

REPORT TO: SCRUTINY COMMITTEE – 24 JUNE 2015

REPORT ON: FOLLOW UP REVIEW: ARMS LENGTH EXTERNAL ORGANISATIONS: ARE YOU GETTING IT RIGHT?

REPORT BY: DIRECTOR OF CORPORATE SERVICES

REPORT NO: 253-2015

1 PURPOSE OF REPORT

To provide elected members with a summary of the attached follow-up review to the above national study that has recently been undertaken by the council's external auditor on behalf of the Accounts Commission.

2 RECOMMENDATIONS

It is recommended that elected members note the key findings arising from this follow-up review.

3 FINANCIAL IMPLICATIONS

There are no direct financial implications arising from this report.

4 MAIN TEXT

4.1 In 2011, as part of its series of 'How Councils Work' publications, Audit Scotland carried out a review of Arm's Length External Organisations (ALEOs) on behalf of the Auditor General for Scotland and the Accounts Commission. The report was aimed at both councils that were considering establishing ALEOs together with those with existing ALEOs and was intended to promote and encourage good practice in the way these organisations are operated. The report also focused on how councils established ALEOs and maintained governance and accountability for both finance and performance. The report was previously considered by Scrutiny Committee on 24 August 2011, (Article II of the Minute of Meeting of the Scrutiny Committee of 24 August 2011, Report No: 375-2011 refers).

4.2 As part of their scheduled work for the year, the council's appointed external auditor was required to undertake a follow-up review to this report. The aim of their review was to:

- provide the Accounts Commission with a position statement on the council's use of ALEO's and, in particular, on progress since the above report was published; and
- inform their consideration of ALEOs in the context of the public audit model.

4.3 The follow-up review was undertaken in accordance with guidance issued by Audit Scotland that identified five key issues surrounding the governance arrangements for ALEOs. KPMG were required to review the policies and procedures in operation within the council for each of these issues, and assess their effectiveness as being either 'basic practice, basic and better practice or advanced practice'. The five key issues identified included:

- has the council formally considered the Commission's 'How Councils Work report on ALEOs'? If so, did it develop an action plan and have these actions been addressed?
- how clear is the council about its reasons for delivering services through ALEOs?
- how well does the council understand the financial commitment and risk to which it is exposed through ALEOs?
- how effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?
- where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?

4.4 The external auditors' findings are summarised within the attached report. It is encouraging to note that no significant improvement recommendations have been made by KPMG and that the council were classified as being 'basic and better practice' for each of the areas reviewed. It is noted however, that their findings identify areas where there is scope to enhance the existing good practice arrangements that are currently in place. The council will consider these items and the relevant officers will make the appropriate arrangements to implement any necessary improvements in due course.

5 **POLICY IMPLICATIONS**

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

6 **CONSULTATIONS**

The Chief Executive and Head of Democratic and Legal Services have been consulted on the content of this report.

7 **BACKGROUND PAPERS**

None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES

15 JUNE 2015



cutting through complexity

Dundee City Council

Targeted follow-up report

Arm's-Length External Organisations – *Are you getting it right?*

Audit: Year ended 31 March 2014

3 June 2015

This report is presented in connection with our audit for the year ended 31 March 2014 under the terms of our appointment by the Accounts Commission for Scotland. The contacts at KPMG in connection with this report are:

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Dundee City Council ("Council") and is made available to Audit Scotland and the Accounts Commission for Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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This report sets out our findings from a targeted follow-up on the Council's arrangements as they relate to the Accounts Commission report *Arms-Length External Organisations: Are you getting it right?*, which was published as part of the Commission's *How Councils Work* series of improvement reports for councillors and officers.

Background

Arm's-length external organisations ("ALEOs") provide recognised 'council services' e.g. leisure services, but they can also manage commercial operations e.g. exhibition facilities and commercial properties. While the ALEO is responsible for services, the council remains responsible for the public money it gives to the ALEO and the quality of services the ALEO provides.

The Accounts Commission's interest in ALEOs goes back to the 1996 *Following the public pound* Code produced with COSLA. In 2011, the Commission published *Arm's-length External Organisations: Are you getting it right?* as part of its *How Councils Work* series of improvement reports for councillors and officers.

The aim of the targeted follow-up work is to:

- provide the Accounts Commission with a position statement on councils' use of ALEOs and, in particular, on progress since the *How Councils Work* report on ALEOs was published in 2011; and
- inform the Accounts Commission's consideration of ALEOs in the context of the public audit model.

This follow-up work is being undertaken in accordance with the local government planning guidance issued by Audit Scotland to local auditors.

Approach

The governance of ALEOs is a major element of the targeted follow-up audit. To this end, and to support judgements on the effectiveness of governance arrangements, the guidance issued to local auditors was to apply the *Toolkit for improving the governance of ALEOs* set out at the end of the *How Councils Work* report on ALEOs. This identifies the key issues and includes a list of prompts which might indicate 'basic practice, basic and better practice and advanced practice'.

Our audit approach has therefore involved a review of policies and procedures in operation at Dundee City Council, as well as information gathering in respect of certain arrangements. To support reporting to the Accounts Commission, we have included judgements on the effectiveness of the governance arrangements within the Council.

It is recognised that there is of course no single definition of what an ALEO is and therefore for the purposes of this follow-up work, the starting point has been to use the information in the Council's group accounts, supplemented by our local knowledge of the Council and its activities.

This report is structured to answer the five questions identified in the checklist provided by Audit Scotland to inform the follow-up work:

1. Has the council formally considered the Commission's *How Councils Work* report on ALEOs. If so, did it develop an action plan and have also actions been addressed?
2. How clear is the council about its reasons for delivering services through ALEOs?
3. How well does the council understand the financial commitment and risk to which it is exposed through ALEOs?
4. How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?
5. Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?

In reporting our findings, we have classified the Council's practice according to the 'basic practice', 'basic and better practice', or 'advanced practice' classifications included by Audit Scotland within the follow-up guidance.

1. Has the council formally considered the Commission's How Councils Work report on ALEOs. If so did it develop an action plan and have also actions been addressed?

Council arrangements

Following the publication of *Are you getting it right?* report in 2011, the report was submitted to the Council's scrutiny committee on 24 August 2011 together with a covering report by management.

The covering report provided elected members with a summary of the national study report, and recommended that members note the key findings of the report along with the questionnaire checklist and self-assessment toolkit provided in the appendices to the report.

No action plan was produced as a result of the consideration of the report.

In 2013 and 2014, the Council reviewed its standing guidance on *Funding External Bodies and Following the Public Pound*. This guidance was established in response to the original Accounts Commission *Following the Public Pound* Code produced with COSLA in 1996, and has been reviewed at regular intervals since that time.

The latest review took account of the findings of the 2011 publication in revising the guidance and how it would apply within the Council.

KPMG findings

The Council has ensured the 2011 report was formally considered by an appropriate committee.

As no formal action plan was prepared following the consideration of the 2011 report, there is no assessment to be made on how any specific actions have been addressed.

We note, however, that the revision of guidance on funding of external bodies and following the public pound to take account of the 2011 report key findings demonstrated that the Council has given the 2011 report's recommendations due consideration.

Overall assessment

Basic and better practice

Summary of findings (continued)

2. How clear is the council about its reasons for delivering services through ALEOs?

Council arrangements

The Council considers its principal ALEOs to be those entities included in its group accounts, and listed in Appendix 2 to this report. Many of these entities were established a number of years ago and so the detailed risk assessment and analysis of the reasons for establishing the ALEO are more difficult to trace.

The Council's major ALEO, Leisure and Culture Dundee, was established in 2011. A purpose statement outlining its objectives, key services provided, governance structure and other arrangements is available and in the public domain. The services provided are services that the Council would be expected to ensure there were arrangements for the provision of them to the citizens of Dundee, such as library and information services, operation of art gallery, museum, sports centres and swimming pools.

The Council's standing guidance on *Funding External Bodies and Following the Public Pound* covers substantial funding arrangements with their party organisations, and therefore has a wider scope than those bodies the Council considers to be its principal ALEOs. However, within this guidance, there is pro-forma documentation to be completed where the Council enters into a substantial funding relationship, classed as one where funding is in excess of £60,000. The guidance also requires such funding to be the subject of a report to the relevant committee in advance of entering into the arrangement.

KPMG findings

Based on available evidence, the decision to set up or engage with an ALEO is made within the Council's powers and follows an appraisal of options for service delivery.

The Council has established within its reports the clear limits regarding service objectives of the ALEO. The Council has also agreed management agreements or service level agreements with ALEOs.

There is scope for a more obvious regular review process of the ALEOs entered into, the reasons for participating with those ALEOs and how their service provision fits with the strategic objectives of the Council. For example, in the recent review of the standing guidance on *Funding External Bodies and Following the Public Pound*, while this listed the main ALEOs for which the Council held insurance details, this report would have been enhanced by including additional information to advise elected members of the continuing reasons for those ALEOs, and how they align to the Councils' strategic objectives.

Overall assessment

Basic and better practice

Summary of findings (continued)

3. How well does the council understand the financial commitment and risk to which it is exposed through ALEOs?

Council arrangements

The Council is clear in its expectation that all ALEOs have to operate on a viable basis. Performance is monitored at least annually in review meetings with the Council. For Leisure and Culture Dundee, the monitoring is done on a quarterly basis.

In addition, at least one Council finance officer is appointed as a director in each of the ALEOs. As directors of those bodies, the individuals are aware of their responsibilities in respect of monitoring the financial affairs of the ALEOs, and have access to Council guidance on managing conflicts of interest – see question 5 response.

Council guidance for entering into substantial funding arrangements includes consideration of the financial regime associated with the funding, including:

- consideration of the extent and nature of funding;
- the options appraisal requirements prior to investment in the body;
- any Council policies which the funded body will be expected to comply with (eg purchasing policy); and
- any potential exit strategies for the Council.

KPMG findings

Evidence obtained supports the Council's assessment of risk before entering into an agreement. The Council has also agreed management agreements or service level agreements with ALEOs. These allow for agreement of key activities, key activity target levels for the year and expected outcomes.

In a recent example of the Council's arrangements in practice, following a fire at Dundee Energy Recycling Limited ("DERL"), detailed reports were prepared for the Policy & Resources Committee to consider the risk associated with additional investment in the company to ensure its continued operation, against the additional waste disposal costs that would be incurred by the Council should alternative arrangements need to be put in place. On the basis of the analysis, further investment into DERL was approved and the plant has now re-opened and commenced operations.

There is scope for an ongoing update paper to elected members reviewing the Council's overall involvement in ALEOs, providing assurance to members in respect of any potential exposure to risk, and the steps officers have taken during the year to mitigate that risk.

Overall assessment

Basic and better practice

Summary of findings (continued)

4. How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?

Council arrangements	KPMG findings	Overall assessment
<p>Council guidance for entering into substantial funding arrangements includes consideration of:</p> <ul style="list-style-type: none"> ■ Accounting and audit requirements, including <ul style="list-style-type: none"> — setting standards for maintaining accounting records; — defining the responsibility and accountability of the organisation's management committee (or equivalent); — securing access to documentation and financial records by Council officers; and — ensuring there is access to records and accounts of the body for the Council's internal auditor and/or external auditor. ■ Financial and performance monitoring arrangements, including <ul style="list-style-type: none"> — agreeing proposed methods of measuring performance to be included in a service level agreement; — reporting on achievement of objectives; — details of annual budget and comparison of actual income and expenditure against this; and — notification of events which may trigger a Council-review of arrangements, eg change in personnel at the organisation. 	<p>The Council's arrangements as set out in its standing guidance are considered comprehensive and meet the requirements for ensuring appropriate financial and service performance monitoring of ALEOs, and other bodies where a substantial funding relationship is in place.</p> <p>In respect of the Dundee Ice Arena, during the year the activities of this charity were transferred to Leisure and Culture Dundee. This new arrangement took effect from 1 April 2014.</p> <p>We note that the Council's internal auditor has included reviews within the internal audit plan for the year which cover governance arrangements at Leisure and Culture Dundee, and separately as a general review of the application of the monitoring arrangements as described opposite as they apply to partnership organisations that the Council works with.</p> <p>It is considered good practice to include the internal audit analysis of arrangements within the audit plan. The standing guidance, however, indicates that a corporate register of substantial funding arrangements should be held centrally. From our discussion with officers, it was not clear that this is routinely updated and so there is scope to enhance the ongoing compliance with the Council's established arrangements.</p>	<p>Basic and better practice</p>

Summary of findings (continued)

5. Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?

Council arrangements

The Council's guidance on funding external bodies and following the public pound contains a section on the roles and responsibilities of council elected members and officers where they are appointed to the board, or equivalent, of an ALEO.

This guidance highlights the importance of ensuring that elected members or officers in this position are provided with appropriate advice, particularly in respect of legal and insurance requirements, as the duties owed by the members or officers to the outside bodies they sit on can give rise to confusion of roles, conflicts of interest, and the placing of different additional obligations on them.

The guidance notes that elected members and officers will only be covered by the Council's indemnity insurance policy when they act in a purely advisory capacity in connection with the Council's functions on outside bodies' board/committee meetings. Otherwise, where the individual acts in an executive or decision-making role for the outside body, they need to ensure that appropriate insurance arrangements are in place.

The Council's Insurance and Risk Management section maintains a database of relevant outside organisations' insurance details.

The Head of Democratic and Legal Services at the Council maintains an officers register of interests. In addition, each of the Council's ALEOs is expected to keep a register of interests.

KPMG findings

A briefing was held for all elected members of all ALEOs in May 2012. This outlined their duties to their companies. However, in discussion with several officers involved in ALEOs, it is not clear that detailed training on changes in legislation have been provided to them, or that the Council has ensured that this is provided by the organisation where they serve.

In respect of Leisure and Culture Dundee, evidence was available of training provided to the charity trustees at the time of set-up by the appointed external auditor. Further training was provided to the directors of Leisure and Culture Dundee in February 2015.

We inspected the minutes of selected ALEO board meetings to confirm that declarations of interest formed part of the agenda items.

We inspected the register of interests for officers and noted general compliance, although one officer of the Council had not at the time listed their involvement as a director on a Council ALEO. We understand this has now been completed.

Overall assessment

Basic and better practice



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Appendices

Appendix 1 – Significant audit recommendations

No significant audit recommendations have been made to management as a result of our targeted follow-up.

Recommendations to management

We have not made any significant recommendations to management as a result of this targeted follow-up.

Our findings identify areas where there is scope to enhance existing good practice arrangements.

Appendix 2 - Pro forma for collection of quantitative data

The table opposite sets out the required collection of quantitative data for each of the entities which the Council considers to be an ALEO.

Name of ALEO	Legal status	Services delivered	Turnover	Net assets	Workforce	Source of data e.g. 13/14 accounts (or most recent available), developments in 13/14 etc.
Dundee City Developments Ltd (DCD)	Private limited company without share capital	Economic regeneration and to maintain momentum across a range of economic development initiatives in the city.	£392,068	£1,417,646	-	30 April 2013 audited financial statements
Dundee Energy Recycling Ltd (DERL)	Private limited company with share capital	To construct and operate a Waste-to-Energy Plant at Baldovie, Dundee.	£6,601,000	£(4,252,000)	45	Dundee City Council group accounts 2012-13
Leisure and Culture Dundee	Scottish Charitable Incorporated Organisation	To manage and operate the Council's swimming and leisure facilities.	£12,995,220	£(12,735,456)	549	Dundee City Council group accounts 2012-13
Dundee Contemporary Arts	Charitable company limited by guarantee without share capital	To operate the Arts Centre in Dundee, which is owned by the Council	£1,909,336	£(364,089)	40	31 March 2013 audited financial statements

The Council also has an interest in other bodies such as associated committees which they do not consider to be ALEOs.

Note that the Council does not consolidate its interest in Dundee Contemporary Arts as its interest in this entity is not considered material to the group accounts.

Appendix 3 - Pro forma for potential case studies

Please include brief details of any ALEOs or governance arrangements you consider might be worth highlighting. E.g. example of effective governance arrangements, a recent review of governance arrangements, a recent robust options appraisal process leading to a new ALEO being created, an ALEO that is performing particularly strongly or which is not.

In a recent example of the Council's arrangements in practice, following a fire at Dundee Energy Recycling Limited ("DERL") in 2012, detailed reports were prepared for the Policy & Resources Committee to consider the risk associated with additional investment in the company to ensure its continued operation, against the additional waste disposal costs that would be incurred by the Council should alternative arrangements need to be put in place. On the basis of the analysis, further investment was approved into DERL and the company has now re-opened and commenced operations.



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