risks incurred by members and officers in their dealings with ALEOs.</p>
<b>5. Limitations:</b> in entering into a substantial funding commitment with an ALEO, the council lays down a timetable for the achievement of its objectives.	<p>17. In entering into a substantial funding commitment with an ALEO, the council lays down a timetable for the achievement of its objectives.</p> <p>18. The council sets clear limits on the extent to which it will become involved financially in an ALEO and in its affairs.</p> <p>19. The council sets out ground rules at the outset for terminating the funding agreement and separating its interest from that of the ALEO.</p>
<b>6. Accountability:</b> the council makes arrangements for suitable access by external audit.	<p>20. The council ensures that its external auditor has a right of access to key records in an ALEO and, if appropriate, its accounts and financial arrangements so that s/he may follow the trail of public money from the council through the ALEO to its destination.</p> <p>21. The external auditor is able to seek, through the council, any explanations which s/he considers necessary from representatives of an ALEO.</p> <p>22. The external auditor has access, through the council, to an ALEO's external auditors.</p>

Source: Audit Scotland - drawn from the Code

## APPENDIX C

### RISK ASSESSMENT FOR EXTERNAL FUNDING APPLICATIONS

The risk assessment should be completed by the Council Officer responsible for assessing the grant application and should be used as part of the decision making process in determining if the application is to be successful.

<b>GRANT APPLICANT</b>
<b>VALUE OF GRANT</b>

**What are the risks to the Council in providing this grant?** *(some generic risks are identified below, this list is not exhaustive, if these risks are relevant to the grant applicant they should be assessed. Any other specific risks should be added or delete any that are not relevant).*

Risk	Probability of occurrence (P)	Impact if risk occurs (I)	Risk Rank = (P x I)	Acceptable Risk Yes/ No
1. Potential fraud and or misappropriation of grant expenditure.				
2. Potential breach of grant conditions				
3. Grant does not meet Council's objectives.				
4. Lack of detailed supporting information to support application.				
5. Multiple applications made by one group, could have reputation impact to council.				
6. Potential work or project not completed and or significantly delayed.				
7. Projects fails to deliver stated objectives/benefits.				
8. Lack of awareness of Grant applicant and their ability to deliver.				

#### **Risk Ranking Key:**

<b>HIGH</b> = Unacceptable do not approve this grant at all or until demonstration by applicant of how risks are to be controlled.	<b>Score =12 &amp; above</b>	<b>MEDIUM</b> = Acceptable, approve grant but with frequent monitoring of to ensure conditions of grant are being met.	<b>Score = 4-12</b>	<b>LOW</b> = Acceptable, grant should be approved.	<b>Score =4 or below</b>
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\* See Criteria for risk assessment process on next page.

<b>What are the potential impacts to the Council and its objectives if the above risks occur?</b>
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If the risk score is above 12 and the decision is made to approve the grant, list the additional measures required by the grant applicant if the request is to proceed?

ACTION	Who	When



## Risk Assessment Process

(Taken from the Council's corporate risk management strategy)

		IMPACT				
		Catastrophic Failure	Significant Impact	Serious	Marginal	Insignificant
		5	4	3	2	1
PROBABILITY	Highly Probable >90%	5	Review Risk in Great Detail. Amend Strategy to Reduce / Avoid			
	Very Likely >70%	4				
	Even Chance 50%	3	Develop Contingency Plans. Monitor Risk Development			
	Could Happen 30%	2				
	Improbable <10%	1	Maintain record of Risk, consider adequacy of control measures.			

Description	Likelihood of Occurrence	Score	Impact	Score
Highly Probable	90%	5	Catastrophic	5
Very Likely	50-70%	4	Significant	4
Even Chance	50%	3	Serious	3
Could Happen	10-30%	2	Marginal	2
Improbable	1-10%	1	Insignificant	1

### Impact Criteria

Score	Descriptor	Categories of impact	Description of Impact
1	Insignificant	Reputation Finance	Minor impact to council reputation, no press interest. 0.5% of Overall Grant Budget
2	Marginal	Reputation Finance	Some public embarrassment no lasting damage to reputation. 0.5-2% of Overall Grant Budget
3	Serious	Reputation Finance	Local adverse public embarrassment leading to limited damage, elected members become involved. 2-3% of Overall Grant Budget
4	Significant	Reputation Finance	Regional / National adverse publicity. 3-5% of Overall Grant Budget
5	Catastrophic	Reputation Finance	Highly damaging adverse publicity. >5% of Overall Grant Budget

**WRITTEN AGREEMENT**

When preparing a written agreement with an ALEO, services should consider including the following issues:

- Expectations on the use of the funding;
- Timecales;
- Amount of funding and limitations;
- Minimum standards of management arrangements which the ALEO needs to have in place;
- Minimum arrangements for accounting and audit purposes;
- Minimum insurance cover;
- Requirements of the ALEO to operate in a particular manner in relation to, e.g. equality, sustainability, environmental and ethical issues;
- Monitoring arrangements and frequency of monitoring reports;
- Performance measures;
- Review/Exit strategy – circumstances under which funding will be subject to review or termination;
- Access to financial and other records for inspection by the Council's internal and external auditors.

**REPRESENTATION OF ALEO's – ELIGIBILITY CRITERIA**

When appointment of members and/or officers to sit on the boards of ALEO's is proposed, the following criteria should be considered:-

(a) Members

Membership of Service Committee with terms of reference associated with the ALEO's activities (background knowledge of service issues) .

Political group nomination within relevant sphere of interest (portfolio/spokesperson appointment).

Local member interest and knowledge (geographical link, economic considerations).

(b) Officers

Managerial responsibility for services associated with the ALEO's activities.

Professional and technical experience within related operational areas.

Knowledge of external partnership and support frameworks associated with ALEO's activities.