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30 May 2014

Dear Mary

**Falkirk Council****Targeted follow-up audit - Arm's-length external organisations: Are you getting it right?****Background**

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

Councils in fulfilling their statutory best value duties should consider options for delivering services including the use of ALEOs. ALEOs can offer an alternative means of providing services compared to the more traditional 'in-house' or contract-based approach. Invariably, ALEOs are established as either companies or trusts. There may be benefits in this approach, but there are also risks.

The Accounts Commission's interest in ALEOs dates back to 1996 when it worked jointly with COSLA to produce the *'Following the public pound'* Code. Furthermore, in 2011, the Accounts Commission published *'Arm's-Length External Organisations: Are you getting it right?'*<sup>(1)</sup>. This report set out good practices to be considered when setting up and operating ALEOs.

More recently, following its consideration of a case involving the Highland Council (2), the Chair of the Accounts Commission's wrote to all councils highlighting the serious financial consequences of weak governance in the arrangements for overseeing ALEOs. The Chair took this opportunity to remind councils about the Commission's previous work in this area.

The Commission's ongoing review of ALEOs reflects its interest in ensuring effective governance of public finances and service performance, regardless of the way services are delivered.

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1 How councils work: An improvement series for councillors and officers - Arm's-length external organisations: Are you getting it right?, June 2011 [http://www.audit-scotland.gov.uk/docs/local/2011/nr\\_110616\\_aleos.pdf](http://www.audit-scotland.gov.uk/docs/local/2011/nr_110616_aleos.pdf)

2 The Highland Council: Caithness Heat & Power, Follow-up statutory report, January 2014 [http://www.audit-scotland.gov.uk/docs/local/2014/sr\\_140109\\_chap.pdf](http://www.audit-scotland.gov.uk/docs/local/2014/sr_140109_chap.pdf)

## Audit scope and objectives

The targeted follow-up audit of ALEOs is being carried out across all local authorities in Scotland. The primary aims of the audit are to:

- Provide the Accounts Commission with a position statement on councils' use of ALEOs and, in particular, on progress since the *'Arm's-Length External Organisations: Are you getting it right? (2011)*.
- Inform the Accounts Commission's consideration of ALEOs in the context of the public sector audit model.

More specifically, we have been asked to provide a high level assessment of the governance arrangements that Falkirk Council has in place for overseeing its ALEOs. In carrying out this assessment we used the toolkit accompanying the 2011 report.

Our review covered the following ALEOs:

Name of ALEO	Legal status	Services delivered	Turnover	Net assets	Workforce
Falkirk Community Trust Ltd	Charitable company limited by guarantee	Management and operation of a range of community facing sport, recreation, arts, heritage and library services provided by Falkirk Council.	£16.712m	£742,000	344
Falkirk Community Stadium Ltd	Company limited by guarantee	Management and operation of The Falkirk Stadium.	£843,919	£941,047	16
thinkWhere Ltd (formerly known as Forth Valley GIS Ltd)	Company limited by guarantee	Providing location based information products and consultancy services. Provides geographical information services to the council under contract.	£1,396,091	£669,725	25

## Key findings

### ***Has the council formally considered the How Councils Work report on ALEOs?***

The national report *'Arm's-Length External Organisations: Are you getting it right? (2011)* has not been considered by the council's elected members. Our 2012/13 annual audit report to members highlighted the absence of a formal process by which members consider national audit reports. The Audit Committee has recently approved an approach to address this and, in future, national reports will be considered by an appropriate committee. Members of the committee will have the opportunity to question the relevant senior officer on the council's position in relation to the report and any action

that has been planned in response. The Audit Committee will be provided with an overview of the council's consideration and response to all national reports to allow the members to retain oversight of the process. We will monitor the effectiveness of the new arrangements through our attendance at committee meetings and our follow-up audit work. In line with ongoing reporting arrangements for local audit findings, this letter is to be considered by a meeting of the Audit Committee.

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

The decisions to deliver services through ALEOs have been subject to approval by Falkirk Council. Members were provided with a comprehensive and detailed appraisal when considering the delivery of leisure, cultural and library services via Falkirk Community Trust ("the Trust"). The decision to establish the Trust was made in the context of significant financial constraints on the council. The financial element was clearly an important consideration and members were advised on the contribution a Trust could make to bridge the council's savings gap. Other potential benefits of establishing a Trust were explained to members as well as alternative options to a Trust that members could consider.

Similarly, the evidence provided to support the decision to establish thinkWhere Ltd in 2007 was comprehensive and demonstrated that other options were assessed and presented to members for consideration. Furthermore, members requested further information on the proposed business model and financial forecasts. This was provided prior to a final decision being made to proceed with setting up the company.

The proposal to wind up Falkirk Community Stadium Ltd is on the basis that financial loss can be avoided by 'gifting' assets to the Trust. This option was not possible prior to the establishment of the Trust.

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

The council is required, as set out in the funding agreement with the Trust, to approve the Trust's business plan on an annual basis including the funding commitment for the year. The information provided to members to inform such approval was comprehensive and detailed. At the 2014/15 council budget meeting, members requested that a separate meeting be held in future years to consider the Trust's business plan. Their view was that more time is required to scrutinise the plan in detail and ensure that there is no risk of it being overshadowed by the discussions around Falkirk Council's annual budget. This demonstrates a good level of self-awareness amongst members of the importance of having sufficient information and time to scrutinise the Trust's activities and funding arrangements.

In terms of Falkirk Community Stadium Ltd (FCSL) and thinkWhere Ltd, members have played a more limited role in the governance of these bodies. As regards Falkirk Community Stadium Ltd the council has only been involved with the company at pivotal moments, including the de-merger in 2009 and the recent proposal to wind up the company. The situation is notably different from that of Falkirk Community Trust because the council does not provide regular significant funding to the company. FCSL does however have accrued debt to the Council of £1.011m which is unlikely to be repaid in the short term. This has previously been reported to members as well as the fact that this is covered by the value of assets within FCSL.

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

The performance of the Trust has been considered by members of the council on a 6-monthly basis since it was established in July 2011. Responsibility for scrutinising the Trust's performance was passed from the Best Value Forum to the Leisure, Tourism and Community Committee in early 2013 and, under the council's revised decision making structure, now lies with the Scrutiny Committee. The most recent report presented to committee was in the style of a *Following the Public Pound* report which covered, amongst others things, performance against key objectives. The report also offered members the opportunity to request further information or follow-up action. This is consistent with good practice.

In addition to the routine scrutiny described above, the council has taken the decision to carry out a comprehensive review of the effectiveness of the Trust. The review is expected to start in the summer of 2014 when the Trust will have been in operation for three years. It is understood the review will be led by the council's Section 95 Officer and full use will be made of the toolkits which accompanied the Audit Scotland report on 'Arm's-Length External Organisations: Are you getting it right?' The proposed use of toolkits is good practice.

While recognising that the council is following good practice in relation to the Trust, this is not evident to the same extent in the case of the other ALEOs. In particular, we noted that elected members do not routinely monitor the financial and service performance of other ALEOs. The council instead relies on senior officers on the Boards of both Falkirk Community Stadium Ltd and think Where Ltd to identify and inform any issues that should be brought to the attention of the council. It is better practice for members to receive periodic reports on the performance of all ALEOs, even if only to provide positive assurance on their performance (***refer to improvement point 1***).

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

The council agreed on 2 March 2011 that the Board of the Trust would comprise 2 members from the Labour Group; 2 members from the SNP Group and 1 member from the Conservative or Independent Groups or a non aligned member. Opposition members declined at that time and again in May 2012 to take up positions on the Board. This is similar to the position reported in our 2012/13 Annual Audit Report where we commented that not all members are participating in decision-making structures and scrutiny committees (***refer to improvement point 2***).

The representation of the council on the Board of the Trust has been the subject of review with, for example, a report being presented to Council on 26th June 2013 seeking a decision on three appointments which had reached the end of their respective two year terms. In addition, all members appointed to the Board of the Trust have, prior to their first Board meeting, received training on directors' roles and responsibilities conducted by the council's Legal Services supported by the Chief Executive of the Trust and Finance Services.

Senior officers are appointed to both the Board of Falkirk Stadium Ltd and thinkWhere Ltd. Elected members need to be clear about these appointments and the rationale behind them. They need to be assured that appointees have the appropriate skills and experience to perform effectively in their role. The council's Depute Chief Finance Officer (DCFO) currently sits on the Board of Falkirk Stadium Ltd but his retiral is imminent. An appropriate individual will need to be identified to take on this role following the DCFO's departure and we understand action is currently being pursued to address this.

## **Improvement action plan**

Issues arising from our follow-up audit together with management's responses are detailed in the Improvement Action Plan included at Appendix A.

The issues identified in letter are only those which have come to our attention during the course of the review and are not necessarily, therefore, all the issues that may exist. It remains the responsibility of management to determine the extent of any improvement actions appropriate. We would stress, however, that commitment to an improvement agenda is an essential part of the efficient management of any organisation.

## **Acknowledgements**

The contents of this letter have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

Please do not hesitate to contact me on 0131 625 1777 or 01325-506258 if you have any queries on this management letter.

Yours sincerely

**Jim Rundell**  
**Senior Audit Manager**

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## Appendix A

### Improvement Action Plan

Point No.	Improvement Point	Planned management action	Responsible officer	Target date
1	It is good practice for regular financial and performance reports on ALEOs to be presented to the council for scrutiny so that follow-up actions can be initiated where performance standards are not being met.	Suitable arrangements are already in place for Falkirk Community Trust. Annual reports on the performance of the other ALEOs will be presented to the Scrutiny Committee in line with the Following the Public Pound arrangements.	Head of Policy, Technology & Improvement	By 30 September 2014
2	All Opposition members previously offered places on the Board of the Trust should be encouraged to take up their positions as vacancies arise.	We will continue to encourage participation by all members in the decision making process.	Chief Executive & Chief Governance Officer.	October 2014