



cutting through complexity

East Lothian Council

Targeted follow-up report
Arm's-Length External Organisations – Are you getting it right?

7 July 2014

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 East Lothian Council ("Council") and is made available to Audit Scotland and the Accounts Commission (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 required to complete the questionnaire.

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The purpose of this report is to report 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 this 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 the Council, as well as information gathering in respect of certain arrangements.

To support reporting to the Accounts Commission, we have provided in our report 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. In appendix one we set out the Council's ALEO, and subsidiary entities as noted in the Council's group accounts.

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?

Our consideration of the overall arrangements for governance and accountability has focused on Enjoy East Lothian Limited. Management have identified this to be the sole ALEO of the Council.

Question	Evidence	Conclusion*
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?	Management presented the Commission's report on ALEOs to the audit and governance committee on 27 September 2011. This was discussed by the audit and governance committee however an action plan was not developed. The committee requested a clearer paper on ALEOs to be prepared, however this has not yet been completed.	Basic
How clear is the council about its reasons for delivering services through ALEOs?	<p>An options appraisal was prepared by external advisers, exploring the rationale and risks for a number of scenarios for delivery of sport and leisure services. This was considered by the Council before it committed to progress a transfer to an ALEO, being Enjoy East Lothian Limited ('Enjoy'). The specification for leisure services document sets out the minimum service provision required. This does not set out the circumstances in which the agreement would be terminated.</p> <p>Management do not formally review whether the services provided by the ALEO remain aligned with the Council's wider objectives, although recently the Enjoy Board was encouraged to recruit a health care professional to provide expertise in light of the evolving Council objectives in relation to community health partnerships. There are no formally documented circumstances which would trigger a review of the Council's involvement in the ALEO, although management discussed three situations (under performance of service delivery, not meeting the wider Council objectives and significant financial difficulties) whereby they would consider a review. Ongoing regular contract management helps mitigate the associated risks.</p>	Basic

* Our conclusion is based the three levels of practice (basic, basic and better, advanced) as defined in *appendix two: toolkit for improving governance of ALEOs* in the Audit Scotland report.

Question	Evidence	Conclusion*
<p>How well does the council understand the financial commitment and risk to which it is exposed through ALEOs?</p>	<p>Financial commitment and risk were two elements of the option appraisal considered by Council prior to transferring services and staff to the ALEO. During the transfer process, the Council was advised by external legal and financial advisers who were considered to be specialists in the field. A project board and project group were constituted and explored issues raised in respect of funding and risk. Reports to Council were prepared and considered at appropriate milestones in the process to ensure elected members were content with progress and with the direction of travel.</p> <p>There is a management contract between East Lothian Council and Enjoy East Lothian Limited and there are a number of service level agreements for IT, HR, payroll and property maintenance, which set out the summary of charges in relation to these services provided to Enjoy.</p> <p>The services to be delivered by Enjoy are specified in the contract between the parties and the effects of failure to perform are also set out. Further improvements in accountability and performance measurement are being explored by Council officers and the Enjoy Board at this time.</p> <p>The Council has not set specific governance, finance and performance indicators for Enjoy and there are no documented contingency plans to ensure continuous service delivery if the agreement were to end. Financial statements are prepared and audited annually, with a summary presented to the audit and governance committee of the Council each year, together with a management report, enabling consideration of performance and related financial risks.</p>	<p>Basic and better</p>

* Our conclusion is based the three levels of practice (basic, basic and better, advanced) as defined in *appendix two: toolkit for improving governance of ALEOs* in the Audit Scotland report.

Question	Evidence	Conclusion*
<p>How effective are the council's arrangements for monitoring the financial and service performance of ALEOs, maintaining accountability and for ensuring audit access?</p>	<p>The initial specification for leisure services identified that the Company would liaise at regular intervals. The specification also sets out the expected standards of service and ways in which the Company would work with stakeholders.</p> <p>Enjoy presents its annual accounts to the Council; the audit and governance committee meeting in September 2013 included a management report on the performance, which covered financial performance, user statistics, future developments and an extract of the audited financial statements. This enabled members to scrutinise performance of the ALEO.</p> <p>There are quarterly contract meetings between senior officers of the Council and Enjoy. The quarterly meetings are attended by the depute chief executive (support services) and finance manager. The head of infrastructure and senior manager for sport, countryside and leisure attend all Enjoy Board Meetings as observers.</p> <p>The council receives forward plans and scrutinises the contents; Enjoy is developing the business plan and this will be presented to the Council in 2014,</p> <p>We understand that there are no significant performance or financial concerns about the ALEO and there are no other public organisations directly involved in Enjoy activities.</p> <p>The Council expects Enjoy to develop and monitor its own targets and methods of measurement for monitoring performance; these are not stipulated by the Council. Management of Enjoy report internally within the entity on employment practices, equality requirements, purchasing policies and sustainability, although there is no requirement for the Council to monitor these elements.</p> <p>The access rights for internal and external audit are not covered in the management contract. Enjoy appoints its own independent auditor, currently Scott Moncrieff.</p>	<p>Basic and better</p>

* Our conclusion is based the three levels of practice (basic, basic and better, advanced) as defined in *appendix two: toolkit for improving governance of ALEOs* in the Audit Scotland report.

Question	Evidence	Conclusion*
<p>Where members or senior officers are appointed to the board or equivalent of ALEOs, how clear are they about their role?</p>	<p>One third of the Enjoy Board is appointed from elected members of the Council, the appointments are determined at the start of each term. A paper was put to the 12 May 2012 Council meeting which set out the proposed appointments to the Enjoy Board. This did not set out the reasons behind its decisions to select the individual members.</p> <p>Following the last local election, all elected members (including those that had previously been members of the Council) were offered a package of induction training that included a session on potential conflicts of interest arising from their positions on external bodies. Although not all members attended training, management consider that those that did appeared to understand the issues that might arise. There are disclosure policies to be followed and management consider that members appropriately declare interests at Council and committee meetings and seek advice from the monitoring officer / legal advisers if uncertain.</p> <p>On the formation of the Enjoy Board, the external legal advisors provided an induction to Board members and there is subsequently an induction for all new Enjoy Board members.</p>	<p>Basic and better</p>

* Our conclusion is based the three levels of practice (basic, basic and better, advanced) as defined in *appendix two: toolkit for improving governance of ALEOs* in the Audit Scotland report.



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Appendix

The table opposite provides the required collection of quantitative data for each of the entities identified by the Audit Scotland in its paper *Arm's Length External Organisations: Powers of the Commission* presented to the Accounts Commission in October 2013.

Name of ALEO	Legal status	Services delivered	Turnover (£)	Net assets (£)	Workforce	Source of data e.g. 12/13 accounts, developments in 13/14 etc.	Status
Enjoy East Lothian Limited	Company limited by guarantee	The activities of the company are to provide recreational facilities for the people of and visitors to East Lothian, organise recreational activities, which are available to members of the public at large with the objective of improving their conditions of life, contribute to advancing the wellbeing of the inhabitants of, and visitors to the area.	5,784,103	5,262,379	298	2012-13 accounts	ALEO

The following entities are identified within *Arm's Length External Organisations: Powers of the Commission* as subsidiaries and are not considered to be ALEOs.

Name of entity	Legal status	Services delivered	Turnover (£)	Net assets (£)	Workforce	Source of data e.g. 12/13 accounts, developments in 13/14 etc.	Status
East Lothian Land Limited	Private company limited by shares	The principal activity of the company continued to be that of trading in land for development.	9,511	606,702	None	2012-13 accounts	Sub committee
East Lothian Investments	Private company, without share capital	The principal activity of the company continued to be that of granting interest free loans to businesses in East Lothian with the aim of encouraging commercial activity and enterprise in the area.	14,610	552,726	None	2012-13 accounts	Sub committee
Brunton Theatre Trust	Registered Charity	Provision of arts services	1,016,268	386,274	None*	2012-13 accounts	Associated committee
Musselburgh Joint Racing Committee	Joint Racing Committee	The remit of the committee is to organise and develop horse racing at Musselburgh Links. The council nominates four of the seven Committee members.	1,370,241	212,645	Not disclosed	2012-13 accounts	Associated committee

* Brunton Theatre Trust does not have any employees, however there are 11.5 FTE members of staff employed by the Council who work at the Theatre.



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