

# Governance, Risk and Best Value Committee

10.00am, Tuesday 28 August 2018

## Accounts Commission: Councils' use of arm's-length organisations

Item number	7.15
Report number	
Executive/routine	
Wards	n/a
Council Commitments	n/a

### Executive summary

---

Following Audit Scotland's performance audit of Scottish councils' use of arms-length external organisations (ALEOs) between summer 2017 and spring 2018, the Accounts Commission published its [report](#) in May 2018.

The City of Edinburgh was one of nine sample councils chosen by Audit Scotland to give a cross-section of councils that make significant use of ALEOs in terms of their numbers or scale.

The report examines how councils use ALEOs, how they are overseen, what they are achieving and their future direction, building on the messages from their 2011 [report](#) Arm's-length external organisations (ALEOs): are you getting it right?

## Accounts Commission: Councils' use of arm's-length organisations

### 1. Recommendations

---

- 1.1 Members of the Governance, Risk and Best Value Committee are asked to:
  - 1.1.1 note the contents of the report; and
  - 1.1.2 refer the report to the Corporate Policy & Strategy Committee for its consideration, in particular whether elected members should be on the boards of ALEOs.

### 2. Background

---

- 2.1 ALEOs are used widely across local government in Scotland to provide a range of activities including: sport and leisure; cultural services; economic development and regeneration; property; and social care services.
- 2.2 Audit Scotland defines ALEOs 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.
- 2.3 Their 2011 report aimed to promote and encourage good practice in the way ALEOs are set up, operate and deliver services and how councils maintain governance and accountability for finance and performance. It highlighted the risks and opportunities of using ALEOs and built on the principles set out in the [Following the Public Pound \(FtPP\) code](#), which sets out how councils should manage their relationships and be accountable for ALEOs and other external bodies they are involved with.
- 2.4 In March 2015 the Accounts Commission carried out follow-up work on its 2011 report which identified some improvements in councils' governance of ALEOs but that the standard of practice varied.
- 2.5 Since the Commission's 2011 report the Council has carried out two reviews of its companies with reports to Council on [13 December 2012](#) and [30 June 2016](#).
- 2.6 In 2016 Council approved a number of actions, including redefining roles and responsibilities, improving scrutiny at committee level and creating the

companies Governance Hub. These arrangements are now well established and it is in this context that the Council's use of ALEOs was examined by Audit Scotland.

### 3. Main report

---

- 3.1 The Accounts Commission report comprises four distinct parts. Part 1 examines councils' use of ALEOs, including their spread, form, function, financial arrangements, legal forms and recent and ongoing changes in their use. EDI is one example used to illustrate evolving change at Exhibit 4.
- 3.2 This part also covers the reasons for councils' use of ALEOs, including taxation benefits; income/funding generation; commercial focus; stakeholder involvement; partnership working and the strengths of a dedicated board. It warns of business case assumptions changing over time, eg. The Barclay Review, and that stronger business cases can be made where benefits are clearly linked to improved outcomes for citizens and communities.
- 3.3 The auditors found few councils have guidelines or policy for making service delivery choices and emphasise the importance of councils being able to demonstrate that any policy position enables the securing of Best Value.
- 3.4 They also suggest councils could do more to involve local communities and businesses in their choice of options and that public opinion should also be a consideration.
- 3.5 Part 2 covers councils' oversight of ALEOs in applying the FtPP code; reasoning for council appointments to ALEO boards; alternatives to council representation to limit conflicts of interest (an Edinburgh example is referenced at 43. on page 23); appointments based on role requirements (Edinburgh's approach is mentioned at 48. on page 24); training and support to board members; systematic testing of Best Value; and the accountability of ALEOs.
- 3.6 Part 3 examines what ALEOs are achieving. Given the diversity of services provided and their individual circumstances, the auditors found it difficult to draw on clear patterns of performance that apply to all. As a result, they focussed on a sample covering sports and leisure (with Edinburgh Leisure referenced in 68. on page 30); social care and a small number of more commercial ALEOs (an Edinburgh example is referenced at 88. on page 34).
- 3.7 The narrative in this part is predominantly positive but also highlights the ongoing cost and workforce pressures for social care ALEOs and a need for councils to improve their measurement of the outcomes achieved by ALEOs.
- 3.8 Part 4 considers the future direction of ALEOs and acknowledges the value to councils of this model to sustain services and innovate. It highlights the key issues councils should be taking account of when considering the future of their ALEOs, including the involvement of communities, business, service users and the public; joint service provision between councils (Lothian Buses in referenced

in 99. on page 36 and highlighted as a case study on page 37); and the consideration of benefits and risks as ALEOs evolve.

### Relevance to Edinburgh

3.9 There are nine recommendations for councils on page 6 of the report. The table below illustrates how the Council currently complies with each recommendation and where improvement action is required:

Report Recommendation		CEC Approach
1	Examine wider options that can bring similar benefits to ALEOs such as reorganising an existing service, sharing services with other councils, or involving the local community.	<ul style="list-style-type: none"> <li>▪ Discuss at CLT and Governance Hub</li> </ul>
2	Demonstrate how ALEOs help the council meet its objectives and improve outcomes for their communities.	<ul style="list-style-type: none"> <li>▪ Discuss at CLT and Governance Hub</li> </ul>
3	Set clear criteria for reviewing an ALEO, considering risks, performance and how it fits with council priorities.	<ul style="list-style-type: none"> <li>▪ Performance and strategy reporting template agreed with ALEOs at Governance Hub.</li> <li>▪ Council oversight embedded in Committee Terms of Reference, with scrutiny of strategy and performance split between appropriate executive committee and GRBV.</li> </ul>
4	Oversee the performance, financial position, and associated risks of ALEOs.	<ul style="list-style-type: none"> <li>▪ Council senior officer observer at board meetings</li> <li>▪ Quarterly Governance Hub meetings</li> <li>▪ Executive Committee reporting</li> <li>▪ Governance, Risk &amp; Best Value Committee scrutiny</li> </ul>
5	Have clear reasons for appointing councillors and officers to ALEO boards, recognising the responsibilities and requirements of the role, and the risks of conflicts of interest.	<ul style="list-style-type: none"> <li>▪ How the Council tackles this issue is outlined for consideration in this report</li> </ul>
6	Provide training, support and advice from both the perspective of the council and the ALEO. This should include legal responsibilities, scrutiny and oversight, and conflicts of interest.	<ul style="list-style-type: none"> <li>▪ Elected Members' Induction and Training Programme</li> <li>▪ Board member induction and training</li> <li>▪ Provision of issue specific and ad hoc professional advice from officers of the Council and the ALEO</li> </ul>
7	Have processes in place to manage any potential conflict of interest of elected members and officers involved in the operation of ALEOs.	<ul style="list-style-type: none"> <li>▪ No officer representation on ALEO boards</li> <li>▪ Registration of interests with Council and ALEOs</li> <li>▪ Declaration of interests at committee and board meetings</li> <li>▪ Provision of issue specific and ad hoc professional advice from officers of the Council and the ALEO</li> </ul>

		<ul style="list-style-type: none"> <li>▪ Code of conduct training for councillors detailing conflicts and how to avoid.</li> </ul>
8	Take an active role in managing their relationship with ALEOs, including their compliance to service level agreements, contracts and other obligations.	<ul style="list-style-type: none"> <li>▪ Council observer role and responsibilities</li> <li>▪ Council Executive Director responsibilities for maintenance and monitoring of service level/shareholder agreements</li> <li>▪ Quarterly Governance Hub meetings</li> <li>▪ Executive Committee reporting</li> <li>▪ Governance, Risk &amp; Best Value Committee scrutiny</li> </ul>
9	Make information about ALEO funding and performance clear and publicly available.	<ul style="list-style-type: none"> <li>▪ Annual report to executive committee</li> <li>▪ Governance, Risk &amp; Best Value Committee scrutiny</li> </ul>

### **Progressing the Report's Recommendation**

- 3.10 There are three recommendations (1,2 and 7) in the report that the Council requires further consideration. The first asks councils to consider any wider options that could be implemented that would benefit ALEOs such as shared services. The second recommendation is focussed on how the impact of ALEOs on the Council's objectives can be demonstrated. These recommendations will be considered at the Council's Leadership Team and the Governance Hub to explore possible improvements.
- 3.11 Recommendation seven highlights the ongoing debate about the advantages and disadvantages of elected members being board members. It outlines these considerations and asks Councils to consider other approaches to limit conflicts of interest.
- 3.12 This is not the first time the Council has considered this issue. In 2012, a review of Council companies was completed advocating that elected members should not sit on the boards of Council owned companies due to the potential for a conflict of interest to exist between their role as an elected member and their role as a director on the company's board. The Council rejected this recommendation and indicated they wished elected members to still have an active role on Council companies.
- 3.13 In June 2016, the Chief Executive reported to Council on outside bodies and in particular the liability risk to the Council and individual elected members of being members of unincorporated associations and again the issues of conflicts were discussed.

### **Advantages and Disadvantages**

- 3.14 Advantages of elected members as board directors or nominees
- 3.14.1 Builds a strong relationship between Council and ALEO;
- 3.14.2 Committee members and in particular conveners and vice-conveners can have in-depth knowledge of service in relevant ALEO;

- 3.14.3 Elected members gain greater knowledge through the ALEO to apply at Council;
- 3.14.4 ALEO can have an insight into the Council and the needs of the community.
- 3.15 Disadvantages of elected members as board directors or nominees
  - 3.15.1 Additional demands to diverse role;
  - 3.15.2 Elected members may lack the background and skills to perform the role;
  - 3.15.3 Risk of conflict of interest between the ALEO and the Council;
  - 3.15.4 Exposure to legal risks and personal liability as highlighted in the report in 2016.
- 3.16 There is a set of regulatory bodies, documentation and legislation that feeds into this matter. The Councillors' Code of Conduct allows elected members to sit on company boards or as trustees as long as the organisation was established by the Council to provide services to the Council and there is an agreement in place to do so. This exclusion from the Code only applies if an interest is declared and is not applicable to quasi-judicial decisions.
- 3.17 Where elected members sit on the boards of Council owned companies there is an inherent risk that they may put the needs of the local authority before that of the charity or company. Trustees have duties under the Charities and Trustee Investment (Scotland) Act 2005 to comply with, while directors of companies have director duties under the Companies Act 2006 to comply with. However, both pieces of legislation state that individuals should be acting in the best interests of the organisation at all times. It is not enough to act in the best interests of the Council in Council meetings and the best interests of the organisation at the Board meeting. Not complying with these requirements would leave the elected member open to censure and in severe circumstances disqualification. The Code of Conduct also applies a requirement to act in the best interests of the Council. These requirements do not cause any issues if the best interests of the Council and the organisation are the same, when these diverge there is a conflict of interest that is difficult to avoid.
- 3.18 Council companies and charities are arm's length and as such should not be under the direct control of the Council. An inquiry was carried out by The Office of the Scottish Charity Regulator (OSCR) into the Shetland Charitable Trust which was deemed to not have sufficient independence from Shetland Islands Council. This was resolved through a restructure of the governance arrangements in 2013. The lack of independent thought concerned the regulator who argued it could lead to charities not acting in their own best interest. OSCR is also concerned about sole members and instances where there are only elected members on boards or a majority of elected members on boards. OSCR does not go as far to endorse elected members on local authority owned charities but it has recognised that the Act allows it and that there is no evidence

that it can hinder the activities of the charity. OSCR does ask though that local authorities appoint elected members as trustees based on their skills and experience.

- 3.19 The Scottish Parliament Inquiry into ALEOs in 2016 looked specifically at the role of elected members as directors and did not find any issues, satisfying themselves that the Code of Conduct was being properly applied.
- 3.20 Elected member representation on outside bodies is complex due to the wide-ranging nature and status of the organisations. There is no one solution or single piece of advice on whether elected members should be on outside bodies or not. There are inherent conflicts of interest with all appointments and a judgement has to be made on whether the appointment would hinder the business of the Council or hinder the elected member in carrying out their role. The difficult position this can put elected members in should be considered.
- 3.21 If it is determined that elected members should not be on ALEO boards or act as trustees of ALEOs then a report would be required on how this could be practically implemented. This would include how the Council could provide effective oversight of ALEOs such as elected members being observers on boards and/or ALEO board appointments requiring Council approval.

#### **4. Measures of success**

---

- 4.1 That agreed improvement actions are implemented and sustained.

#### **5. Financial impact**

---

- 5.1 There is no financial impact arising from this report.

#### **6. Risk, policy, compliance and governance impact**

---

- 6.1 There will be a positive impact on all areas if the agreed improvement actions are implemented and sustained.

#### **7. Equalities impact**

---

- 7.1 There are no equalities implications arising from this report.

#### **8. Sustainability impact**

---

- 8.1 There are no sustainability implications arising from this report.

## 9. Consultation and engagement

---

- 9.1 The Accounts Commission report has been shared with the Chief Executives of the Council's companies that comprise the Governance Hub, who were regularly updated on progress during the course of the performance audit.
- 9.2 This report and any resulting management actions will be shared and discussed with the company Chief Executives at the next scheduled meeting of the Governance Hub.

### Andrew Kerr

Chief Executive

Contact: Laurence Rockey, Head of Strategy and Insight

E-mail: [Laurence.rockey@edinburgh.gov.uk](mailto:Laurence.rockey@edinburgh.gov.uk) | Tel: 0131 469 3493

Contact: Gavin King, Democracy, Governance and Resilience Senior Manager

E-mail: [gavin.king@edinburgh.gov.uk](mailto:gavin.king@edinburgh.gov.uk) | Tel: 0131 529 4239

## 10. Background reading/external references

---

[Audit Scotland - Arm's-length external organisations \(ALEOs\): are you getting it right? – June 2011](#)

[Following the Public Pound \(FtPP\) code](#)

[City of Edinburgh Council – Council Companies - 13 December 2012](#)

[City of Edinburgh Council – Council Companies - 30 June 2016](#)

## 11. Appendices

---

- 1 – [Accounts Commission: Councils' use of arm's-length organisations – May 2018](#)