

# Following the Public Pound

A follow-up report

Prepared for the Accounts Commission

December 2005



### The Accounts Commission

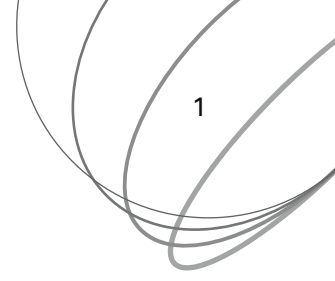
The Accounts Commission is a statutory, independent body which, through the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has four main responsibilities:

- 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 35 joint boards (including police and fire services). Local authorities spend over £13 billion of public funds a year.

**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 Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

# Contents



## Summary Page 2

Background

The study

Key messages  
Page 3

Recommendations  
Page 4

## Part 1. Following the public pound

What we mean by 'following the public pound'  
Page 5

What the study covered

The wider picture  
Page 7

The structure of this report  
Page 8

## Part 2. Supporting ALEOs

Main messages

Councils provided approximately £220 million to ALEOs in 2003/04  
Page 9

Most support was in two service areas

Councils funded 14,000 ALEOs

Over three-quarters of awards were for less than £10,000

Councils also provided ALEOs with considerable non-cash support but had little information about it  
Page 10

Councils need better information about their support for ALEOs, the intended benefits and what is obtained for the money provided

Recommendations  
Page 13

## Part 3. How councils work with ALEOs and manage risks

Main messages

No council fully complied with the Code and all councils must improve their performance

Performance varied across the Code  
Page 14

Councils did not take a systematic, risk-based approach to ALEOs; and there is scope for internal audit to be more involved  
Page 18

ALEOs we interviewed highlighted opportunities for councils to improve

There is scope to review and update the Code

Recommendations  
Page 19

Appendix 1. Code of guidance on funding external bodies and following the public pound  
Page 24

Appendix 2. Index of this report against the Commission's initial findings  
Page 26

Appendix 3. Methodology for the follow-up study  
Page 27

Appendix 4. Summary of councils' financial support for ALEOs  
Page 30

# Summary



Councils need better information about the external organisations they fund, and do not have a systematic, risk-based approach to dealing with them.

## Background

1. Councils fund arms-length and external organisations (ALEOs) to provide important services to the public, or to provide social benefits such as employment opportunities. These funding arrangements are often more complex than purchase contracts for goods or services.

2. To ensure that public money is used properly and achieves value for money, it must be possible to trace funds from the council to where they are ultimately spent – to ‘follow the public pound’ across organisational boundaries.

## The study

3. In March 2004 Audit Scotland reported that councils provided about £200 million to 12,000 companies, trusts and other ALEOs in 2001/02 and that there was a low degree of compliance with the *Code of guidance on funding external bodies and following the public pound* (the Code).

4. The Code promotes proper accountability for public funds when councils support ALEOs. Councils should have a clear purpose and timetable in funding ALEOs; set out a suitable financial regime; monitor ALEOs’ performance; carefully consider representation on the boards of ALEOs; and provide access for auditors.

5. Audit Scotland has now carried out a fuller study of councils to provide more information about the funding of ALEOs and how councils perform against the Code.

6. Each council’s external auditor has prepared a local report that includes an action plan agreed with the council.

## Key messages

**Councils provided £220 million to 14,000 ALEOs in 2003/04. There was no direct relationship between the size of councils’ overall budget and the proportion of it provided to ALEOs**

7. Councils’ spend on ALEOs as a proportion of their total budget averaged 2.4% across Scotland, ranging between 0.4% in East Dunbartonshire and 18% in Orkney.

8. Total expenditure varied from less than £1 million by East Dunbartonshire up to £46 million by Edinburgh, which accounted for one fifth of all Scottish councils’ financial support for ALEOs.

9. In 2003/04 more than half (around 8,500) of the ALEOs supported by councils were voluntary and community organisations. The remainder were charities and companies.

10. Over 83% of individual awards to ALEOs were for less than £10,000. About 3% of the total number of awards were for over £100,000, but these accounted for 60% by value.

**Councils need better information about their support for ALEOs, the intended benefits and what is obtained for the money provided**

11. The majority of councils did not have a corporate system for managing financial support to ALEOs and had difficulty in providing the data we requested. Those councils that did have a corporate system were more effective in their dealings with ALEOs.

12. Where good information is lacking, council members cannot exercise their scrutiny responsibilities effectively.

13. Councils provide ALEOs with non-cash support through the free or low-cost use of council properties, vehicles and facilities. This support needs to be considered as part of councils’ overall approach to asset management. Few councils had policies covering non-cash support or a full picture of its value. Both financial and non-cash support should be considered in committing resources to ALEOs.

**Councils do not have a systematic, risk-based approach to dealing with ALEOs**

14. While the spend on ALEOs was about 2.4% of overall council budgets, this type of expenditure inherently presents more risk to councils.

15. There was little evidence of councils adopting a consistent and comprehensive approach to risk management that takes account of factors such as the amounts of funding, the size of ALEOs, and how they are managed. Internal audit has experience of assessing risk and could play a stronger role in councils’ dealings with ALEOs.

**ALEOs highlighted opportunities for councils to improve**

16. ALEOs interviewed during the study highlighted opportunities for councils to improve their dealings with them. This is particularly so where an ALEO is funded by several councils.

17. For example, a group of councils could agree a lead council for dealing with ALEOs across a particular geographical area or service sector; harmonise policies and procedures for handling applications for assistance; and monitor their results.



### **No council fully complied with the Code and all councils must improve their performance**

**18.** Audit Scotland assessed the extent to which councils complied with the best practice principles set out in the Code, and allocated councils to one of three levels of overall performance. The study found:

- a high level of performance in nine councils
- a moderate level in 18 councils
- a low level in five councils.

**19.** There was no correlation between the total amount of funding that councils provided to ALEOs or the number of ALEOs funded, and the level of performance against the Code.

**20.** Most councils made no distinction between the way in which they dealt with ALEOs receiving high-value funding compared with those receiving relatively small amounts. Also, funding arrangements established more recently were not necessarily more compliant with the Code than long-standing arrangements.

### **There is scope to review and update the Code**

**21.** The Code's broad principles are as relevant today as when it was published in 1996. However, councils' business context and expectations of them have changed since then, particularly around Best Value and Community Planning. Therefore, there is scope to review the Code.

### **Recommendations**

Councils should:

- develop a corporate register of all support for ALEOs. This should enable councils to track both financial and non-cash support, and the extent to which ALEOs contribute to council objectives
- develop a corporate policy on non-cash support for ALEOs and recognise its value, within their overall approach to asset management
- take an informed, risk-based approach to dealing with all ALEOs they support, and target resources for scrutiny accordingly
- explore opportunities for joint working with other councils
- use this report and their external auditor's local report to improve performance against the Code.

More generally:

- The Convention of Scottish Local Authorities (COSLA), the Scottish Executive and the Accounts Commission should discuss how the Code can best be updated so that it remains relevant and useful in today's more complex environment.

# Part 1. 'Following the public pound'

**22.** This part of the report describes:

- what we mean by 'following the public pound'
- what the study covered
- the wider picture.

## What we mean by 'following the public pound'

**23.** Councils fund ALEOs for a range of purposes related to council services and their broader objectives. These arrangements are different from standard purchase contracts for goods or services and are usually designed to deliver wider public benefits. They involve the transfer of public funds from the direct control of a council to ALEOs. [Exhibit 1 \(page 6\)](#) contains some examples of councils' involvement with ALEOs.

**24.** 'Following the public pound' principles do not apply to conventional contracts which involve councils purchasing goods, materials or services eg, contracts with a private care home to provide residential care places.

**25.** Nor do the principles extend 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.

**26.** In practice, council support for ALEOs ranges from relatively small grants for voluntary organisations and small community organisations, to payments to trusts set up by councils to manage all of their leisure facilities.

**27.** A council may make a fixed payment to an ALEO, or the ALEO may have the power to commit council funds. To ensure that public funds are used properly, to maintain accountability, and to ensure that value for money 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 organisation. In other words, it is important to be able to 'follow the public pound' across organisational boundaries.

**28.** Councils fund external organisations to provide important services to the public, or to provide wider social benefits, such as employment opportunities.

**29.** Voluntary organisations can engage with socially excluded groups, such as people with drug problems and homeless people, who may be reluctant to contact statutory agencies. As well as providing services, funded bodies can bring further benefits to local communities by, for example, helping people to develop skills and encouraging community involvement.

**30.** Councils may consider that an external organisation can provide a better range or quality of service, or can provide services that would otherwise not be provided. External bodies may also be able to attract funding from sources not so readily accessible to the council, such as the private sector or charitable trusts.

**31.** Councils also establish arms-length bodies to deliver services where this may provide economic advantages.

## Exhibit 1

### Examples of council support for ALEOs

This is a small sample from the 14,000 cases across Scotland.

#### **Aberdeenshire**

The Archaeolink Trust runs an outdoor 'prehistory park', with councillors as trustees. Between the facility opening in 1996 and March 2005, the council provided the Trust with £1.5 million, and is now closely involved in its management.

#### **Clackmannanshire**

Ceteris, a company limited by guarantee, was set up in 1984 to promote economic growth through business development and job creation. It had a turnover of £2.8 million in 2003/04. During the year, the amount under guarantee by the council increased from £428,000 to £484,000.

#### **Dundee**

Dovetail Enterprises Limited was established to provide training and employment for persons with disabilities. The council provides annual grant funding and has also provided an interest-free loan of £400,000.

#### **Edinburgh**

Edinburgh Leisure is a non-profit-distributing company which manages sport and leisure facilities on behalf of the council. In 2003/04 the council paid £7.7 million for services from the company, who generated other operating income of £11.1 million.

#### **Glasgow**

In 2003/04 the council provided £13.1 million in revenue support to some 1,400 voluntary and community bodies, mostly in the form of small grants. Of all the revenue awards it made that year, nearly half (46%) were for less than £1,000 and 75% were for less than £10,000.

The Scottish Exhibition Centre Limited promotes international exhibitions, conferences and events. The council made a contribution of £646,000 to the company in 2003/04.

#### **Orkney**

The council wholly owns Orkney Ferries Limited, a company that operates services in the Orkney Islands. In 2003/04, the company had a turnover of £1.7 million, received £4.4 million in subsidy from the council, and carried forward an accumulated deficit of £7.5 million.

#### **Perth & Kinross**

The Perth Repertory Theatre Limited is a society established under the Industrial & Provident Societies Act 1965, and has charitable status for tax purposes. The company's main objective is the production of stage plays and other entertainment. The council owns the theatre building. In 2003/04, the council made a contribution of £301,000 to the company.



For example, an arms-length company may be more effective at engaging with the private sector to promote economic development.

**32.** The common purpose is usually to offer a wider range of services, often in conjunction with other public organisations, and to provide joined-up services. Councils also envisage greater choice for service users and general improvements in the quality and cost of service delivery.

**33.** These types of arrangements are not new. However, in recent years councils have been considering more innovative approaches to service delivery. This has led to a rise in the number of such arrangements and the range of activities to which they apply, with associated changes in the scope of responsibilities and the allocation of risks.

**34.** COSLA and the Accounts Commission jointly published the *Code of guidance on funding external bodies and following the public pound* in 1996 (the Code) (Appendix 1, page 24). This sets out principles of best practice when councils establish significant funding relationships with ALEOs.

Councils should:

- have a clear purpose and timetable in funding ALEOs
- set out a suitable financial regime
- monitor ALEOs' performance against both financial and service expectations
- carefully consider representation on the boards of ALEOs
- establish limits to involvement in ALEOs
- provide for audit access.

**35.** COSLA subsequently published operational guidance in 1998, and in July 2005, Scottish ministers issued a Direction to councils, under the Local Government in Scotland Act 2003, giving the Code statutory backing.

### What the study covered

**36.** In March 2004 Audit Scotland published the report *Following the public pound*. On the basis of this initial review, the Accounts Commission had concerns about councils' funding of arms-length bodies, particularly about the lack of reliable information on the position (Appendix 2, page 26). The Commission anticipated that these issues would grow in significance and therefore asked Audit Scotland to carry out further work to establish councils' support for ALEOs and performance against the Code.

**37.** This fuller study of all 32 councils across Scotland provides new information. The study examined councils' management information systems for ALEOs; how councils apply the Code to ongoing and new funding arrangements; and whether they assess risk and tailor their approach accordingly.

**38.** Councils completed a comprehensive self-assessment which was independently validated by their external auditor. Each council's external auditor has prepared a separate local report which includes an action plan agreed with the council.

**39.** Audit Scotland also interviewed ALEOs to find out their views on councils' arrangements. More information on the study methods is set out in Appendix 3 (page 27).

**40.** In this report we make recommendations where councils' performance needs to improve overall. Specific actions which need

to be taken by individual councils can be found in their local report. External auditors will monitor councils' progress against their action plan.

### The wider picture

**41.** The Code was published nearly a decade ago and there have been important developments since then, in the form of measures to improve corporate governance and update professional practice.

**42.** There have also been significant changes in local authority legislation. The Local Government in Scotland Act 2003 established statutory duties on councils to make arrangements to secure Best Value and maintain a Community Planning process. The Act also gave councils a general power to promote or improve the well-being of their area and people within that area. The intention was to allow councils greater flexibility to respond to the needs of their communities.

**43.** Scottish ministers have issued statutory guidance that sets out what councils are expected to demonstrate in fulfilling their statutory duties under the Act. This highlights the need for sound governance at a strategic, financial and operational level. The guidance states that a council which secures Best Value will be able to demonstrate the use of review and options appraisal, to ensure that services remain competitive and that quality is maintained for the benefit of service users.

**44.** These wide-ranging powers and duties are designed to encourage councils to review their approach to providing services and consider innovative service delivery vehicles. These could include new arms-length agencies and closer partnership working between councils and other

organisations. In time, this move may lead councils and their public sector partners to develop and expand the use of funding arrangements covered by the Code.

**45.** This report considers councils' funding of arms-length and external organisations. But similar types of funding arrangements exist elsewhere in the Scottish public sector. For example, the NHS has a shared interest in promoting the well-being of vulnerable people, possibly through joint funding of the same ALEO. In parts of Scotland, for instance, Age Concern is funded by both the NHS and councils to deliver advocacy services for older people. Issues raised in this report will therefore have relevance beyond local government.

### **The structure of this report**

**46.** Following Part 1:

- [Part 2 \(page 9\)](#) describes the support that councils provided to ALEOs in 2003/04.
- [Part 3 \(page 14\)](#) looks at how councils worked with ALEOs and managed risks.

## Part 2. Supporting ALEOs

### Main messages

- Councils provided approximately £220 million to ALEOs in 2003/04; 2.4% of total council expenditure. There was no direct relationship between the size of councils' overall budget and the proportion provided to ALEOs.
- Most support was in social work & welfare services, and in cultural & leisure services.
- Councils supported around 14,000 organisations. Over three-quarters of awards were for less than £10,000.
- Councils also provided ALEOs with considerable non-cash support, but had little information about it.
- Councils need better information about their support for ALEOs, the intended benefits, and what is obtained for the money provided.

### Councils provided approximately £220 million to ALEOs in 2003/04

**47.** In 2003/04, councils' spend on ALEOs as a proportion of their total budget averaged 2.4% across Scotland and ranged between 0.4% in East Dunbartonshire and 18% in Orkney (Exhibit 2, page 11).

**48.** Total spend on ALEOs ranged from less than £1 million by East Dunbartonshire, up to £46 million by Edinburgh, which alone, accounted for one fifth of all Scottish councils' financial support for ALEOs.

**49.** Five councils each provided £10 million or over to ALEOs: Edinburgh, Fife, Glasgow, Highland, and South Lanarkshire.

**50.** Six councils spent less than £2 million: Angus, Argyll & Bute, East Dunbartonshire, Midlothian, Scottish Borders and South Ayrshire.

**51.** Appendix 4 (page 30) summarises councils' support for ALEOs.

**52.** We found no direct link between the size of councils' overall budgets and the proportions provided to ALEOs. Some councils with a relatively small budget spent a higher proportion of it on ALEOs than larger councils, and vice versa. For example, Edinburgh provided 6% of its revenue budget to ALEOs against 3% in Glasgow; Orkney allocated 18% compared to 2% in Eilean Siar.

**53.** The £220 million comprised:

- £205 million of revenue support (93%)
- £12 million of capital (6%)
- £3 million of loans (1%).

**54.** For the purpose of this report we do not distinguish between revenue, capital and loans.

### Most support was in two service areas

**55.** Over two-thirds of expenditure was in two areas: social work & welfare services, and cultural & leisure services (Exhibit 3).

**56.** Funding to ALEOs for **social work & welfare services** (£89 million) was mainly revenue grants to voluntary and community bodies, and allocations of funding to larger organisations frequently regulated through service level agreements (SLAs).

**57.** Funding for **cultural & leisure services** (£60 million) included revenue subsidies to leisure trusts and grants to cultural organisations.

**58.** Support for **planning & economic development** (£17 million) reflected assistance for ALEOs that run conference centres, business promotion schemes and property development companies.

**59.** ALEOs related to **education** (£15 million) provided services such as after-school clubs, adult literacy programmes and community development initiatives.

**60.** **Housing** ALEOs (£15 million) assisted both the private and public sectors through services such as handyman help for the elderly; the provision of advice and guidance; and schemes for common repairs to blocks of flats.

**61.** ALEOs in **environmental services** attracted funding of £4 million. **Other services** (£11 million) covered a wide range of assistance, including support to citizens advice bureaux, community councils, healthy living initiatives, CCTV and community safety schemes, and contributions to cross-service advocacy groups such as the local council for voluntary organisations.

### Councils funded 14,000 ALEOs

**62.** In 2003/04 councils funded 14,000 ALEOs. More than half of these (around 8,500) were voluntary and community organisations. The remainder were charities, companies and other bodies. The number of ALEOs reported by councils ranged from 17 in Shetland to around 1,600 in Glasgow and South Lanarkshire.

**63.** As councils explore alternative ways of delivering services, so the type and number of ALEOs have become increasingly diverse. In one part of the country, a service may be provided by the council itself; in another part by a voluntary community group, or elsewhere, through a special purpose company set up by the council.

**64.** Two councils funded over 100 companies each: Glasgow (120), and South Lanarkshire (116). Edinburgh was involved in around 100 companies. Council-supported companies often operate at arms-length and can provide services such as transport, economic development and conference centre management.

**65.** Councils may have shares in some companies and make no other financial contribution to them, while other companies have no council shareholding but attract annual funding. A property development company could be a joint venture between the council and a private firm or even between two public bodies. For example, a company owned jointly by the City of Edinburgh Council and Scottish Enterprise Edinburgh & Lothian manages the redevelopment of Edinburgh's Granton area.

### Over three-quarters of awards were for less than £10,000

**66.** Around 83% of individual awards to ALEOs were for less than £10,000 (Exhibit 4, page 12). These were typically grants to community and voluntary organisations. More than half of all awards were grants of less than £1,000.

**67.** A small number of organisations received a large share of council support. These mostly involved support for companies and trusts. About 3% of the total number of awards were for over £100,000, but these accounted for 60% by value.

**68.** In 17 cases the amount of funding exceeded £1 million, the largest being £7.7 million from the City of Edinburgh Council to Edinburgh Leisure, which provides the council's leisure services.

**69.** While the value of funding varied widely and most awards were small, councils did not consistently pursue a risk-based approach to funding, or take account of the effect that even a modest award can have on a small ALEO.

**70.** Risk management is considered in more detail in Part 3 (page 14) of the report.

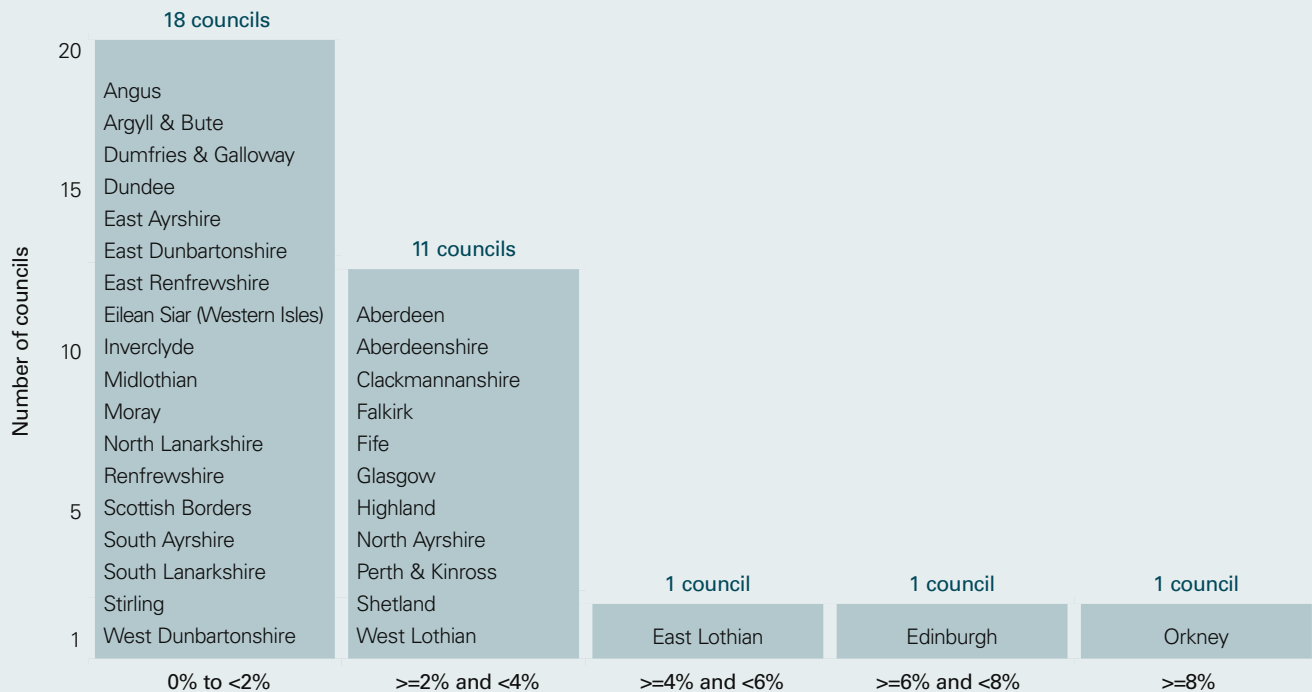
### Councils also provided ALEOs with considerable non-cash support but had little information about it

**71.** Councils provide ALEOs with substantial non-cash support in the form of free or low-cost use of council properties, vehicles and equipment; and advice and guidance by council staff. Exhibit 5 (page 12) gives examples of this support.

## Exhibit 2

### Councils' relative support for ALEOs

Councils' spend as a proportion of their total budget averaged 2.4% across Scotland.



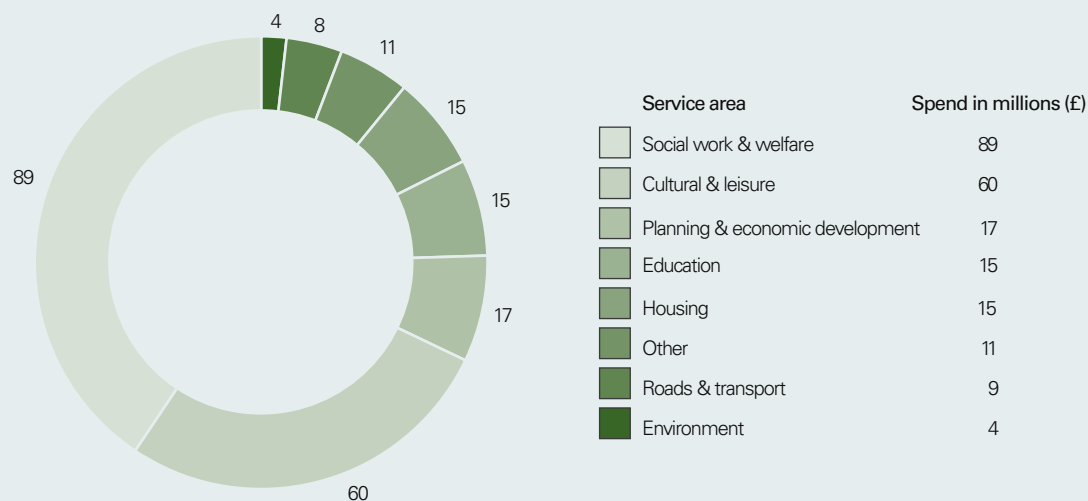
Note: Relative council spend = percentage of the council's total revenue budget that was spent on ALEOs, in 2003/04.

Source: Audit Scotland

## Exhibit 3

### Councils' support by service area

The majority of funding was directed to ALEOs in social work & welfare services, and in cultural & leisure services.



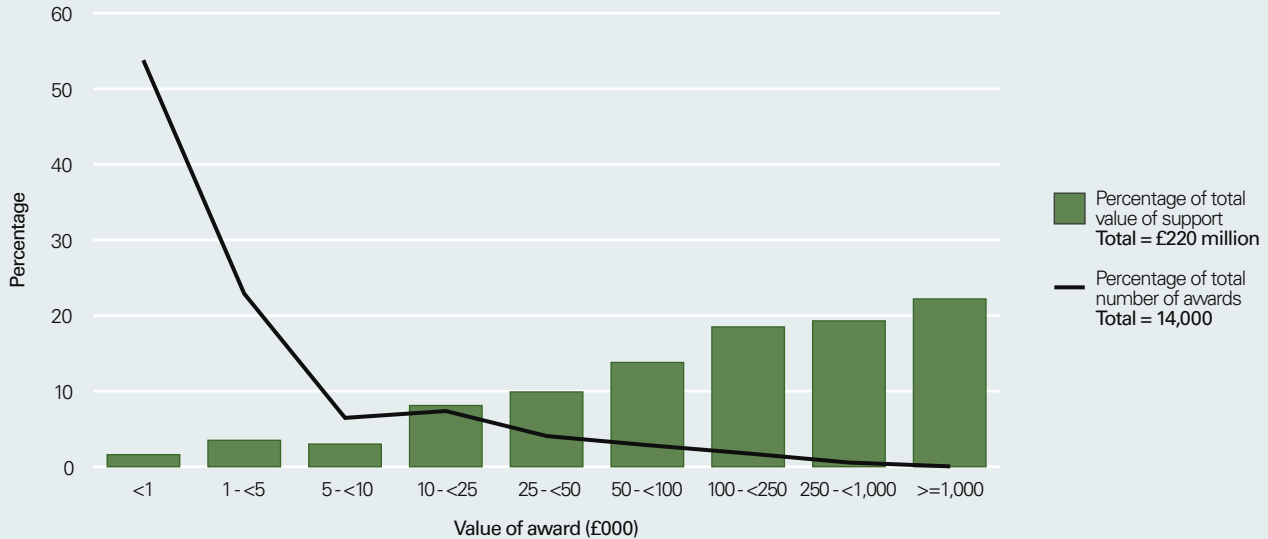
Source: Audit Scotland



## Exhibit 4

### The value and number of awards

Over 83% of individual awards to ALEOs were for less than £10,000. About 3% of the total number of awards were for over £100,000, but these accounted for 60% by value.



Source: Audit Scotland

## Exhibit 5

### Councils' non-cash support for ALEOs

Councils provided a wide range of non-cash support to ALEOs.

#### Aberdeen

The council estimated the value of its non-cash support at £1.1 million comprising £416,000 from giving ALEOs low-cost or free access to council property; £22,000 from the low-cost use of facilities and equipment; £175,000 worth of training, translation and interpretation services; and £443,000 from granting charities discretionary exemption from business rates.

#### Argyll & Bute

The council estimated the value of non-cash support at £175,000; comprising £34,000 from affording ALEOs low-cost access to property; £37,000 from subsidised school lets for voluntary organisations; and £104,000 from granting charities discretionary exemption from business rates.

#### Glasgow

The council's policy was to accept an ALEO's proposal for the use of council land and property. This may mean low or 'peppercorn' (nominal) rents are granted, and there is a requirement to report these to the committee. The council was unable to assess the value of such support to ALEOs. However, in many cases there are no other offers for the use of the land or property. It estimated that the value to charities of discretionary exemption from business rates was £775,000.

#### Orkney

The council had no formal policy on free or low-cost use by ALEOs of council property, facilities or equipment. The council said its minibuses were used by voluntary organisations when not required for use on council business, but could not quantify the value of this support to ALEOs or the income forgone by the council. It estimated the value of low-cost property used by ALEOs at £12,000, and the value to charities and sports clubs of discretionary exemption from business rates at £109,000.

Source: Audit Scotland

**72.** Councils generally did not have information about the nature and value of this support, policies on how it was provided and used, or link non-cash support to their overall approach to asset management.

**73.** Where councils did have a policy, its application varied among departments frequently and possibly within departments. Even where a policy was in place, councils were often unable to provide comprehensive data on the levels of non-cash support they provided.

**Councils need better information about their support for ALEOs, the intended benefits and what is obtained for the money provided**

**74.** Many councils struggled to meet the audit's information requirements. Several took many months to provide us with information we expected them to have ready access to. Without good information, councils cannot be clear about what is being achieved with the money. Council members will therefore have difficulty in fulfilling their responsibilities for scrutinising the value obtained from the funding.

**75.** Thirteen councils had a comprehensive corporate register of financial support and were better placed to meet their information needs when dealing with ALEOs, and to provide the information needed for the study:

- Aberdeenshire
- Argyll & Bute
- Dumfries & Galloway

- Dundee
- East Ayrshire
- Edinburgh
- Falkirk
- Fife
- North Ayrshire
- Orkney
- Perth & Kinross
- Renfrewshire
- West Dunbartonshire.

**76.** A council without information on the full range of its support for ALEOs will be limited in making coordinated decisions about funding applications and have difficulty in showing how spend fits with the council's over-arching aims and objectives. Without good information, if more than one department supports the same ALEO, the council's overall financial commitment may not be known.

**77.** Monitoring support for ALEOs is facilitated by systems that capture all departmental activity, rather than rely on the periodic collation of data from different systems.

**78.** A corporate register also provides important data to meet new accounting requirements. For example, good information will assist in identifying the 'group' (comprising the parent local authority and its associated companies and joint ventures) for the new group accounting requirements.

### Recommendations

Councils should:

- develop a corporate register of all support for ALEOs. This should enable councils to track both financial and non-cash support, and the extent to which ALEOs contribute to council objectives
- develop a corporate policy on non-cash support for ALEOs and recognise its value.

# Part 3. How councils work with ALEOs and manage risks

## Main messages

- No council fully complied with the Code and performance varied across the Code.
- Councils did not take a systematic, risk-based approach to ALEOs; and there is scope for internal audit to be more involved.
- The value of councils' support and the length of their involvement with ALEOs had no material bearing on councils' performance.
- ALEOs highlighted opportunities for councils to improve.
- There is scope to review and update the Code.

## No council fully complied with the Code and all councils must improve their performance

**79.** The *Code of guidance on funding external bodies and following the public pound* (the Code) is summarised in [Exhibit 6](#) and set out in full at [Appendix 1](#) (page 24).

**80.** We placed councils into one of three performance bands according to how they performed against the Code overall: high, moderate, or low. [Exhibit 7](#) (page 16) summarises each council's performance. [Appendix 3](#) (page 27) sets out the study methodology.

**81.** No council fully complied with the Code, but nine displayed a **high** level of compliance and face a relatively small gap to achieve full compliance.

**82.** Over half of councils demonstrated **moderate** compliance. Some performed well on certain aspects of the Code but poorly on others.

**83.** Five councils displayed a **low** level of compliance with the Code overall. They have some way to go to achieve full compliance and urgently need to review this area.

**84.** There was no correlation between the total amount of funding that a council provided to ALEOs or the number of ALEOs funded, and its level of compliance with the Code.

## Performance varied across the Code

**85.** Councils' performance across the Code's six principles was moderate overall but ranged between very low and high ([Exhibit 8](#), page 17).

**86.** The nine councils in the high performance band performed consistently well across the six principles.

**87.** The following paragraphs set out findings against each of the Code's six principles. [Exhibit 9](#) (pages 20 & 21) and [Exhibit 10](#) (pages 22 & 23) contain examples of good practice.

## Exhibit 6

### A brief overview of the Code

The Code covers six key principles.

The 'following the public pound' Code highlights that the principles of openness, integrity and accountability which apply to councils in their decisions on spending public money apply equally to funds or other resources which are transferred by councils to arms-length bodies. The guidance is intended to ensure proper accountability for public funds and that the principles of regularity and probity are not circumvented. The Code seeks to ensure that councils are clear about:

- **Purpose** – the reasons for their involvement in any arms-length funding arrangement
- **Financial regime** – the extent of the financial commitment and the nature of the relationship
- **Monitoring** – financial and performance monitoring and reporting arrangements
- **Representation** – how their interests are represented in arms-length bodies
- **Limitations** – limitations in any funding relationship and an 'exit' strategy
- **Accountability** – how the council and its external auditors may access the ALEOs' records.

Source: The Code of guidance on funding external bodies and following the public pound, COSLA/Accounts Commission (1996)

#### Principle 1 – Purpose

**88.** Councils that performed well on this principle had written procedures which were followed by departments; and standard conditions for funding that specified monitoring arrangements, and defined the outcomes expected as a condition of funding.

**89.** It is important at the outset that councils establish a good fit between their objectives and those of ALEOs. We found many instances, often involving large amounts of money, where the reasons for supporting an existing ALEO or creating an arms-length company were not clear.

#### Principle 2 – Financial regime

**90.** Some councils stipulated their expectations in the grant application form. SLAs and arrangements with companies often had comprehensive terms tailored to the ALEO in question.

**91.** However, councils did not consistently stipulate the standard of management and audit arrangements that an ALEO should have in place.

#### Principle 3 – Monitoring

**92.** Over three-quarters of councils specified monitoring arrangements for financial support to ALEOs, though all needed to do more by way of monitoring service outcomes.

**93.** Several councils liaised with ALEOs through link officers who can provide front-line assistance, and had a separate tier of monitoring officers.

**94.** Grant funding for ALEOs was typically tracked through annual committee reports. SLAs, normally for larger ALEOs and often providing social work & welfare services, were usually monitored for both financial and service performance. Monitoring of companies mostly assessed only annual financial performance, though there were specific instances where monitoring was more comprehensive and extended to service outputs, volumes or impact.

**95.** Most monitoring took place at planned intervals, but there was limited provision for more frequent reporting should problems arise. Too much reliance was placed on receiving ALEOs' audited accounts,

perhaps long after the financial year-end and a long time after a matter of interest to the council had emerged.

#### Principle 4 – Representation

**96.** The involvement of councillors or officers on ALEOs' boards or management committees does not in itself represent a robust monitoring mechanism to enable the council to discharge its stewardship responsibilities.

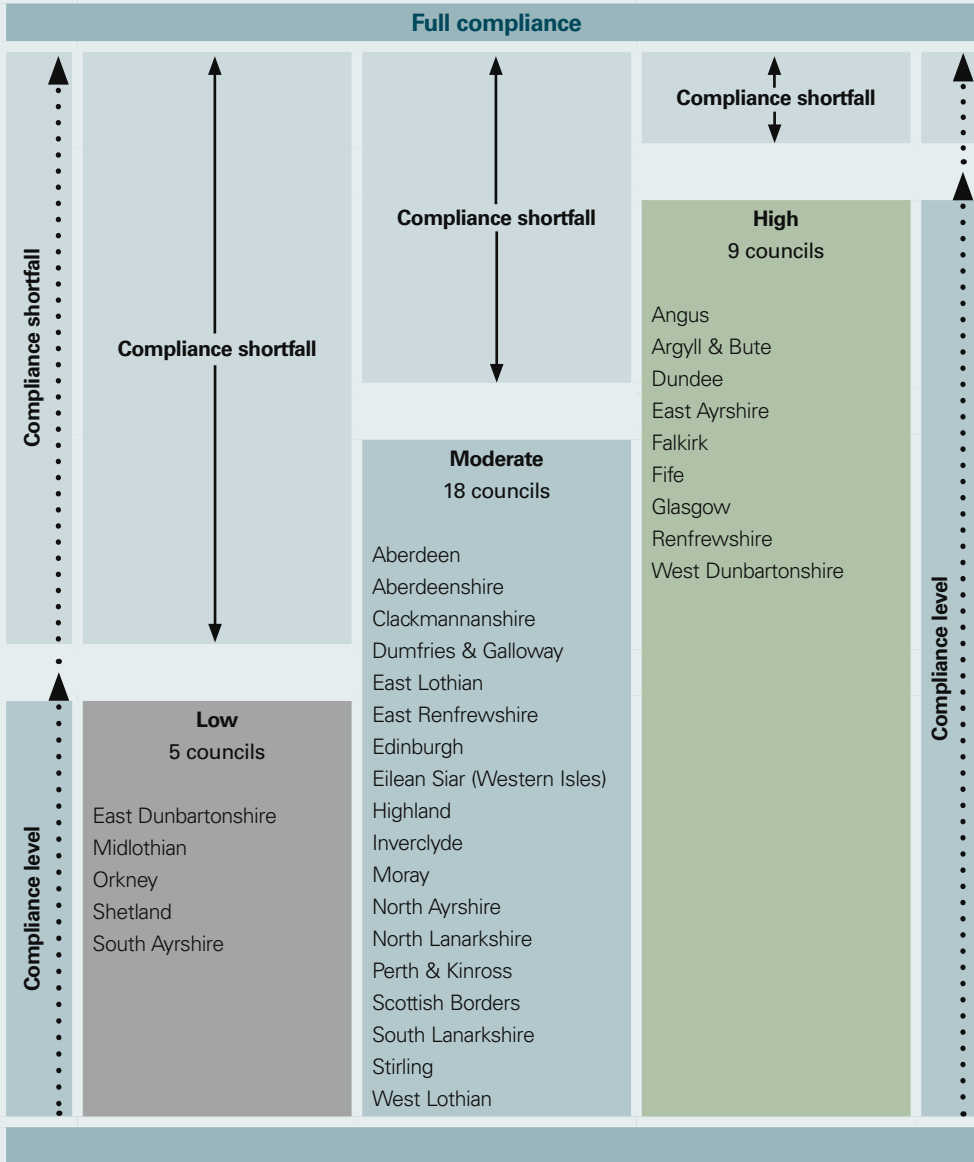
**97.** Some councils are moving away from appointing councillors to ALEOs, and instead seek to ensure they are clear about what they expect the ALEO to achieve, and how the arrangement will be monitored. The intention of this approach is that councillors are not exposed to potential conflicts of interest.

**98.** Five councils did not maintain a register of members who sat on the boards/committees of ALEOs that received council funding, and 18 councils did not maintain an equivalent register for officers.

## Exhibit 7

### Councils' compliance with the Code

No council fully complied with the Code overall. The compliance shortfall was greatest in the five councils that displayed a low level of compliance. However, all councils must improve their performance.



Source: Audit Scotland



## Exhibit 8

### Councils' performance overall, and on each principle

Performance was weakest in the principles associated with the financial regime, monitoring, and representation. Within each performance band, councils are listed in alphabetical order.

Band	Council	Overall	1. Purpose	2. Financial regime	3. Monitoring	4. Representation	5. Limitations	6. Accountability
High performance overall in nine councils	Angus	●●●●	●●●●	●●●●	●●●●	●●●	●●●●	●●●●
	Argyll & Bute	●●●●	●●●	●●●●	●●●●	●●●	●●●●	●●●●
	Dundee	●●●●	●●●●	●●●●	●●●●	●●●	●●●●	●●●●
	East Ayrshire	●●●●	●●●●	●●●●	●●●●	●●●●	●●●●	●●●●
	Falkirk	●●●●	●●●●	●●●●	●●●●	●●●	●●●●	●●●●
	Fife	●●●●	●●●●	●●●●	●●●●	●●●	●●●●	●●●●
	Glasgow	●●●●	●●●●	●●●●	●●●●	●●●●	●●●●	●●●●
	Renfrewshire	●●●●	●●●●	●●●●	●●●●	●●●●	●●●●	●●●●
	West Dunbartonshire	●●●●	●●●●	●●●●	●●●●	●●●	●●●●	●●●●
Moderate performance overall in 18 councils	Aberdeen	●●●	●●●	●●●	●●●	●●●	●●●	●●●
	Aberdeenshire	●●●	●●●●	●●●	●●●●	●●●	●●●●	●●
	Clackmannanshire	●●●	●●●	●●●	●●	●●●	●●●	●●
	Dumfries & Galloway	●●●	●●●●	●●●	●●●●	●●●●	●●●●	●●
	East Lothian	●●●	●●●	●●	●●●	●●●	●●●	●●●
	East Renfrewshire	●●●	●●●●	●●●	●●●	●●●●	●●●	●●●
	Edinburgh	●●●	●●●●	●●●	●●●●	●●●●	●●●	●●●
	Eilean Siar (Western Isles)	●●●	●●●●	●●●	●●●	●●●●	●●●●	●●●●
	Highland	●●●	●●●●	●●●	●●●	●●●●	●●●	●●●●
	Inverclyde	●●●	●●●	●●●	●●	●●●	●●●	●●●●
	Moray	●●●	●●●●	●●	●●	●●●●	●●●	●●●●
	North Ayrshire	●●●	●●●●	●●	●●	●●●●	●●●●	●
	North Lanarkshire	●●●	●●●	●●●	●●●	●	●●●●	●●
	Perth & Kinross	●●●	●●	●●	●●	●●●●	●●●	●●●
	Scottish Borders	●●●	●●●	●●●	●●	●●●	●●●	●●●●
	South Lanarkshire	●●●	●●	●●	●●●	●●●●	●●●	●●●
Stirling	●●●	●●●	●●●	●●●	●●●	●●●●	●●●	
West Lothian	●●●	●●●	●●●	●●●	●●●	●●●●	●●●	
Low performance overall in five councils	East Dunbartonshire	●●	●●	●●	●●●	●	●●●	●●
	Midlothian	●●	●●●●	●●	●	●●	●●	●●
	Orkney	●●	●●	●●	●●	●●●	●●	●●
	Shetland	●●	●●	●●	●	●●●	●●●	●
	South Ayrshire	●●	●●	●●	●●●	●	●●●●	●●●
<b>Scotland</b>	<b>●●●</b>	<b>●●●</b>	<b>●●●</b>	<b>●●●</b>	<b>●●●</b>	<b>●●●</b>	<b>●●●</b>	<b>●●●</b>
<b>Key</b>		<b>Overall performance totals in each band</b>						
●●●●	High performance	9	17	9	12	12	17	14
●●●	Moderate performance	18	9	13	11	16	13	9
●●	Low performance	5	6	10	7	1	2	7
●	Very low performance	-	-	-	2	3	-	2
	<b>Scotland</b>	<b>32</b>	<b>32</b>	<b>32</b>	<b>32</b>	<b>32</b>	<b>32</b>	<b>32</b>

**99.** Several councils had arranged insurance for actions by councillors or officers while others were unclear whether it was appropriate for them to do so. Some councils insisted on ALEOs taking out insurance.

**100.** Various councils offered training to councillors and officers to alert them to issues arising from their involvement in ALEOs. But one quarter of councils did not offer council members training on their respective responsibilities to the council and the ALEOs, and 17 did not extend training to officers.

### **Principle 5 – Limitations**

**101.** Councils indicated that grant-funding for community and voluntary organisations was decided annually, and that the annual review coupled with the normally small size of awards limited the council's exposure.

**102.** There was little evidence that councils specified at the outset criteria under which funding could be withheld or reclaimed from the ALEO.

**103.** Some ALEOs had clearly been funded for many years. A review of the range of funding against a council's objectives might indicate that its involvement with ALEOs could be better aligned with the council's current objectives.

### **Principle 6 – Accountability**

**104.** Arrangements for audit access tended to be implicit rather than explicitly defined at the outset, but there was little evidence of significant problems. Even where access for external audit was not specified, it was unusual for the external auditor not to be able to obtain required information from the council.

### **Councils did not take a systematic, risk-based approach to ALEOs; and there is scope for internal audit to be more involved**

**105.** While at 2.4% the spend on ALEOs is relatively small compared with councils' overall budgets, this type of expenditure is inherently more risky because it takes place where the council has less control over how public money is managed and spent.

**106.** The common theme emerging from the review of councils' performance against the Code's principles is the importance of sound risk management.

**107.** A systematic approach involves identifying and assessing the financial and other risks, such as the risk to the council's reputation if problems emerge at an ALEO.

**108.** The scale of funding is one of many risk factors, which also include the ALEO's legal form; the size of the organisation; how it is managed; the services it provides and the client group it serves; and the scale of any council shareholding. Each ALEO will have its own associated risk factors.

**109.** A community or voluntary organisation may receive a small annual grant but could still present a reputational risk to the council if things go wrong.

**110.** Conversely a large company, perhaps providing leisure services across the whole council area, is more likely to have robust management and sound corporate governance. But while the risk of problems occurring may be small, the consequences should difficulty actually arise may be significant, affecting many clients, and presenting a substantial cost to the council.

**111.** Where councils did consider the risks associated with supporting ALEOs, it was usual for risk to be considered simply as a function of the amount of funding involved and for there to be little if any systematic consideration of wider risks.

**112.** Most councils made no distinction between the way in which they dealt with ALEOs receiving high-value funding compared with those receiving relatively small amounts. A few councils have a tiered approach to voluntary and community organisations. Fife, for example, tailors its approach according to whether a body applies for less than £1,000, between £1,000 and £10,000, or over £10,000. Falkirk distinguishes between ALEOs applying for under or over £5,000.

**113.** The specific nature of the arrangement between a council and an ALEO had more of a bearing on the council's performance than whether the arrangement was recent or long-standing, or whether the funding was large or small.

**114.** Internal audit has experience of assessing risk and could play a stronger role in councils' dealings with ALEOs. It would be worth exploring, for example, whether a council's audit plan and main risk register could be extended to cover ALEOs. It would be necessary for internal audit periodically to review control arrangements, as an ALEO's risk profile will change over time.

**115.** There is also scope for council members to consider ALEOs as part of their wider scrutiny role.

### **ALEOs we interviewed highlighted opportunities for councils to improve**

**116.** ALEOs complained that councils which joint-funded them often made different demands, meaning that an ALEO could be dealt with by various councils in different ways, especially in relation to monitoring.

**117.** They identified scope for councils to harmonise their policies and procedures in areas such as the application process; requirements of ALEOs in areas such as personnel practice and environmental impact; and monitoring of performance.

**118.** ALEOs also made a case for councils agreeing a lead authority to deal with an ALEO operating across a particular geographical area or service sector.

### **There is scope to review and update the Code**

**119.** The Code's principles are as relevant today as when the Code was first published in 1996, and the status of the Code was enhanced recently through statutory backing.

**120.** However, councils' business context and expectations of councils have changed since 1996, particularly around Best Value and Community Planning. Councils now find themselves dealing with a large number of diverse ALEOs and, increasingly, working in partnership with other public bodies which often have overlapping interests in supporting the same ALEOs.

**121.** It would therefore be appropriate to review and update the Code to ensure it continues to be relevant and of value – to councils, their statutory community planning partners, and the ALEOs they support.

**122.** In taking the Code forward, there is scope for a wide-ranging discussion among key stakeholders, such as:

- COSLA and the Accounts Commission, as joint signatories to the current Code
- the Scottish Executive – which itself provides financial support for ALEOs, sometimes via councils and their community planning partners, and is responsible for issuing statutory guidance that impacts on public bodies.

### **Recommendations**

**123.** Councils should:

- take an informed, risk-based approach to dealing with all ALEOs they support and target resources for scrutiny accordingly
- explore opportunities for joint working with other councils
- use this report and their external auditor's local report to improve performance against the Code.

**124.** More generally:

- COSLA, the Scottish Executive and the Accounts Commission should discuss how the Code can best be taken forward.

## Exhibit 9

### Examples of good practice

This is a small sample and other councils will also have good practice to offer.

#### Principle 1. Purpose

##### Angus

The council has a process and guidelines governing decisions about funding for ALEOs. This includes the justification for using council resources in this way as being the best route to providing/supporting council objectives. Grants to voluntary bodies are covered by specific and comprehensive guidance. Documents specifying criteria for grants are available on the Internet. Guidelines are reinforced by the committee report process which sees comprehensive information given to councillors in respect of organisations' purposes and officers' recommendations.

##### East Ayrshire

Officers involved in the administration of funds for ALEOs are required to input to a database, and committee reports, the statutory power which is applicable to the award being made.

##### Glasgow

All applications for funding from ALEOs are measured against key criteria. No grant is awarded where the application does not contribute towards the achievement of the council's objectives.

##### Renfrewshire

The legal power behind support for an ALEO is evaluated as part of the application process by the relevant department seeking advice from legal services. Approval of the commitment is then documented in the council-wide grants database together with the specific legal power which has been relied upon.

##### West Dunbartonshire

An information pack for ALEOs includes a flow chart of procedures, and covers timescales and council requirements of grant receivers. If a grant is agreed, a 'conditions of grant' form is sent to the organisation. Funding is not paid over until the conditions of grant have been agreed by the ALEO.

#### Principle 2. Financial regime

##### Angus

A standard SLA sets out: the level of funding; a description of the approved use of funding; and requirements in respect of monitoring, auditing and reporting on the progress of the agreement. In addition, the finance department has issued guidance that clarifies how the financial provisions contained within the SLA interact with the council's budgeting and committee reporting processes. Grant aid guidance is clear as to the types of expenditure to which funding can be applied. This is laid out in committee reports and is reinforced when the applicant is advised of any grant approval.

##### Fife

The council communicates with the voluntary sector in various ways. A Voluntary Sector Information Brief outlines the procedures for applying for grants, and the monitoring and evaluation requirements. A Community Grants Scheme booklet describes the non-recurring grant schemes operated by the council and includes signposts to a range of other funding opportunities.

##### Glasgow

The council's application material and Conditions of Grant Award make clear the requirement it has of ALEOs to operate in specific ways.

##### West Dunbartonshire

In the application form for grant funding, the council asks an ALEO for a main contact point; the authorised signatories for its bank account; and the signature of two officer bearers. The ALEO's constitution must be signed and dated by two office bearers.

### Principle 3. Monitoring

#### Aberdeenshire

Monitoring of Recreation grants is reported to the Grants sub-committee, which meets four times a year. For other services, monitoring is carried out each month from June to January as part of the overall council monitoring activity. Four of these reports would normally be considered by the Policy & Resources Committee. Where a committee is not scheduled, reports are sent to the leaders of each political group.

#### Angus

The standard SLA contains full details of the council's requirements with regard to monitoring of the agreement. Bodies in receipt of grant aid are informed by letter of the terms of the grant approval, including all requirements in terms of monitoring the use of the funds.

#### Dumfries & Galloway

The council requires, as appropriate, annual reports, management reports and reports on specific targets and overall outcomes set out in SLA for grants of over £10,000. Services are required to identify a link officer to support the monitoring process. For awards of less than £10,000, letters of agreement are issued. However, Planning & Environment use a Project Initiation Document which does not specify how the council intends to monitor the ALEO.

#### Fife

Monitoring procedures are set out in the Monitoring and Evaluation Framework whose implementation is supported by monthly meetings of the Voluntary Sector Task Group and an annual training programme for Link and development officers. All awards of over £1,000 are monitored. ALEOs receiving between £1,000 and £10,000 complete a self-monitoring form. Those receiving over £10,000 complete a more rigorous monitoring exercise.



## Exhibit 10

### Examples of good practice

This is a small sample and other councils will also have good practice to offer.

#### Principle 4. Representation

##### Angus

Council involvement in the Angus Digital Media Centre sets out the demarcation of duties for the members and officers who are involved.

##### East Ayrshire

Where an officer or councillor takes on a decision-making role in an ALEO, the organisation must have Director's and Officers' Liability Insurance. Reports on appointments to ALEOs remind officers and councillors that adequate insurance cover should be in place. One of the grant conditions points out that the council will not accept liability for damages or injuries associated with grant-funded projects.

##### Fife

The council runs an annual training programme for officers who support the voluntary sector. Training covers all six Code principles but focuses on the financial regime and monitoring. It provides officers with a greater understanding of what their support role entails; the council's expectations of them; a grounding in implementing the monitoring and evaluation framework; a basic knowledge base for some of the issues they may encounter; and also provides an opportunity for officers to network and give feedback on their views and needs.

##### Perth & Kinross

The council has developed an intranet 'one-stop-shop' for employees and elected members, which provides tools and reference information to help them understand and implement the council's policies on funding ALEOs and 'following the public pound'.

#### Principle 5. Limitations

##### Angus

A standard SLA details the level of funding, the duration of the funding agreement, and the council objectives to be met. The SLA also contains termination provisions to which both parties must agree at the outset. The council adopts a pragmatic approach whereby the SLA is applied most rigorously to the more material funding arrangements. Although no strict value is applied to determine materiality (each case is determined in its own right), nominal funding commitments are covered less formally through the council's internal guidance documents, procedures, and communication between parties.

Notification letters for approved grants contain timescales within which funding must be utilised.

##### Argyll & Bute

The standard contract entered into by ALEOs includes terms limiting the extent to which the council can be involved financially. If an ALEO has underspent, the council reserves the right to reduce funding in subsequent years and, in the final year, require the ALEO to return unspent monies. SLAs are now being set up in line with three-year funding commitments. These have annual reviews built in to appraise performance and, where necessary, terminate funding before the end of the original agreement. The council has the right to terminate funding if the ALEO's performance persists below a pre-agreed, acceptable standard.

##### Glasgow

The council's Conditions of Grant Award refers to areas where the council will become involved (eg, by allocating a council support officer) and where it will not (eg, on the ALEO's internal employment matters). The award documentation includes sections on terminating the funding agreement and separating the council's interests from those of the ALEO.

## Principle 6. Accountability

### Angus

Access rights for both internal audit and external audit are covered in the council's standard SLA.

### Argyll & Bute

The standard agreement includes two clauses:

- 'We understand that in order to follow the trail of public money we must provide the council's external auditors with a right of access to our records, accounts, financial arrangements etc.'
- 'We understand that the council's external auditors have access through the council to our own external auditors.'

### East Ayrshire

The ALEO has a duty to co-operate fully with the designated council monitoring officer, and to provide such explanations as may be required by the council's external auditor.

### Glasgow

The council's Conditions of Grant Award give its external auditor a right of access to key records in ALEOs.

### Renfrewshire

Grant conditions require ALEOs to keep records available for inspection by council officers for three years where the award is less than £5,000, and for five years if the award is for over £5,000.

ALEOs are also required to take account of the record-keeping requirements of organisations such as HM Revenue & Customs and the European Commission.

Internal Audit has had significant involvement in distilling the Code into specific recommendations for improvements to the council's operational arrangements, and includes in its strategic audit plan reviews of such arrangements.

# Appendix 1. Code of guidance on funding external bodies and following the public pound

The Code was published jointly by the Accounts Commission and the Convention of Scottish Local Authorities, in 1996.

## Objective of the Code

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.

## 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.

## 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.

## 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.

## Monitoring arrangements

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.

## 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 Act.

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.

## 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, a change of leading personnel in the external body.

## 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.

# Appendix 2. Index of this report against the Commission's initial findings

On the basis of Audit Scotland's initial review, published in 2004, the Accounts Commission had concerns about councils' funding of arm's-length bodies and particularly, about the lack of reliable information on the position. The Commission anticipated that these issues would grow in significance as councils become increasingly involved in partnership working and innovative ways of delivering services. The Commission therefore asked Audit Scotland to carry out further work as a matter of priority to establish:

- application of the Code – action taken by councils to apply the Code to funding relationships already in place; and steps being taken to apply it to new funding relationships
- information systems – the extent of implementation of improvements being made by councils in management information systems and controls
- high-value versus low-value funding – the amounts going to companies and trusts which receive high-value funding from councils and the amounts going to the large number of organisations which receive relatively small individual grants, and the ways in which councils are dealing with both categories.

The table below indexes the Commission's concerns to the key messages in this follow-up report.

Key message in this report	Accounts Commission query		
	Application of the Code to existing and new relationships	Management information systems	High-value versus low-value funding
1. There was no direct relationship between the size of councils' overall budget and the proportion of it that was provided to ALEOs.			Summary Paras 7, 8, 9, 10
2. Councils need better information about their support for ALEOs, the intended benefits, and what is obtained for the money provided.	Summary Para 12	Summary Paras 11, 12, 13	
3. Councils do not have a systematic, risk-based approach to dealing with ALEOs.		Summary Paras 14, 15,	Summary Paras 14, 15
4. ALEOs highlighted opportunities for councils to improve.	Summary Paras 16, 17	Summary Paras 16, 17	Summary Paras 16, 17
5. No council fully complied with the Code, and all councils must improve their performance.	Summary Paras 18, 20	Summary Para 19	Summary Para 20
6. There is scope to review and update the Code.	Summary Para 21		Summary Para 21

# Appendix 3. Methodology for the follow-up study

## What was our overall objective?

We sought to identify the total amount of council support for ALEOs and the extent to which councils performed against the Code.

## Which councils were covered by the study?

The study covered all 32 councils in Scotland.

Within each council, a point of contact was responsible for distributing a questionnaire to all council departments, collating departments' returns, then supplying the council's external auditor with a single amalgamated, corporate return on behalf of the council.

## What sorts of ALEOs were within the scope of the study?

We looked at councils' support for ALEOs in the form of companies, charitable trusts, community and voluntary organisations, and some organisations particular to each council.

We did not assess councils' involvement with trades unions, political bodies, Community Regeneration Funds (CRFs), pension schemes, educational endowments, funding to other statutory public sector bodies as part of their core business (eg, police forces), or tourist boards. Nor did we investigate the ALEOs themselves – they are outside our remit.

## Which funding arrangements were within the scope of the study?

We collected information about councils' support for ALEOs through grants, service level agreements, deficit funding arrangements, loans and loan guarantees, joint funding agreements, and match funding.

We did not look at: arrangements for councils' expenditure through commercial contracts for the purchase of goods and services; situations where a council administers the distribution of funds on behalf of another agency or acts as a banker (eg, in channelling monies to CRFs); PFI contracts; or the block or spot purchase of personal services for individuals, such as residential care home places for the elderly.

## What information did we collect from each council?

Through the questionnaire, we collected data on:

- financial support:
  - in the form of revenue, capital or loans
  - by the service area that the supported ALEOs operate in eg, social work, housing
  - by the type of ALEO supported eg, charity, company, voluntary/ community body
  - by the amount of funding involved
- non-financial support:
  - in the form of low-cost or 'free' use of council property and facilities, and discretionary rating relief
- the council's involvement with companies and trusts, where they had:
  - a significant shareholding
  - a significant investment in terms of loan capital, or
  - which were set up by the council for a commercial objective and where the

council has contributed significant financial support or transferred significant assets to the body; examples included property development vehicles, leisure trusts, and joint ventures with private sector companies

- a summary of internal control and operational arrangements
- data on the council's performance against the Code
- any evidence-based examples of good practice.

## How robust is the information?

Councils provided information about their funding arrangements in relation to ALEOs and self-assessed their performance against the Code using the questionnaire supplied by the study team.

External auditors validated the information provided by councils.

## Assessment of council performance

We broke out the Code's six principles into 22 statements of good practice.

### Principle 1. Purpose

- The council operates within its statutory powers.
- The prime purpose of involvement with an ALEO is the achievement of the council's objectives in the most effective, efficient and economic manner.
- Council policy sets out procedures covering funding of an ALEO.
- The council sets out its expectations on the use of funding.



### Principle 2. Financial regime

- 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).
- The council defines the extent and nature of its involvement with an ALEO.
- 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.
- At the outset of a new relationship with an ALEO, the council specifies minimum arrangements for accounting and audit purposes.

### Principle 3. Monitoring

- 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.
- The council stipulates how it intends to monitor the relationship between itself and an ALEO.
- Monitoring reports on an ALEO are regularly submitted to the council (or a committee or its equivalent, as appropriate), which takes appropriate action.

### Principle 4. Representation

- The council appoints members or officers to sit on ALEOs where this is necessary and appropriate.

- 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.
- The council ensures that all members and officers involved in an ALEO understand their respective responsibilities to the council and to the ALEO.
- 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.
- The council has taken steps to safeguard itself from risks incurred by members and officers in their dealings with ALEOs.

### Principle 5. Limitations

- In entering into a substantial funding commitment with an ALEO, the council lays down a timetable for the achievement of its objectives.
- The council sets clear limits on the extent to which it will become involved financially in an ALEO and in its affairs.
- The council sets out ground rules at the outset for terminating the funding agreement and separating its interest from that of the ALEO.

### Principle 6. Accountability

- 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 they may follow the trail of public money from the council through the ALEO to its destination.

- The external auditor is able to seek, through the council, any explanations which they consider necessary from representatives of an ALEO.
- The external auditor has access, through the council, to an ALEO's external auditors.

### Questionnaire for councils

Councils were provided with a questionnaire and asked to evidence a score for each statement, on the following five-point scale, for both processes and key documents:

- 1 = the process was not in place/ plans to introduce the process were at very early stage. A relevant document did not exist or was at the very early draft stage.
- 2 = the process was not yet in place but plans were at an advanced stage or the process was in place but most key mechanisms were missing. A draft document existed but was yet to be approved or was not in use operationally. Alternatively, a formally approved document omitted most of the important issues.
- 3 = the process existed but some key mechanisms were not in place. A formally approved document existed, but omitted some of the important issues, or a draft document, although yet to be formally approved, was in use operationally.
- 4 = the process was fully in place. A formally approved document covered all, or almost all, of the important issues.
- 5 = the process was fully in place and clearly integrated into everyday working practice. Use of a document was clearly integrated into everyday working practice.

Each council submitted its completed questionnaire to the auditor, who reviewed the council's scores and the evidence to support them. In discussion with the council, the auditor had the discretion to revise scores in light of the evidence – either upwards or downwards.

Once auditors had validated councils' returns, they submitted them to the study team at Audit Scotland headquarters, where a 'moderation panel', which included the study team and a number of auditors, carried out an exercise to ensure consistency in the assessment of Code compliance.

For each council, the study team computed a mean score for each of the six principles, based on the scores for its constituent statements of good practice.

An overall Code compliance score for the council was computed from the mean of its scores for each of the six principles.

A council's level of Code compliance, both overall and on each of the six principles, is defined on the following, four-band scale:

- Very low = greater than or equal to 1.0, but less than 2.0.
- Low = greater than or equal to 2.0, but less than 3.0.
- Moderate = greater than or equal to 3.0, but less than 4.0.
- High = greater than or equal to 4.0, and no more than 5.0.

### Local audit reports

Each council's external auditor has prepared a local report that includes an action plan agreed with the council.

### Good practice

All councils were invited to submit examples of good practice. Any good practice returns by councils were validated by external auditors for factual accuracy.

### Interviews with ALEOs

The study team interviewed a senior representative of a small sample of ALEOs to canvas their views on councils' arrangements and opportunities for improvement.

The 16 ALEOs we met were selected to cover a wide range of service areas, organisation types, geography, and council areas. After each meeting, we prepared a meeting note whose factual accuracy was agreed with the interviewee:

- Dunfermline Facelift Trust
- Edinburgh Leisure
- ELCAP – provides support for people with disabilities, and their families
- Forth and Clyde Canal Society
- Lemon Tree
- Scottish Adoption Association Ltd
- Scottish Pre-School Play Association
- Shelter Scotland
- Small Business Gateway Fife.
- Age Concern
- Barnardo's Scotland
- Brunton Theatre
- Carr Comm – provides person-centred support, supporting living and community care services
- Citizens Advice Scotland
- Dovetail Enterprises Charitable Trust/Limited
- Dundee Repertory Theatre Ltd

# Appendix 4. Summary of councils' financial support for ALEOs

## Support by service area – amount of funding

The table shows the amount of money each council provided to ALEOs in 2003/04, (£000).

Council	Total spend	Cultural & leisure	Education	Environment	Housing	Planning & economic development	Roads & transport	Social work & welfare	Other
Aberdeen	7,529	1,802	713	1,350	814	1,889	3	371	586
Aberdeenshire	7,936	1,115	1,990	68	787	558		3,290	128
Angus	1,656	63	51	58	169	158		1,142	16
Argyll & Bute	1,364	93	302	9	3	82		733	142
Clackmannanshire	2,442	1,381	364		159	38		468	34
Dumfries & Galloway	4,319	1,147	14	207	568	631		1,272	479
Dundee	2,973	849		25	174	414		1,149	362
East Ayrshire	2,326	643	110		1	936		636	
East Dunbartonshire	757	130	37		5	177		170	240
East Lothian	6,379	1,957	62	201	2,065	58	44	1,987	6
East Renfrewshire	2,220	134	38		114	49		1,886	
Edinburgh	46,272	10,600	2,624	223	626		1,330	30,869	
Eilean Siar (Western Isles)	3,420	1,231	358	965	85	400	22	233	125
Falkirk	5,417	213	899	411	43	937		2,915	
Fife	14,263	1,924	101		3,918	1,638	15	5,191	1,476
Glasgow	32,198	7,838	826	52	2,782	1,768		16,615	2,317
Highland	11,634	3,927	336	69	86	798	1	6,418	
Inverclyde	2,191	1,701	110					381	
Midlothian	1,491	328	193			161		809	
Moray	2,734	790	1,294	148	320	43		139	
North Ayrshire	6,122	4,561	134		246			527	654
North Lanarkshire	3,254	114	1,004		12	204	191	918	811
Orkney Islands	9,496	89	123	4	92	7	6,973	1,274	933
Perth & Kinross	7,376	3,534	1,123	27	496	263		1,933	
Renfrewshire	6,025	3,882	354	5	4	221		1,398	161
Scottish Borders	1,843		1,205	53		199		11	375
Shetland Islands	3,066	51	175	4	93	2,720	23	0	
South Ayrshire	1,370	376		96	340			406	153
South Lanarkshire	9,999	6,733	155	2	559	796		161	1,592
Stirling	2,606	443	215	38	54	136	140	1,574	5
West Dunbartonshire	2,510		55		14	1,415		550	476
West Lothian	5,900	2,167	112		113			3,508	
<b>Scotland</b>	<b>219,089</b>	<b>59,815</b>	<b>15,077</b>	<b>4,014</b>	<b>14,742</b>	<b>16,694</b>	<b>8,742</b>	<b>88,934</b>	<b>11,070</b>

## Support by service area – number of ALEOs

The table below shows the number of ALEOs each council supported in 2003/04.

Council	Total	Cultural & leisure	Education	Environment	Housing	Planning & economic development	Roads & transport	Social work & welfare	Other
Aberdeen	279	55	22	5	6	9	1	29	152
Aberdeenshire	555	165	133	4	8	101		73	71
Angus	169	44	24	1	7	11		53	29
Argyll & Bute	242	49	105	1	5	5		74	3
Clackmannanshire	101	8	14		10	1		38	30
Dumfries & Galloway	440	70	3	6	7	39	1	22	292
Dundee	168	24		1	22	4		31	86
East Ayrshire	323	155	37		7	42		82	
East Dunbartonshire	142	43	10		11	6		8	64
East Lothian	254	74	51	28	14	4	1	80	2
East Renfrewshire	190	70	15		14	61		30	
Edinburgh	574	64	115	8	8		20	359	
Eilean Siar (Western Isles)	725	241	90	157	44	68	8	38	79
Falkirk	135	69	9	5	1	4		47	
Fife	945	511	4		42	46	6	170	166
Glasgow	1,619	573	22	2	26	9		252	735
Highland	1,067	649	7	44	33	188	1	145	
Inverclyde	83	37	19					27	
Midlothian	252	118	42	1		24		67	
Moray	192	55	67	24	5	16		25	
North Ayrshire	369	93	34		16			38	188
North Lanarkshire	1,045	18	273		26	4	1	84	639
Orkney Islands	260	25	76	1	11	3	6	75	63
Perth & Kinross	266	107	70	28	2	6		53	
Renfrewshire	455	14	63	2	13	7		61	295
Scottish Borders	396		104	10		43		13	226
Shetland Islands	17	2	8	1	2	2	2		
South Ayrshire	179	11		9	6			11	142
South Lanarkshire	1,582	23	2	1	42	155		4	1,355
Stirling	339	59	142	27	5	38	2	63	3
West Dunbartonshire	151		10		14	10		60	57
West Lothian	260	96	34		2			128	
<b>Scotland</b>	<b>13,774</b>	<b>3,522</b>	<b>1,605</b>	<b>366</b>	<b>409</b>	<b>906</b>	<b>49</b>	<b>2,240</b>	<b>4,677</b>



# Following the Public Pound

A follow-up report



If you require this publication in an alternative format and/or language, please contact us to discuss your needs. It is also available on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)

Audit Scotland  
110 George Street  
Edinburgh EH2 4LH

Telephone  
0131 477 1234  
Fax  
0131 477 4567