

Councils' use of arm's-length organisations



ACCOUNTS COMMISSION 

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We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

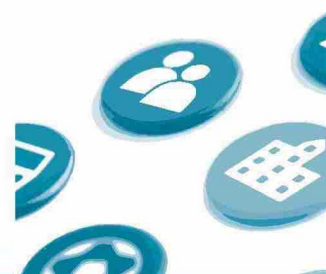
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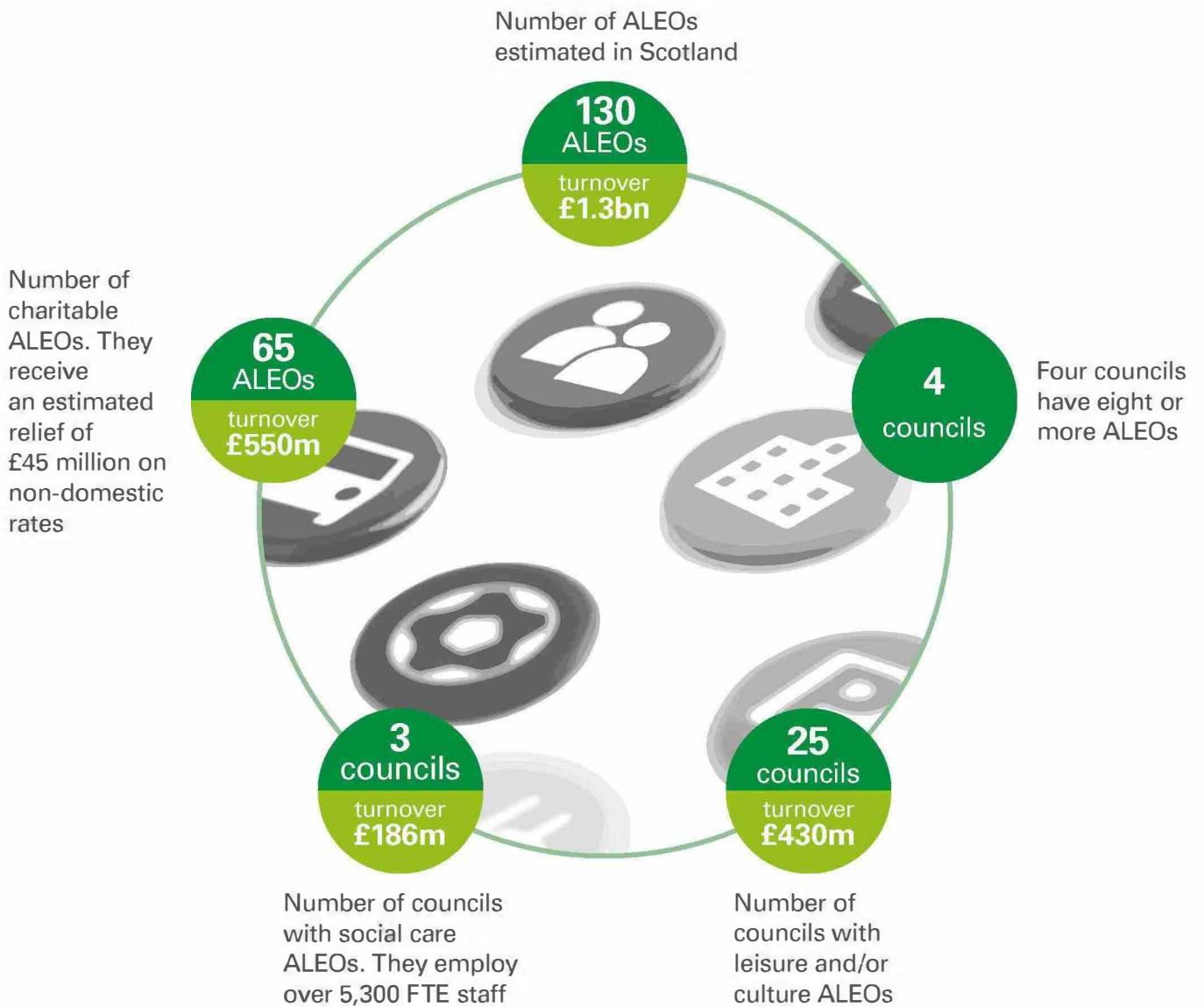
Audit team

The core audit team consisted of: Carol Calder, Peter Worsdale and Derek Hoy, with support from other colleagues and under the direction of Ronnie Nicol.

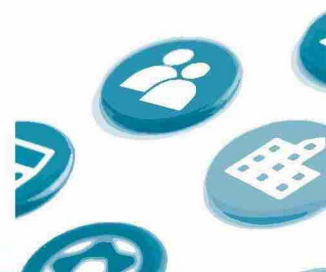
Links

-  PDF download
-  Web link

Key facts



Summary



Key messages

- 1** Arm's-length external organisations (ALEOs) are separate organisations used by councils to deliver services. They can bring both financial and operational benefits.
- 2** Councils should consider the risks associated with ALEOs at the outset. Oversight, accountability and good management are essential. In managing ALEOs, councils should continue to apply the principles in the Following the Public Pound Code (FtPP).¹
- 3** Councils have improved and strengthened their oversight of ALEOs. They need to set clearer criteria for how councillors and officers are involved with ALEOs, and demonstrate more clearly how ALEOs secure Best Value.
- 4** Councils show improving practice in evaluating ALEOs as an option for delivering services. They could do more to involve the public and other stakeholders in the process.
- 5** Taxation advantages for registered charities have been a strong driver for councils establishing ALEOs. Following a Scottish Government review, these benefits are now less certain and some councils are exploring other options.
- 6** ALEOs have brought benefits including reduced service costs, increased uptake in sports and leisure, and improved standards of care. Councils need to better demonstrate how their use of ALEOs improves outcomes for people (by outcomes we mean the local improvements councils and their partners seek to make such as people's health and wellbeing, and a better-quality environment).
- 7** The context in which ALEOs operate is changing and cost pressures remain. Councils must have clear reasons for establishing ALEOs and consider alternatives. In doing so they should be clear on the risks involved, and work closely with local communities and businesses.

ALEOs have brought benefits but need to be managed carefully

Recommendations

We have identified the following recommendations for councils:

In deciding whether an ALEO is the best way to provide services over the longer term, while providing value for money, councils should:

- examine wider options that can bring similar benefits to ALEOs such as reorganising an existing service, sharing services with other councils, or involving the local community
- demonstrate how ALEOs help the council meet its objectives and improve outcomes for their communities
- set clear criteria for reviewing an ALEO, considering risks, performance and how it fits with council priorities.

Councils should continue to apply the Following the Public Pound (FtPP) principles ensuring that they:

- oversee the performance, financial position, and associated risks of ALEOs
- have clear reasons for appointing councillors and officers to ALEO boards, recognising the responsibilities and requirements of the role, and the risks of conflicts of interest
- provide training, support and advice from both the perspective of the council and the ALEO. This should include legal responsibilities, scrutiny and oversight, and conflicts of interest
- have processes in place to manage any potential conflict of interest of elected members and officers involved in the operation of ALEOs
- take an active role in managing their relationship with ALEOs, including their compliance to service level agreements, contracts and other obligations
- make information about ALEO funding and performance clear and publicly available.

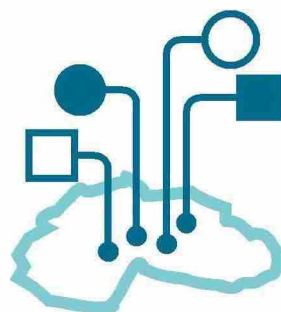
Background

1. In local government, services can be delivered in a variety of ways. In Scotland the term arm's-length external organisation or ALEO, has come to be used where a separate body with its own legal identity is set up by a council to deliver services. Local government services are also delivered through community planning partnerships, integrated health and social care boards, valuation joint boards, and regional transport partnerships. Unlike these statutory arrangements, ALEOs can be created at the discretion of the council, within the boundaries set by local government legislation.

2. ALEO is a descriptive term for a delivery approach that can take many forms. It is not a legal definition. We describe an ALEO in [Exhibit 1](#).

Exhibit 1

What is an ALEO?



Arm's-length external organisation



An arm's-length external organisation (ALEO) is a term used to describe an organisation that is formally separate from the council but is subject to its control or influence. The level of control or influence can vary.



ALEOs can take many forms including companies, community enterprises, charitable organisations and trusts. Services they deliver include leisure, transportation, property development, and care services.



The council might own the ALEO. It might have representatives on the ALEO board. It might be the main funder or shareholder of an ALEO.



ALEOs can be set up as non-profit-making organisations and as charities to promote public benefit in areas such as health, education, recreation and equal opportunities.

Source: Audit Scotland

3. ALEOs are an established feature of local government in Scotland. Their use grew throughout the 1990s in areas such as sports and leisure and urban regeneration, and they are now used by most councils to provide a range of activities. Arm's-length organisations are also long established in England and Wales and are used in areas such as buildings management, social care, housing and children's services. Depending upon their form and functions they may be referred to as arm's-length organisations (ALEOs); local authority trading companies (LATCs); and arm's-length management operations (ALMOs).

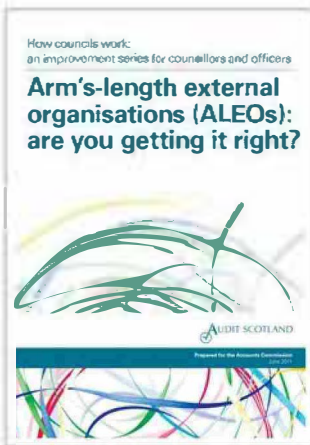
The Accounts Commission has a continuing interest in ALEOs

4. The Accounts Commission has a strong and continued interest in how councils use ALEOs. This performance audit builds on the good governance messages of our earlier work. It also examines further the reasons councils use ALEOs, and the extent to which they are improving services and meeting their intended objectives. We will continue to examine councils' use of ALEOs in our audit work in councils.

- In June 2011, the Accounts Commission published its *How councils work: Arm's-length external organisations (ALEOs): are you getting it right?* [Download](#). This set out good practice and highlighted the risks and opportunities of using ALEOs ([Exhibit 2, page 8](#)). The report provided checklists and a self-assessment tool to highlight good practice for councillors and officers.

Exhibit 2

2011 How councils work ALEOs headline messages



- The Following the Public Pound principles provide the basis for sound governance
- Decisions to use ALEOs should be based on an options appraisal and sound business case
- Sound governance is needed from the outset
- Conditions attached to the use of public funds should be clear
- Clarity on roles and responsibilities is vital
- Councillors and officers require ongoing advice and training

Source: Audit Scotland

- The How councils work (HCW) report built on the principles set out in the FtPP code. This sets out how councils should manage their relationships and be accountable for ALEOs and other external bodies they are involved with. It is based on the premise that, to ensure public money is used properly, it must be possible to 'follow the public pound' across organisational boundaries.
- In March 2015, the Accounts Commission carried out follow-up work on its HCW report. This identified some improvements in councils' governance of ALEOs, and found that the standard of practice varied. The Commission wrote to all council leaders and chief executives to emphasise the need for good governance, including monitoring and reviewing the performance, costs and risks of ALEOs.

About this report

5. We have examined practice across a sample of councils to highlight messages for all councils. The audit did not focus specifically on any individual council or ALEO. We also drew on findings from our audit activity across all councils. Our audit approach is set out in [Appendix 1 \(page 39\)](#), and our audit examined the following:

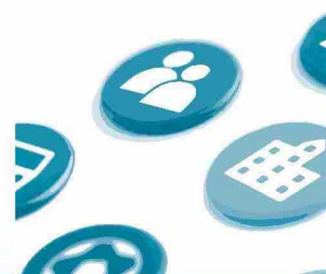
- Councils' reasons for using ALEOs.
- How councils oversee and govern ALEOs.
- What ALEOs have achieved.

6. This report has four parts:

- [Part 1 \(page 9\)](#) gives an overview of ALEOs and why councils use them.
- [Part 2 \(page 17\)](#) considers councils' oversight and governance of ALEOs.
- [Part 3 \(page 27\)](#) examines what ALEOs have achieved.
- [Part 4 \(page 35\)](#) considers the future direction of ALEOs.

Part 1

How councils use arm's-length external organisations



Key messages

- 1** ALEO is not a legal definition but is a term that applies to separate organisations used by councils to deliver services. ALEOs provide many different services and can take many forms. Most councils use them to varying degrees. Around half are registered charities.
- 2** Councils need to examine a wide range of options to deliver the best outcomes for their communities. ALEOs bring the benefits of a more independent organisation, while allowing councils to retain some control or influence.
- 3** Councils show improving practice in how they plan to use ALEOs including detailed business cases. However, few have an overall policy for how they should consider options. Councils could do more to involve public and other stakeholders in the process.
- 4** Taxation advantages of charitable ALEOs have been a strong driver for their use. These are now subject to change and councils are considering other options.
- 5** ALEOs bring further benefits through their ability to trade more widely and attract new funding. They also provide a responsive and more focused operating model under the direction of a dedicated board.

tax benefits have been a driver for ALEOs but these may change

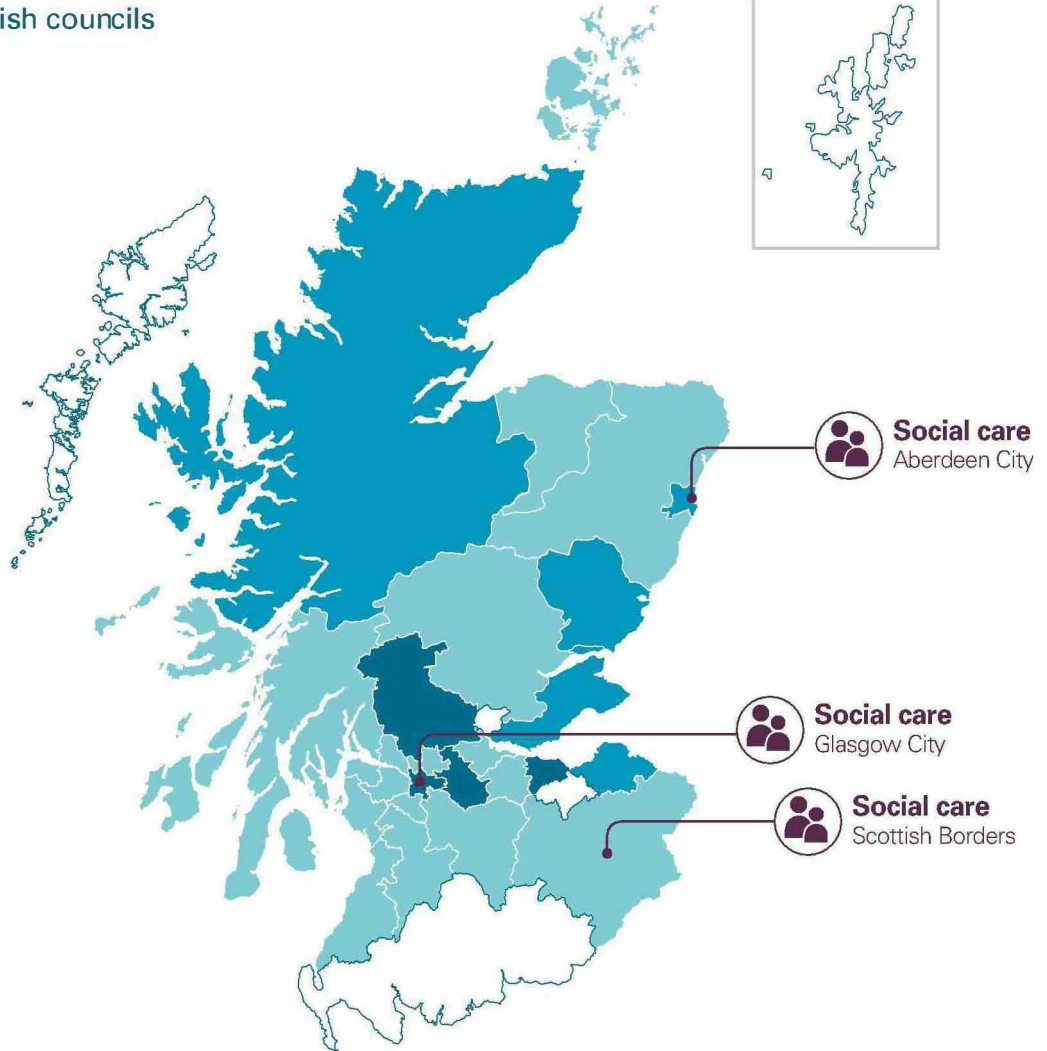
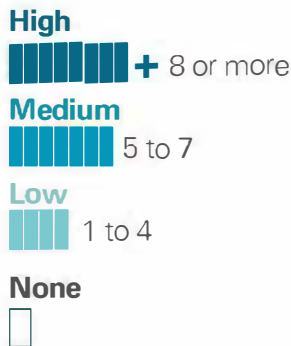
Most councils use ALEOs and their use continues to evolve

7. The range of ALEOs in Scotland is extremely diverse in size, function, and structure. Almost all Scottish councils use ALEOs to varying degrees. Larger urban councils are more likely to have a higher number of ALEOs. They are also more likely to have ALEOs that have been set up to achieve more commercial objectives, such as property development, conference facilities and marketing.

8. There are inconsistencies in how councils identify ALEOs and make information about them available. Indeed, there is little consensus even on what an ALEO is. This together with ongoing changes in their use, makes it difficult to quantify the number of ALEOs. [Exhibit 3 \(page 10\)](#) shows the use of ALEOs across councils and the functions they provide. This is based on information available to us from our 2015 follow-up work on ALEOs, councils' annual accounts, and ongoing changes we are aware of across councils, the most significant of which are summarised in [Exhibit 4 \(page 11\)](#).

Exhibit 3

ALEO use across Scottish councils

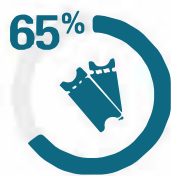


Approximate numbers of councils using ALEOs to deliver the following services:



Around 25 councils
Sport and leisure¹

Includes leisure centres, swimming pools and sports development.



Around 20 councils
Cultural services¹

Includes museums, galleries, theatres and libraries.



Around 15 councils
Economic development and regeneration

Includes employability services, business support and physical regeneration.



Around 10 councils
Property

Includes property development, management and maintenance.



Three councils²
Social care services

Includes care homes, homecare services and day centres.

Other activities delivered through ALEOs include waste management, energy and community safety.

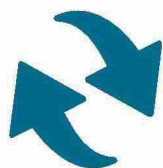
Notes:

- 1. Thirteen councils have joint leisure and culture ALEOs.
- 2. The three councils are Glasgow City, Aberdeen City and Scottish Borders.

Source: Audit Scotland

Exhibit 4

Recent changes with ALEOs



Recent and ongoing changes in the use of ALEOs

- The City of Edinburgh Council had consolidated its property development companies under one body – Edinburgh Development Initiative (EDI). It is now disbanding EDI to bring its property functions back into the council.
- Glasgow City Council has entered into a joint venture with the Wheatley Group to share ownership of its property maintenance ALEO, City Building.
- Glasgow City Council has wound up its city marketing ALEO and transferred its functions to its leisure and culture ALEO, Glasgow Life. It is bringing its social care and facilities management ALEO, Cordia, and its community safety ALEO back into the council.
- Some councils including Dundee and Scottish Borders have merged cultural and leisure services into a single ALEO.
- Some smaller ALEOs have been wound up, and their functions transferred to larger ALEOs, eg Dundee Ice Arena was transferred to Leisure and Culture Dundee.
- Some ALEOs are set up for a limited duration. For example, Steadfast Homes LLP is a partnership between Stirling Council and Scottish Futures Trust to provide mid-market rent properties, anticipated to operate for up to ten years.

Source: Audit Scotland

9. The diversity of financial arrangements across ALEOs makes it difficult to give a meaningful financial overview of them. In 2015, we estimated that spending through ALEOs was over £1.3 billion, with ALEOs accounting for around a quarter of the total spending for Glasgow City Council, their largest user.

ALEOs can be set up in many ways and take different legal forms

10. ALEOs are legally separate bodies from the council and can take different forms ([Appendix 2, page 40](#)) There are many possible variations within these, for example charities can operate trading subsidiaries such as a café in a museum or leisure centre.

11. Most ALEOs across our sample group of councils take the form of limited companies or limited liability partnerships and are wholly owned by the council. This means that the council is the ultimate decision-maker, with powers to wind up the ALEO or to determine board membership. It also sets the ALEO's objectives and powers. In the case of joint venture companies, third parties can also hold a stake in the ALEO, an example being property joint ventures with the council and private sector as partners.

12. We estimate that around half of ALEOs are registered charities. The majority of these provide leisure and cultural services, other examples include urban regeneration and tourism. ALEOs that have charitable status are regulated by the Office of the Scottish Charity Regulator (OSCR).² Charities must have a defined charitable purpose, for example in the areas of health, education, recreation or equal opportunities. Charities are non-profit making and are required to reinvest any surpluses to further their activities. The trustees of charitable ALEOs have duties over and above those of the directors of non-charitable ALEOs.

Councils' reasons for using ALEOs

13. We examined councils' reasons for using ALEOs, including the effectiveness of their use of options appraisal and business cases to reach decisions. The statutory duty of Best Value, within the Local Government in Scotland Act 2003 (LGiSA), requires councils to secure the best options for providing services to their communities. It requires them to demonstrate continuous improvement and deliver good-quality services at reasonable cost. The legislation aims to remove barriers to innovation, but put in place safeguards that make councils accountable for how they use public money.³ The main options open to councils include:

- reorganising the way the council itself provides services
- 'outsourcing' or contracting services to private providers or the third sector such as voluntary groups and charities
- entering into partnerships with other councils or providers
- establishing 'arm's-length' bodies to deliver services
- any combination or hybrid of the above.

14. Implementing an ALEO or any other new delivery option is a complex and expensive process. It involves thoroughly appraising the options available and a sound business case. Councils must consider many detailed operational, legal, financial and commercial factors, and the risks involved. Set-up costs can be several hundred thousand pounds, and the time from the initial appraisal through to implementation can be more than a year. It follows that councils must proceed with caution when pursuing any new approach.

15. We found that councils have consistent reasons for using ALEOs. Generally, where councils provide services themselves they see direct control as an advantage. Contracting services to the private sector can save money, but reduces a council's control and influence. Councils see ALEOs as a good compromise between these two options. Though not without risk, the council can retain a degree of control or influence, and the ALEO can bring the benefits of a separate and more independent organisation. Business cases we examined identified these potential benefits of ALEOs:

- Taxation benefits of a charitable organisation including relief on non-domestic rates.
- Ability to generate income from additional services, and attract new income from funding, donations, sponsorship or loans.
- Strong service or commercial focus as a smaller more independent organisation under the direction of a dedicated board.
- Ability to involve public stakeholders in the management and direction of their services.
- Ability to foster a positive working relationship with an ALEO as a 'trusted partner'.

16. Councils saw the dedicated board of an ALEO as a strength. These can involve community and industry representatives and bring wider experience and new opportunities.

Business case assumptions may change over time

17. Many councils had established charitable ALEOs such as those for leisure and culture to benefit from relief on non-domestic rates (NDR). Some business cases we examined identified this as a way for councils to meet their savings targets without having to cut services. Business cases identify NDR relief as a specific benefit provided that the ALEO meets the requirements for charitable status. While NDR relief can bring benefits locally, it offers no net financial gain to the public sector.

18. The ALEO model is also seen to bring a more commercial focus to generate income and attract new funding. In the case of charities, their charitable status is also seen as a safeguard against an overly commercial approach. Another unique benefit of charities is their ability to attract specific funding and donations.

19. In 2017, the Barclay Review into non-domestic rates brought the availability of NDR relief into question (**Exhibit 5**). It estimated that overall, charitable council ALEOs save £45 million annually through relief on NDR. Had the recommendation been accepted by the Scottish Government, the impact on the viability of leisure and other charitable ALEOs would have been significant. As things now stand, the policy changes make charitable ALEOs a less attractive option for councils. We are aware of at least one council that is reconsidering its proposal to form a culture and leisure ALEO following this development.

Exhibit 5

The Barclay Review



The Barclay Review

was set up in 2017 to examine and recommend reforms to the business rates system in Scotland.

One of the Barclay Review recommendations was to end the rates relief offered to ALEOs as this was seen to be an unfair advantage in a competitive market. In its response to the review, the Scottish Government announced in November 2017 that rates relief will remain in place for qualifying facilities already operated by councils. However it indicated it would offset any further charity relief benefit for future ALEO expansion by councils, for example by limiting their grant funding.

Source: Audit Scotland

20. Councils can make a stronger business case where the benefits are clearly linked to improved outcomes for citizens and communities. That is, the choice is not based on a narrow financial advantage that may be subject to change.

21. The more recent business cases we examined do consider a wide range of financial and operational factors. Financial considerations, of NDR relief and the treatment of VAT were the most prominent features in the earlier business cases we looked at.

22. Business case assumptions may change and need to be reconsidered during the design and set-up of an ALEO. We found more effective practice where councils identified risks, and re-evaluated business case assumptions before taking a final decision.

Councils are improving how they plan for and appraise ALEOs

23. Our sample group of councils have significant experience in contracting, options appraisal and implementing change. The options appraisal and business cases we examined were comprehensive and detailed. Councils use external consultancy expertise in more complex legal and financial matters. They also draw on evidence from similar organisations that have been set up elsewhere.

Exhibit 6 summarises good practice we identified and highlights areas where councils could improve.

Exhibit 6

Options appraisal and business case

Effective practice



- Clearly specifying service quality, financial, operational, accountability and other factors, on which to base decisions.
- Objective process to evaluate factors for example using scoring.
- Using external expertise for more technical, legal, financial, and other operational matters.
- Including all set-up and implementation costs in the appraisal.
- Using a third party expert to verify the process and assumptions.
- Revisiting assumptions throughout the process.
- Incorporating risk management from the outset through to implementation.

Where things can improve



- Setting clear corporate guidelines for how options are to be considered.
- Being clear why the council identified its chosen range of options, and which options it may have excluded.
- Involving the public and interested communities, such as local businesses.
- Assessing the impact on local interested communities.
- Including contingency planning at the outset.

Source: Audit Scotland

24. Councillors must provide strategic direction and understand the range of options the council is considering. Options appraisals should clearly set out the alternatives along with their respective benefits and risks. This is important as part of open and transparent decision-making and public scrutiny. We saw evidence of improving practice in this area. More recent options appraisals presented councillors with a good level of information across a range of options including contracting with private sector, or using community enterprises. However, we also found options appraisals that considered only a narrower set of options, and did not explain why options such as outsourcing had not been included.

25. Councils should also consider the risks of various options, and be clear what happens if an ALEO fails to meet its objectives. Such contingency planning should be considered at the outset. We found that while business cases tended to consider these factors in some detail, there was less evidence of contingency planning featuring at the initial options appraisal stages.

Few councils have guidelines for making service delivery choices

26. Most of our sample councils undertook options appraisals on a case-by-case basis. Few have guidelines in place to set out the council's overall approach, for example the trigger points for reviewing a service and the criteria to apply when looking at options.

27. The Highland Council has introduced its redesign review process to examine delivery options across all services. This aims to strengthen councillors' and officers' understanding of options, including ALEOs, as part of all service reviews. North Lanarkshire Council has introduced an ongoing review process to cover all its significant ALEOs over a three-year cycle. These reviews consider how the ALEO contributes to the council's priorities and offers value for money.

28. One council from our sample had expressed 'a presumption of in-house provision unless there are service performance issues' within one of its organisational change programmes. This contrasts with another council that had expressed the presumption of 'using third sector parties or ALEOs where services can be delivered safely, more cost effectively and efficiently.'

29. What is important is that councils can demonstrate that any policy position enables them to secure Best Value. This means making an objective assessment of cost, quality and other service benefits. Otherwise there is a risk the council will miss the best options to sustain or improve a service.

Councils could do more to involve communities in their choice of options

30. Councils could do more to involve local communities and businesses in their choice of options. Giving communities more say in their services is an area of growing national interest and the Community Empowerment (Scotland) Act 2015 brings new duties to public bodies. This is an area where councils are developing their practice.

31. We saw limited evidence of public opinion shaping options appraisals. The choice of option is treated mainly as a technical issue, but we would expect councils to show how they have considered the views of the public. This could include their expectations over service quality and the standard of facilities. Such dialogue can also make councils aware of options they may not have otherwise considered. [Part 4 \(page 35\)](#) of this report considers this topic further.

Some benefits may not be unique to the ALEO model itself

32. Some of the benefits associated with ALEOs may not be unique to the ALEO model itself. Councils should explore all options and understand the associated risks and alternatives. Ultimately, good management and staff commitment are key factors for success. [Appendix 3 \(page 41\)](#) outlines some of the benefits associated with ALEOs, along with alternative points to bear in mind. This provides a context for [Part 3 \(page 27\)](#) of this report which examines evidence of what ALEOs are achieving.

Part 2

How councils oversee ALEOs



Key messages

- 1** Oversight, accountability and good management are essential to deliver effective public services however councils choose to deliver them. Councils should continue to apply the principles in our Following the Public Pound Code (FtPP).
- 2** Councils have improved and strengthened their oversight of ALEOs. This includes clear roles, scrutiny that is proportionate to risk, and officers taking a stronger liaison role with ALEOs.
- 3** Councils should put in place more formal processes to demonstrate that their use of an ALEO provides Best Value. They should take steps to be more transparent about their use of ALEOs.
- 4** Councils need to set clearer criteria for councillor or officer involvement with ALEOs. These should consider the associated risks and how conflicts of interest should be dealt with. Alternative arrangements can be made to reduce the risks of conflicts of interest.
- 5** Where councils appoint representatives to ALEO boards, they should foremost consider the skills, background and experience required of the role. Training and development is important both from the perspective of the council and the ALEO.

councils have strengthened their oversight of ALEOs, but they are not without risk

Councils must apply the Following the Public Pound Code

33. Councils are ultimately accountable for how they spend public money, including the services they commission through ALEOs. This means having clear oversight and appropriate governance arrangements in place. The Following the Public Pound Code sets out the principles for how councils should do this ([Exhibit 7, page 18](#)). The Code states that having council representatives on a board as trustees or directors does not in itself achieve effective governance. Regardless of any representation on boards, councils should monitor ALEOs and insist on regular reporting from them.

Exhibit 7

Following the Public Pound



Following the Public Pound principles and ALEOs

The principles of openness, integrity and accountability apply to councils in their decisions on spending public money. These apply equally to funds or other resources which are transferred to ALEOs.

The Code sets out six principles that require councils to:

- have a clear purpose in funding an ALEO
- set out a suitable financial regime
- monitor the ALEO's financial and service performance
- carefully consider representation on the ALEO board
- establish limits to involvement in the ALEO
- maintain audit access to support accountability.

Source: Following the Public Pound Code

34. An ALEO board needs to act independently to decide how it meets its objectives including its obligations to the council. For a registered charity this means acting in the interest of the charity and promoting charitable purpose. In practice the FtPP principles require a range of measures to be in place:

- Governance documents setting out the ALEO objectives and powers, along with contractual or service agreements between the ALEO and the council.
- Ongoing performance, financial and contract monitoring; and periodic review of the ALEO's business plans and objectives by the council.
- Assurance from internal audit over the council's governance and control processes for ALEOs. ALEOs may also have their own audit or finance subcommittees.

Councils have better oversight of ALEOs, but issues can still occur

35. Councils need to understand how well ALEOs are performing, and be aware of risks and difficulties that may arise. All our sample councils had appropriate governance processes for overseeing ALEOs. More effective practice included scrutiny proportionate to the risks involved, and clear roles and responsibilities for councillor and officer oversight ([Exhibit 8, page 19](#)).

Exhibit 8

Improving practice in governance

Councils have developed governance frameworks to achieve a more proportionate level of scrutiny for ALEOs



Glasgow City Council's framework for councillor and officer oversight

Glasgow has a diverse portfolio of ALEOs. Its governance framework for ALEOs differentiates between democratic, strategic, and operational scrutiny as follows:

- Political decision-making and scrutiny: councillors oversee ALEOs through the Operational Performance and Delivery Scrutiny Committee and the Finance and Audit Scrutiny Committee.
- Strategic oversight and scrutiny: a Governance Management Group of senior officers meets with ALEO representatives on a six-monthly basis to review and discuss their financial and operational performance, business plans, and issues arising.
- There is regular liaison and monitoring between the council and ALEOs over operational issues: corporate teams within the council help to maintain the relationship between ALEOs and their client departments in the council.



Aberdeen City Council's ALEOs Assurance Hub

Aberdeen introduced a new ALEOs Assurance Hub in 2017. This draws on expertise from CIPFA and the Good Governance Institute. The Assurance Hub has a clear focus on risk management, financial management and governance.

- The council has split its ALEOs into tiers based on the level of funding they receive and the level of control the council has over them. The Hub assesses the level of oversight required for individual ALEOs and reports to the council's Audit Risk and Scrutiny Committee.
- Service directorates and committees are responsible for monitoring performance and contractual compliance.
- An ALEO Strategic Partnership Group provides advice and support to the council's ALEOs including strategic planning and resource sharing. The group comprises ALEO chief executives, and council finance, legal, and procurement officers.



North Lanarkshire Council's dedicated ALEOs committee

North Lanarkshire Council introduced a dedicated ALEOs and External Organisations Monitoring Committee in 2016. It meets in public and considers the financial management, performance, risks and governance of ALEOs.

- The frequency of ALEO monitoring reports to the committee is proportionate to risk and ranges from quarterly to annually. More detailed performance information is scrutinised by the relevant council service committee.
- Client officer roles are being reviewed, and a Monitoring Officer Working Group established to bring about consistency of approach across all areas of ALEO service delivery.

Source: Audit Scotland

36. Councils must oversee and manage many factors and be aware of the risks associated with ALEOs. Despite evidence of improving governance, we are aware of governance or operational issues that have arisen:

- Glasgow City Council's employability ALEO faced financial pressures in 2015/16 resulting from it having been required to repay European funding. As a result, it reduced its activities significantly and shed 150 posts through voluntary severance. The body has since restructured.
- East Lothian Council and the Lothians Racing Syndicate Ltd (LRS) jointly commissioned an independent governance review to evaluate the structure, composition and constitution of the Musselburgh Joint Racing Committee, and operational matters relating to the conduct of business at the racecourse. This identified options which are being considered by the council in consultation with the LRS.
- The creation of a subsidiary in 2011 by the council's ALEO, North Lanarkshire Leisure, had not been reported to a council committee. Also, the need for, and circumstances surrounding the setting up of, the company was not approved by, or reported to, the ALEO Board. There have since been a number of changes within the ALEO and North Lanarkshire Council has significantly strengthened its approach to the governance of ALEOs.
- In Stirling Council, a tender evaluation carried out in February 2017 following an options appraisal for the provision of sports and leisure services recommended the award of the contract to an external company. However, councillors decided that neither of the two bids submitted as part of the extensive tender process met the best value criteria and, as a result, the contract award was rejected. The council is now pursuing an alternative option involving reconstituting its existing sports and leisure ALEO.

Councils must have clear reasons for their appointments to ALEO boards

37. It is up to councils to decide on the most appropriate governance arrangements. They must consider very carefully the question of council representation on the ALEO board. The main consideration is what skills or experience are required of the board and who is best placed to meet these. Where councillors or officers take such positions, they should be clear about the responsibilities and requirements of the role.

38. There are risks of conflicts of interest where councillors or council officers take board positions. The Accounts Commission has highlighted that such conflicts can become starker if an ALEO encounters difficulties. The Companies Act and Charities and Trustee Investment (Scotland) Act require board members or trustees to act in the best interests of the company or trust on which they serve, and to put these interests first ([Exhibit 9, page 21](#)). But there may be times where this requirement may conflict with councillor or officer duties in the council. This can be a difficult balance where council representatives may be privy to certain information, but are prohibited from sharing or acting on it because of their role. As a small council with fewer councillors, Stirling Council told us that it can be much more difficult to manage potential conflicts.

Exhibit 9

Duties within companies and charities law



Companies Act requirements for directors include:

- act within powers
- promote the success of the company
- exercise independent judgement
- exercise reasonable care, skill and diligence
- avoid conflicts of interest
- not accept benefits from third parties
- declare any interest in a proposed transaction or arrangement.

Charities and Trustee Investment (Scotland) Act requirements for trustees include:

- act in a manner consistent with the charity's purpose
- act with the care and diligence expected of someone managing another person's affairs
- put the interest of the charity before those of any person or organisation who appoints trustees where there is a conflict of interest, or withdraw from the decision-making involved.

Source: The Companies Act (2006); Charities and Trustee Investment (Scotland) Act 2005

39. The Councillors' Code of Conduct sets out principles that councillors must follow where they take a role on outside bodies including ALEOs.⁴ The Standards Commission's Advice Note for Councillors on ALEOs provides supplementary guidance to help clarify this area of the Code. This sets out the practice required of councillors who are also board members or trustees:⁵

- Councillors who are also ALEO board members can participate in council committees, but they must declare interests.
- The Code prohibits councillors from taking 'quasi-judicial' decisions in the council that may affect any ALEO they are involved with, for example planning or licensing decisions.
- It is considered good practice for councillors not to participate in scrutiny or funding decisions within the council that may affect the ALEO they are involved with.

40. There is an ongoing debate about the advantages and disadvantages of using councillors as board members. Councillors bring their experience as elected community representatives and their knowledge of the council and its services; however, there are potential conflicts of interest between their roles on the council and the ALEO. [Exhibit 10](#) outlines some of the main advantages and disadvantages identified by our sample group of councils.

Exhibit 10

Pros and cons of councillors or officers acting as trustees or directors

Potential advantages of council nominees as board directors or trustees



- Can improve the relationship between the ALEO and the council.
- Can bring an insight into the council and its objectives and the broader community.
- Council representatives can gain valuable first-hand experience of service issues and different sectors.

Potential disadvantages of council nominees as board directors or trustees



- Can bring additional demands to their already diverse role.
- Representatives may lack the background, skills or understanding required of the role.
- Risk of conflict of interest between their role on the ALEO and their role on the council.
- Negative impact on council decision-making where councillors withdraw from committees owing to conflicts of interest.
- Exposure to legal risks and personal liability.
- Risk to continuity if councillors lose their position if not re-elected.

Source: Audit Scotland

41. We found a range of practice for councillors and officers taking trustee and director roles across our sample group:

- Across most of our sample councils, councillors and officers can take board positions on ALEOs. However, it is becoming less common to involve officers, and in Stirling and Edinburgh, for example, council officers no longer take director positions.
- Practice varied in social care ALEOs. Councillors and council officers are appointed as board directors in Glasgow's Cordia; this contrasts with the care ALEOs in Aberdeen City and Scottish Borders where councillors are not appointed as directors. In the Scottish Borders, councillors oversee the care ALEO through a dedicated Strategic Governance Group.
- OSCR recommends that the majority of trustees in a charitable ALEO should be independent of the council; we observed this to be the case across our sample group.

42. Officers and councillors holding director positions felt they could balance their dual roles, and saw this as very much part of their job. We are not aware of any significant breaches to the Councillors Code of Conduct regarding councillors' involvement with ALEOs. Our audit work in councils has emphasised the need for clear roles and responsibilities in relation to ALEOs to risk of conflicts of interest arising.

43. The City of Edinburgh Council highlighted a previous situation where an officer had been in a difficult position concerning the sale of assets from an ALEO back to the council. As an ALEO director, his aim was to achieve the best price for the company; but as the council's chief financial officer he had a duty to achieve value for money for the council. Council officer posts are no longer nominated as directors of that company.

44. We found that few councils have policies or guidelines setting out how councillors or officers should be involved with ALEOs. Stirling Council has guidelines that aim to focus councillors on their strategic role of providing direction, oversight and challenge over ALEOs. The policy restricts councillors from participating as directors on more commercial ALEOs, but allows them to be involved if the ALEO has a clear community benefit purpose that is in line with the council's objectives. [Case study 1](#) illustrates how the council applied these guidelines in the case of a joint venture company.

Case study 1



Board representation on a joint venture (JV)

The council recognised that the board of a property development JV had an imbalance of expertise: it comprised councillors and a council officer, and property professionals from the council's private sector partner. In a governance review, the council replaced the councillors and officer with independent experts with knowledge of the commercial property market. This was to reduce the risk of conflicts of interest and to improve the knowledge and experience of the board for the benefit of both the council and its JV partner.

Source: Audit Scotland

Councils should consider other approaches to limit conflicts of interest

45. Some councils have chosen not to use council representatives as board members because of the risk of conflicts of interests. Having council nominees on boards was seen to blur the relationship between the council and the ALEO. It also brings personal liabilities to those taking such roles. Councils can achieve a much clearer separation by using secondments to ALEOs.

46. Councils need to put safeguards in place where they decide to involve a council representative in a decision-making position on an ALEO. These include procedures for dealing with conflicts of interest, making training and advice available, and personal liability insurance to protect board members in their role. Employment contracts can also be used to specify an officer's responsibilities if a conflict of interest arises, however we did not hear of this being used in practice.

47. Council representatives can take a monitoring and liaison role as an alternative to taking a board position. This allows them to oversee and advise the ALEO without taking a decision-making role on the ALEO. Most of our sample group of councils had strengthened the role of such officers to give them greater seniority and influence. Their role involves managing the relationship between the council and the ALEO, and monitoring the performance of the ALEO and its compliance with its contracts or service agreements with the council. Fife Council explained how the expertise and close involvement of its officers helps it to understand local opportunities and encourage the ALEO to improve its performance.

Council appointments to ALEOs should be driven by the requirements of the role

48. We found that councillor appointments to ALEO boards tended to reflect the political balance of the council. This differs from the approach taken by ALEOs for their other board members. These appointments tend to be made through an appointments committee based on the skills, experience and other criteria required of the role. Councils should ensure that they consider the skills or background required of the role. More effective practice in this area included The City of Edinburgh Council where officers provide political groups with guidance on making appointments.

Councils and ALEOs should provide training and support to board members

49. It is important that board members have the necessary training to perform their role effectively and understand what is required of them. Councillors we spoke to recognise that training is important from both the perspective of the council and the ALEO. All the councils we spoke to provide training, for example as part of the induction for new councillors, and more bespoke training in relation to their roles on ALEOs. In Glasgow, training is mandatory for elected members appointed to ALEO boards. OSCR provides guidance on the role of charity trustees.⁶

50. We saw good examples of training for board members, reflecting the growing maturity of councils' experience in this area. Our HCW report on roles and working relationships highlights both training and appropriate behaviours as essential to good governance.⁷ It urges councils to provide councillors with training in the essential areas of scrutiny, audit, and financial decision-making. Indeed, some councillors we spoke to felt that in the case of ALEOs, training should also cover company accounts. More effective practice is described in [Exhibit 11 \(page 25\)](#).

Councils need to provide a systematic test of Best Value

51. It is possible under certain conditions for councils to procure services directly from a third party such as an ALEO without a competitive public procurement exercise.⁸ Generally, this requires the relationship between the council and the ALEO to be the same as that between the council and one of its own directorates. The ALEO must also provide most of its core activities on behalf of the council. Councils must also continue to observe procurement and competition law as part of any changes in their relationship with ALEOs, be it through contract renewal, or changes or diversification in the ALEO's activities.

Exhibit 11

Training and development for ALEOs



Provided by the council

- ✓ The council specifies advice and any necessary training for all councillors and officers who are decision-makers, advisers or observers of an external body.
- ✓ Training explores conflict scenarios, companies and charities law, and the Councillors' Code of Conduct.
- ✓ Training involves external expertise.
- ✓ All councillors are trained in essential aspects of their role in relation to scrutiny, audit and finance.



Provided by the ALEO

- ✓ Induction workshops for all board members.
- ✓ Directors' manual setting out the ALEO's aims, and the activities, responsibilities and duties of directors or trustees.
- ✓ Development programme for board directors including corporate governance standards.
- ✓ Appraising board members, and publishing their attendance record.
- ✓ Specialist training in companies and charities law.

Source: Audit Scotland

52. Councils should be able to demonstrate that their contracts or service agreements with an ALEO offer Best Value. Councils tend to do this by assessing the annual performance of the ALEO, along with its annual report and business plan. There is scope for some councils to put stronger arrangements in place for the interim review of contract performance. For example, one council we spoke to had introduced clearer performance objectives and formal review points in its contract with a joint venture ALEO. In another example, a council had revised its service agreement with a leisure trust to set out its social benefit objectives more clearly.

Councils should take steps to make ALEOs more accountable

53. Services provided directly by councils are often seen as more accountable than services contracted with external providers such as ALEOs. Councillors direct and oversee council-provided services through council committees. Where services are delivered by ALEOs this relationship becomes less direct. The council will oversee the contract or service agreement with the ALEO, but will have less day-to-day influence over the service.

54. ALEOs bring a different kind of accountability. They are, foremost, accountable to their own boards. These can include wider stakeholders including business leaders, community and service users, and employee and trade union representatives. This can allow for a more 'user-driven' form of governance, as opposed to the more representative role that councillors take on a council committee.

55. Some councillors we spoke to felt that the council relationship with ALEOs was different from relationships with a fully outsourced service. As trusted partners they felt they could contact ALEO managers for information, and call ALEO management to committee to present evidence.

56. Making information publicly available is another important aspect of accountability. Measures we identified that can improve transparency include the following:

- ALEO websites making annual reports, board minutes, and governance documents publicly available.
- ALEOs proactively publishing as much information as possible, for example covering the categories of information identified in the Model Publication Scheme.⁹
- ALEOs acting in accordance with the Freedom of Information Act that applies to councils, by responding promptly to information requests, providing information where possible and explaining why information cannot be provided.
- ALEOs adopting customer feedback and complaints-handling standards such as the Scottish Public Services Ombudsman (SPSO) guidelines.

57. Most of the leisure ALEOs across our sample group gave useful service and pricing information. However, not all included performance or user satisfaction information or minutes of board meetings. This is an area that councils should improve and specify in their service agreements with ALEOs. We found that:

- all the ALEOs included information on pricing and concessions
- all included information on Freedom of Information
- most had clear information on how to make complaints or suggestions
- only around half made board minutes available
- only around half made annual and performance reports available.

58. A council's annual accounts are a further source of public information. The governance and financial relationship between a council and its ALEOs can be complex. The Code of Practice on Local Authority Accounting encourages councils to 'tell the story' of their activities and financial performance during the year. This should cover not only the council itself, but also other third parties it is involved with, including ALEOs where they are significant to a council in terms of their risks or their financial implications.

59. The extent to which councils provided a clear commentary on their use of ALEOs varied significantly, with some councils providing only limited information. More effective practice is for councils to give a fuller overview of the ALEOs they are involved with. This could include their purpose, the extent of council ownership if any, and the financial contribution to and from the council. Most of the accounts we reviewed did not provide this level of detail. Glasgow and Fife councils had more effective practice and provided a clearer breakdown of their interests with useful supporting commentary.

Part 3

What ALEOs are achieving



Key messages

- 1** ALEOs are diverse in their range and the services they offer. Councils have used ALEOs to sustain existing services and offer additional services through reducing costs and generating income. However, financial and market pressures remain that can impact on their performance.
- 2** ALEOs have reduced the costs of sports and leisure services to councils through taxation benefits, new funding, and increased participation. Social care ALEOs have improved their care standards and reduced the costs of these services to councils. Financial pressures remain and not all social care ALEOs are achieving their financial targets. Performance in other areas such as property development has been more mixed.
- 3** We found many good examples of ALEOs providing innovation and benefit to communities. Councils need to better demonstrate how their use of ALEOs contributes to the council's priorities and improves outcomes for people.

ALEOs have brought benefits but cost pressures remain

60. The diversity of services provided by ALEOs and their individual circumstances makes it almost impossible to draw clear patterns of performance that apply in all cases. We have examined how ALEOs have contributed to improving services across a sample of ALEO services. This includes sports and leisure services where most councils use ALEOs; and social care, a service that vulnerable people and their families rely on. Our sample also includes examples from more commercial ALEOs.

61. We have based our assessment on the following sources of information:

- The Local Government Benchmarking Framework (LGBF) performance information for leisure services that applies across all Scottish councils. We have extracted data specifically for councils that operate sports and leisure ALEOs.
- Financial returns made by ALEOs to OSCR to identify broad sources of income.
- Care Inspectorate assessments to identify the quality of care for care homes, day centres and homecare services in relation to the three social care ALEOs.
- ALEO performance information and examples from across our sample councils. These include areas of service quality, efficiencies and financial performance.

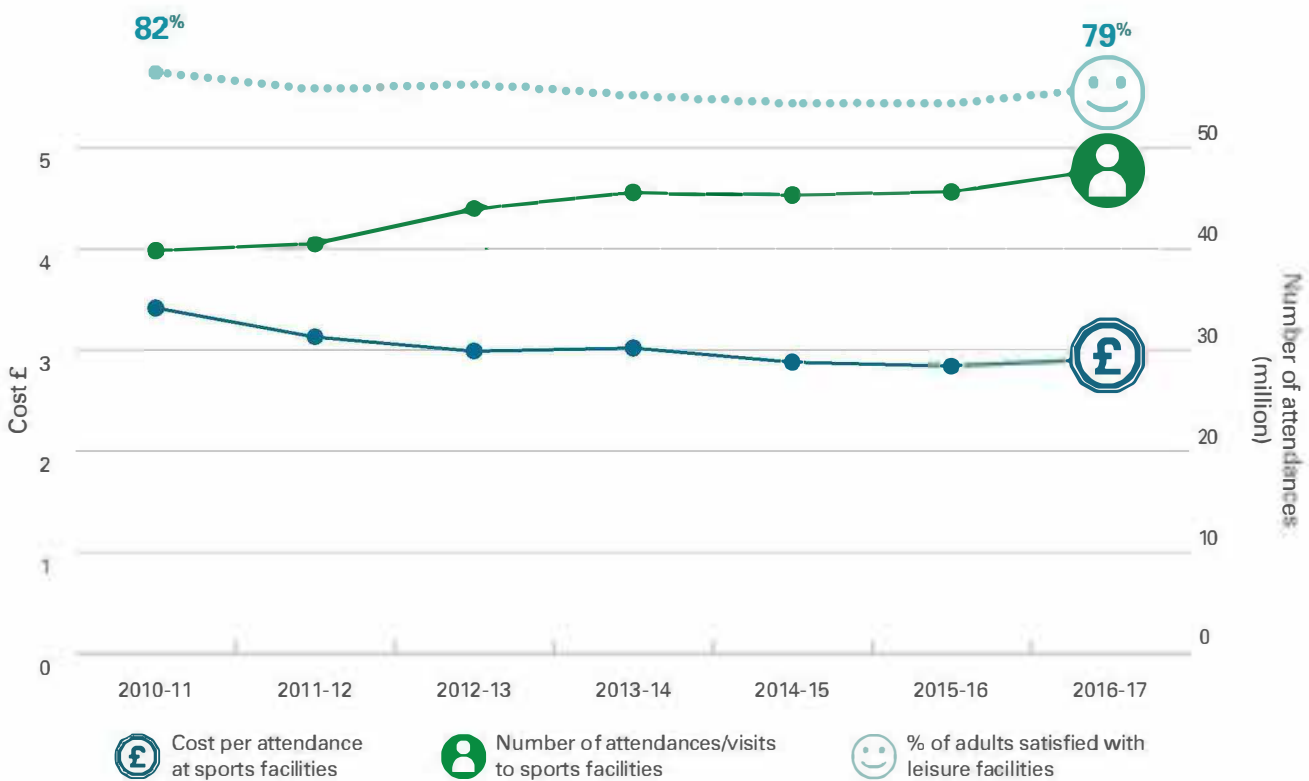
Sports and leisure ALEOs have increased uptake and reduced costs

62. In Scotland over three-quarters of councils provide sports and leisure services through an ALEO. Sports and leisure services aim to encourage sports development, physical activity and wellbeing. These are provided through facilities including sports centres, swimming pools, and outdoor sports facilities. We estimate the total turnover of leisure and culture trusts to be approximately £430 million in 2016/17. Glasgow Life is a joint leisure and culture ALEO and operates on a significantly larger scale than other ALEOS in the sector, with total turnover of around £127 million.

63. Exhibit 12 shows LGBF indicators for how the 25 ALEOs that provide sports and leisure services across Scotland have performed. This shows that from 2010/11 to 2016/17 the cost per visit to leisure facilities has fallen, while service uptake has increased. Public perceptions of the service show a slight decline:

- Net costs per visit have decreased from £3.41 to £2.91.
- Visits (per year) to sports facilities increased from 39.8 million to 47.9 million, although uptake has declined in recent years in some council areas.
- Satisfaction with sports facilities fell from around 82 per cent to 79 per cent.¹⁰

Exhibit 12
The performance of sports and leisure ALEOs



Source: Local Government Benchmarking Framework 2016/17

64. This equates to a reduction in net costs of around 15 per cent, and an increase in service uptake by 20 per cent. The trend in these broad indicators was less marked for the seven councils that directly provide sports and leisure services without using ALEOs. Here there has been a reduction in costs of nine per cent, and an increase in uptake of ten per cent; user satisfaction is lower at 66 per cent and has declined by two per cent. These councils tend to be smaller or more rural councils.

Financial benefits have been a major reason for establishing leisure ALEOs

65. Financial benefits have been a major reason for setting up charitable leisure ALEOs. This includes both taxation through NDR relief and VAT, and additional income through service uptake and new funding. We estimate that leisure and culture ALEOs generate around £61 million annually through donations, grants, fund-raising, investments, and other commercial activity.¹¹ This is equivalent to around 14 per cent of their overall income. Below are some examples of how ALEOs have reduced the costs of providing leisure services to councils include:

- The Glasgow City Council's service fee for Glasgow Life at £73 million is equivalent to around 57 per cent of the ALEO income in 2016/17, compared to around 71 per cent of income in 2008 (£69 million service fee).
- Leisure and Culture Dundee has made a cumulative saving of £15 million (2011 to 2017) allowing it to remove a £3.5 million funding gap and invest £1.2 million. Income generated by the ALEO now exceeds the funding paid by the council.
- High Life Highland has realised a saving of £9.1 million in its first five years of operation; with rates and VAT savings making up around 56 per cent of the savings, and the remainder being achieved through income and efficiencies.
- From 2008–16, Fife Council saw a 50 per cent reduction in costs, and a 50 per cent increase in service uptake for sports and leisure. The annual costs to the council fell by over £3 million, from 60 per cent of turnover to only 20 per cent.

66. Fife Council's capital investment programme has contributed to its improved performance. The council works in partnership with Fife Sports and Leisure Trust to plan and project manage this programme. This has led to £18 million of investment being targeted across sports centres and swimming pools, including easy-access changing rooms. The programme aims to ensure the investment continues to deliver financial benefits by increasing revenue as well as benefiting communities.

Councils need to improve how they measure the outcomes achieved by ALEOs

67. Measuring the impact services have on improving health, wellbeing and other outcomes is an area where the public sector is still developing its practice. It is difficult to identify the contribution of ALEOs to wider outcomes. We have therefore limited our assessment in this area to more qualitative examples of how ALEOs contribute to their social or community benefit aims.

68. As charities, ALEOs have a charitable purpose in areas such as participation in sport, health and wellbeing and encouraging volunteering. Most of our sample group of leisure or culture ALEOs were also involved in their local community planning partnership, either through subgroups or as an additional or non-statutory partner. High Life Highland (HLH) has participated as a member of the Highland Community Planning Partnership since 2015, helping to find new opportunities, for example through partnership working with the NHS. We found many good examples of ALEO initiatives to meet their wider social or community benefit aims:

- Edinburgh Leisure worked alongside a GP practice in Leith to set up referrals to a physical activity programme run by the local swimming pool, targeted at men over 50 at risk of heart disease, stroke and diabetes.
- Linking leisure and wellbeing: High Life Highland working in partnership with NHS provides physiotherapy and rehabilitation services from community leisure facilities. HLH has encouraged participation of teenage girls in exercise through its dance programme, training 300 students to lead weekly sessions involving almost 2,600 participants.
- Fife Sports and Leisure Trust introduced summer free swimming and 'Quid a Kid', an initiative which enables juniors to play racket sports for just £1.
- Leisure and Culture Dundee secured private sector sponsorship for their Park Lives outdoor activities initiative.

69. Like councils and other providers, ALEOs operate concessionary schemes. These include low-cost leisure access schemes and activities for groups such as children or older people. Some councils saw ALEOs as helping to sustain services, such as affordable swimming for school-age children, that may otherwise not be provided.

70. The ALEO model has brought benefits but challenges remain. Financial constraints are impacting on the ability of councils to fund ALEOs. In the culture sector, for example, reduced council funding has led to library closures in some communities. One leisure ALEO from our sample group was also consulting the public over the impact of reduced funding from the council. Other councils indicated that they may need to limit their funding to areas of most need. Factors we have noted that can impact on ALEOs include:

- uncertainty over future taxation and NDR benefits
- impact of reduced funding from councils on the ability of ALEOs to generate income
- need for investment in leisure facilities and their ongoing maintaining costs
- increasing competition for what are limited charitable funding opportunities.

Social care ALEOs have improved standards of care; cost pressures remain

71. The Public Bodies (Joint Working) (Scotland) Act 2014 introduced a significant programme of reform. This aims to bring health and social care services closer together, with Integration Joint Boards (IJBs) being introduced to plan and commission services in their areas. Our audit focused on the contribution of the ALEO model itself to social care services. We did not look at the wider partnership context of IJBs. Our performance audit, *Health and social care integration: Part 2*¹² will examine progress in this major reform programme including strategic planning and governance.

72. Three councils now deliver adult social care services through an ALEO. Services include older people's care, rehabilitation, and enablement to help people regain abilities they may have lost through poor health or disability:

- **Glasgow:** Cordia LLP, established 2008, about 4,000 full-time equivalent (FTE) staff.
- **Aberdeen:** Bon Accord Care Ltd, (BAC), established 2013, about 800 FTE staff.
- **Scottish Borders:** SB Cares LLP, (SBC), established 2015, about 500 FTE staff.

73. Cordia combines facilities management and catering services, along with Cordia Cares, its social care arm. Glasgow City Council has decided to bring the activities provided through Cordia back into the council. Aberdeen City and Scottish Borders councils both operate similar models for their social care ALEOs. These aim to sustain the level and quality of care services service through:

- achieving greater efficiency and flexibility through a more commercial management approach under a specialist board
- generating income through providing additional services.

74. The business cases for social care ALEOs identified potential new sources of income including providing care services as part of self-directed support (SDS), offering accredited training, and supplying aids and equipment. SDS allows clients more choice over their care services and providers, including the option to manage their own care budget.

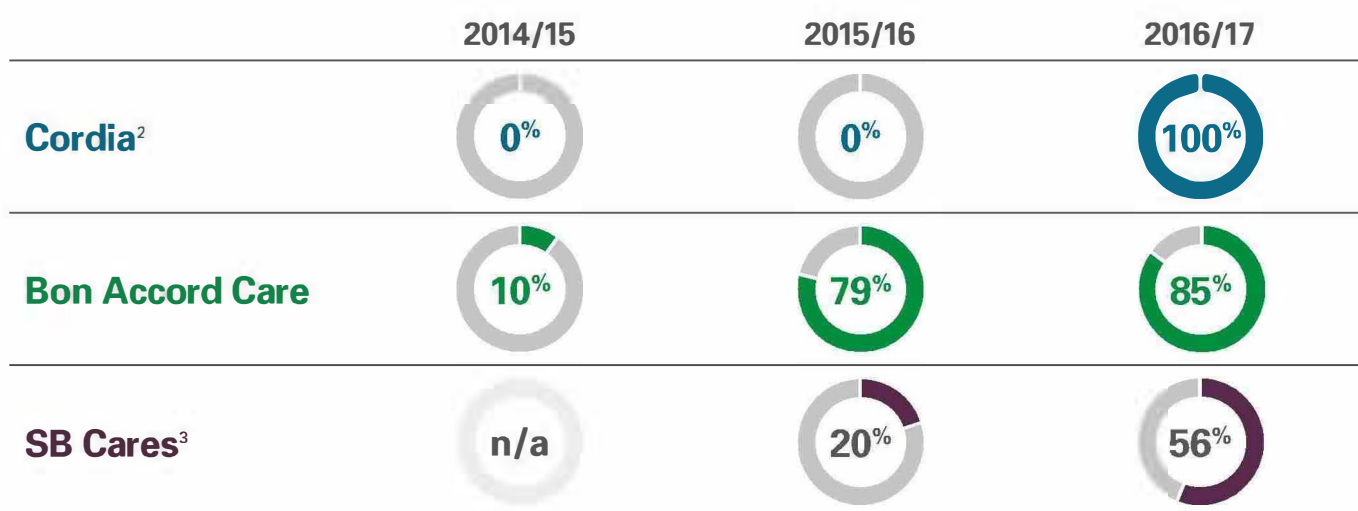
75. The councils' contracts with social care ALEOs allow for a financial contribution from the ALEO, with the ALEO setting out to achieve this through efficiencies and income generation. BAC and SBC are performing inline with their anticipated budgets. Cordia has not realised its planned contribution in recent years. This is mainly because savings from the council's transformation programme have taken longer to deliver than anticipated.

76. The social care ALEOs have increased income by offering additional services, but this is a small proportion of their total income. Social care ALEOs have not yet realised the anticipated levels of additional income from SDS.

77. The social care ALEOs have upheld and improved the quality of the services they provide. **Exhibit 13** gives an overview of Care Inspectorate (CI) grading assessments for services delivered by social care ALEOs in areas including care at home, residential care and day centres.¹³ The table summarises overall movements in the proportions of these gradings rated as good or better over the three-year period from 2014/15 to 2016/17. There has been an improving trend across the three social care ALEOs. Within this, the improvement in care at home, and care home services, is consistent with, or better than, the trend across Scotland.

Exhibit 13

Percentage of ALEO services graded as good or better across all four inspection themes.¹



Notes:

1. The CI grades registered services on four themes: Care and Support; Environment; Staffing; Management and Leadership.
2. Cordia has multiple services grouped into three area-based inspections.
3. SB Cares had no registered services until 2015/16.

Source: Care Inspectorate Datastore

78. The Scottish Health and Care Experience Survey measures user satisfaction for the parent council for the percentage of adults who:

- receive any care or support who rate it as excellent or good.
- are supported at home who agree that their services and support had an impact in improving or maintaining their quality of life.

79. The data is currently only available over two years (2014/15 and 2015/16). It shows that satisfaction levels at around 80 per cent are broadly comparable between councils that use care ALEOs and other councils.

80. We also found examples of innovative and responsive working practices across the social care ALEOs:

- Cordia worked in partnership with Glasgow City Council's education service to develop a new food policy for Glasgow schools encouraging pupils to avoid local fast food outlets.

- BAC's enablement service has trained 187 care staff to encourage greater independence among older people and reduced demand for planned care.
- SB Cares and BAC each stepped in at short notice to take on clients from independent care providers that had failed to deliver the services required of them by the partnership.
- BAC reduced its agency staff hours by 35 per cent in 2015/16 by operating an internal staff pool arrangement to allow its staff to provide cover at short notice.

81. Councils we spoke to said they see a role for social care ALEOs to help regulate a market where low profit margins can impact on the service and its staff. They saw a role for ALEOs to stimulate the market to help meet future demands. By offering accredited training ALEOs were also seen to help uphold service quality and develop employees.

82. The ALEO operating model aims to use the workforce more flexibly to develop the services they offer. This can lead to employee terms and conditions being negotiated that differ from those of the council. We found that ALEOs do put assurances in place, for example over payment of the living wage, adopting council terms and conditions and allowing employees to access local government pension schemes.

83. It is important, however, that councils continue to oversee staffing issues, including how ALEOs comply with equal opportunities and good employment practice. They should also understand how future funding pressures may impact on the workforce. Even where services are provided through an ALEO, the council can be ultimately accountable for the treatment of staff. For example, it was ruled by a Scottish court that the employees of Cordia could compare their pay packages with employees of Glasgow City Council for the purposes of equal pay claims.

84. Healthcare Improvement Scotland (HIS) and The Care Inspectorate (CI) carry out joint inspections across Scottish local authorities of older people's health and social care services. Some recent reports have highlighted concerns over service quality, leadership and governance as some health and social care partnerships adapt to the ongoing changes in how health and social care is provided.

85. The role of social care ALEOs in the context of integrated care services is continuing to evolve. Health and social care partnerships, along with their service providers, must continue to adapt and innovate. And, as we said in our report on social work services, financial and demand pressures remain a major issue.¹⁴

Other more commercial ALEO activities

86. It is difficult to comment generally on the effectiveness of the diverse range of commercial activities that ALEOs provide. We have seen both successes and areas that have not met their objectives across our sample.

87. Councils have used more commercial arrangements, including ALEOs and joint ventures for property development and buildings maintenance activities. The downturn in the commercial property market around 2012 has reduced opportunities for property development activity. Councils across our sample group have responded to these market pressures in different ways.

88. Stirling Council is reviewing its current joint venture ALEO to bring some development sites back within the council's control and align them more closely with its City Regions Deal programme. The ALEO will focus on other more commercial development opportunities. The City of Edinburgh Council has decided to wind up Edinburgh Development Initiative, its property development ALEO, and bring its activities in-house to be closer to the council's planning and development functions.

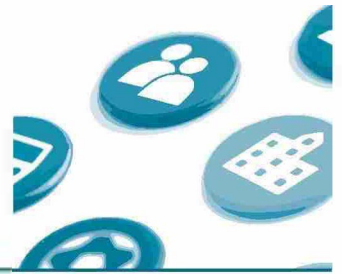
89. Examples of the activities and contribution from what is a diverse range of other commercial ALEOs are set out below. These include both financial benefits and contributions towards council and partner priorities:

- Glasgow City Building took on 70 new apprentices in 2016/17 and employs 324 apprentices in total with over 90 per cent completing their apprenticeship. Almost three-quarters of their expenditure goes to Glasgow-based small to medium enterprises. Around 100 school pupils benefited from work experience opportunities.
- Energy and waste ALEOs in Aberdeen and Fife have reduced fuel poverty for council housing residents, with Fife Resource Solutions ALEO generating renewable power equivalent to the demands of 1,250 households.

90. Business planning is an important feature of ALEOs for them to meet their objectives and contractual obligations. ALEOs need to be commercially viable in the longer term. As an example of longer-term planning, Fife Council and its waste ALEO are working together to deliver a long-term residual waste treatment solution for post-2020. This is a critical project for both parties since landfilling municipal solid waste will be prohibited from 1 January 2021.

Part 4

The future direction of ALEOs



Key messages

- 1** Councils value ALEOs as an option to help them to sustain services and innovate. Their use of ALEOs continues to change and evolve: ALEOs are being merged, disbanded, or created in new areas such as affordable energy. There is only limited use of ALEOs to deliver shared services between councils.
- 2** Some councils are exploring alternatives to ALEOs following the Scottish Government's announcement that it would limit non-domestic rates relief for any new council charitable ALEOs. In doing so, councils should work closely with local communities and businesses.
- 3** Councils need to ensure ALEOs are sustainable in the longer term. At a time of financial constraints, market uncertainty and policy reform it is even more important that councils have clear reasons for establishing new ALEOs. They should continue to review how existing ALEOs are performing and how they fit with council and communities' priorities.

**councils
must keep
ALEOs under
review and
consider
alternatives**

ALEOs remain an important option for councils

91. Councils see arm's-length bodies as an important option that gives them room to manoeuvre in what are challenging times for local government. ALEOs can help to sustain services and bring innovation, but financial and demand pressures remain.

92. However, ALEOs are falling out of favour with some councils. Glasgow City Council has decided to bring both Cordia and its community safety ALEO back in-house. This has resulted from the council's ongoing transformation programme across all activities, and its response to wider legislative changes in community planning, community empowerment, and the integration of health and social care.

Councils are exploring new ways to realise the benefits of ALEOs


93. Any decision to continue or discontinue with an ALEO must be objective and consistent with the requirements of Best Value. It should focus on outcomes not the method of delivering the service. We have emphasised that good management is a key factor for success, whatever way services are delivered.

94. The context within which any ALEO operates can and will change with time. The Barclay Review of non-domestic rates is already changing how councils think about different options. Aberdeenshire Council has found that its grant funding

would be reduced to offset NDR relief awarded, and so its proposal to create a culture and leisure ALEO is no longer viable. It is now looking at other ways to realise some of the benefits of the ALEO model to bring:

- closer involvement from businesses and communities
- innovation and faster decision-making to realise commercial or service opportunities
- expertise in service-specific areas such as marketing.

95. Possible alternatives include enhancing existing council services by creating a separate business unit, or alternatively using a different form of social enterprise to generate and reinvest income.

96. This example highlights that councils need to continue to work closely with businesses and local communities as they develop options. [Community Empowerment \(Scotland\) Act 2015](#)  brings a much stronger impetus for communities to play a stronger part in delivering services. Indeed, councils' experience with ALEOs brings lessons that could be applied to organisations that are more closely linked to communities, for example to:

- include community, business and service user representatives on boards
- protect assets by keeping them within public ownership
- allow limited liability protection for representatives taking director roles.

97. We found that some more recent options appraisals have considered community enterprises. We also saw examples where councils are involving communities more closely. Fife Council purchased a disused military site and leased it at nominal cost to a community organisation for use as a football venue. The arrangement enables community activity to take place and is self-sufficient with no revenue cost to the council. The council has also used planning contributions paid by developers to build a community sports hub. In another example, High Life Highland ALEO took a positive role in supporting community-run organisations that were facing financial difficulties.

98. Councils have also used the ALEO model to innovate and offer new services. As an example, Aberdeen City Council's Aberdeen Heat & Power ALEO has provided district heating schemes since 2002. The council is considering creating a new Energy Services Company (ESCO) to provide a wider range of energy services across Aberdeen as a whole.¹⁵

There is limited use of ALEOs to achieve shared benefits between councils

99. Councils have made limited progress in working together to provide services jointly, and we saw limited evidence of ALEOs being used in this way. Lothian Buses is the most significant example we identified ([Case study 2, page 37](#)). Others include: Dundee Energy Recycling Limited which provides service on behalf of both Dundee and Angus councils; Cordia's social care equipment service trades with neighbouring councils; and Stirling and Falkirk jointly own an ALEO that provides Geographical Information Services (GIS).

Case study 2

Lothian Buses Limited



Lothian Buses Limited is the largest municipal bus company in the UK. It carries about 120 million passengers per year, and contributes to wider transport objectives to deliver a healthy, inclusive, safe transport system.

It is owned 91 per cent by City of Edinburgh Council; and East Lothian, Mid Lothian and West Lothian councils own the remainder. Transport for Edinburgh is the holding company for Lothian Buses Limited and Edinburgh Trams Limited.

The company operates in the main a low fare, high passenger volume inclusive fares policy with a single flat fare across much of the network. As in the rest of Scotland, senior citizens travel free through a concessionary policy operated and funded by the Scottish Government.

Lothian Buses operates about 700 buses and has a vehicle replacement programme that procures vehicles that minimise emissions including hybrid and all electric vehicles. All buses are low floor and wheel chair accessible.

The company is profitable and makes a dividend payment to its constituent councils. For Edinburgh, the principle shareholder, annual dividends have risen from around £2 million in 2010 to over £6 million in 2017. The council has no restrictions on its use of the dividends; they are currently being used in part to fund the infrastructure costs of the Edinburgh Trams Project.

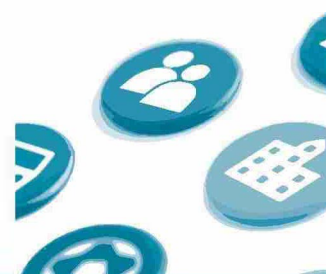
Source: Audit Scotland





Councils will need to consider the benefits and risks as ALEOs evolve

100. Financial constraints may reduce the funding councils provide to ALEOs. ALEO representatives have argued that funding cuts can be double edged as they reduce their ability to generate income and achieve the benefits that setting up an ALEO was meant to make possible.

101. We have seen examples of ALEOs merging to bring related services together and save costs. Mergers between leisure and culture ALEOs are an example. As ALEOs evolve and adapt, councils will need to carefully consider their viability including their ability to operate more independently. There is also a risk that 'super-ALEOs' become so large they lose the focus and flexibility that is seen to be one of their success factors. It is important that councils keep ALEOs under review and consider alternatives where they no longer meet their intended objectives.

Endnotes



- 1 [*Code of guidance on funding external bodies and following the public pound*](#) , Accounts Commission and Convention of Scottish Local Authorities (CoSLA), 1996. In 2005, the Code was given statutory backing in the form of a Ministerial Direction under s51(1) and (2) of the Local Government (Scotland) Act 2003 which required every local authority to comply with the FtPP Code when entering into any arrangement or agreement with a body corporate or implementing such an arrangement.
- 2 OSCR's 2015 report *Arm's-Length External Organisations* lists the charitable ALEOs identified at that time.
- 3 The LGiSA 2003, and the provisions around Best Value, Community Planning, and the power to advance wellbeing.
- 4 *The Councillors' Code of Conduct*, Scottish Government, 2010. The Standards Commission publishes guidance for councillors on how to interpret the provisions within the Code of Conduct.
- 5 *Advice for Councillors on Arm's-Length External Organisations*, The Standards Commission, September 2016.
- 6 www.oscr.org.uk/guidance-and-forms/guidance-and-good-practice-for-charity-trustees 
- 7 [*How councils work: Roles and working relationships in councils: are you still getting it right?*](#) , Accounts Commission, November 2016.
- 8 Under what is known as the Teckal Exemption, codified in regulation 12 of the Public Contracts Regulations (PCR) 2015.
- 9 *Model Publication Scheme*, produced and approved by the Scottish Information Commissioner on 31 May 2017.
- 10 Scottish Household Survey data.
- 11 Financial returns submitted by charitable ALEOs to OSCR.
- 12 *Health and social care integration: Part 2*. To be published autumn 2018 on behalf of the Auditor General and the Accounts Commission.
- 13 Care Inspectorate (CI) grading assessments for registered services: care homes; support services; and housing support services (from The Care Inspectorate Datastore). The CI grades registered services on four themes: Care and Support; Environment; Staffing; Management and Leadership.
- 14 [*Social work in Scotland*](#) , Accounts Commission, September 2016.
- 15 The Scottish Government Scottish Futures Trust identifies Energy Services Companies (ESCOs) as a model for district heating schemes and other initiatives.

Appendix 1

Audit approach



Our audit work included a sample group of nine councils that make significant use of ALEOs, covering both urban and rural areas. We included the three councils that currently operate social care ALEOs.

Sample councils and ALEOs of interest

<p>Aberdeen</p> <ul style="list-style-type: none"> Bon Accord, delivers social care Aberdeen Heat & Power 	<p>The City of Edinburgh Council</p> <ul style="list-style-type: none"> Edinburgh Leisure CEC Holdings, a range of property companies 	<p>Dundee City Council</p> <ul style="list-style-type: none"> Leisure and Culture Dundee Dundee Energy Recycling Ltd
<p>Fife Council</p> <ul style="list-style-type: none"> Fife Sports & Leisure Trust Fife Resource Solutions (waste management) Fife Cultural Trust 	<p>Glasgow City Council</p> <ul style="list-style-type: none"> Cordia (social care) Glasgow Life (leisure and culture) Jobs and Business Glasgow City Building 	<p>The Highland Council</p> <ul style="list-style-type: none"> High Life Highland (leisure and culture) Beinn Tharsuinn Windfarm Community Limited
<p>North Lanarkshire Council</p> <ul style="list-style-type: none"> Culture North Lanarkshire North Lanarkshire Leisure Ltd Mears Scotland LLP (property) 	<p>Scottish Borders Council</p> <ul style="list-style-type: none"> SB Cares Borders Sport and Leisure Trust 	<p>Stirling Council</p> <ul style="list-style-type: none"> Active Stirling Ltd (sports and leisure) Stirling Development Agency Ltd

The audit work comprised document review, research and interviews with representatives from the sample group. These included officers, ALEO representatives and focus groups with elected members. Much of our on-site and research work was undertaken in late 2017.

We looked at a cross-section of ALEOs from this sample group. We did not look at:

- housing associations
- public-private partnerships, private finance initiatives or other financial partnerships
- councils' funding of the numerous smaller-scale activities delivered through the third sector and other external parties
- trading operations within councils or other partnership arrangements.

Appendix 2

The common forms of ALEO



Key features



Limited company

Can be a company limited by shares (CLS) or guarantee (CLG). The 'articles of association' set out the rules for decisions, ownership and control between the company and its 'members' who formed the company (typically the council).



Limited Liability Partnerships (LLP)

As with a company, it is a separate legal identity that offers limited liability to its members. Governed by a partnership agreement, it offers greater flexibility than a company over internal arrangements, eg for taking decisions and the treatment of profits.



Scottish Charitable Incorporated Organisation (SCIO)

A bespoke legal form for registered Scottish charities that has been available since 2011. SCIOs need only register with the Office of the Scottish Charity Regulator (OSCR). Limited companies can also be charities but must register with both OSCR and Companies House.



Community Interest Company (CIC)

A form of company (limited either by shares or by guarantee) created as a 'social enterprise' to use its profits and assets to benefit the community.

Related forms are community benefit societies (CBS) and cooperative societies that serve the interests of their members.



Joint Venture (JV)

A general term for a commercial venture between partners, typically the council and the private sector. Can take different forms, eg CLS, LLP. Public-private partnerships, and private finance initiatives are also forms of JV partnerships.



Trust

A body governed by 'trustees' through a trust deed. Unlike companies, they are not registered with a regulatory body and do not offer limited liability.

Appendix 3

Factors for councils to consider



Business case assumption Factors for councils to consider

ALEOs bring financial benefits through tax advantages, commercial trading and new funding opportunities



ALEOs bring financial benefits through NDR relief, new funding and wider commercial trading.

Charitable status encourages donations and volunteering.

The ALEO model safeguards against contract over-pricing as any surpluses can be retained in the public sector.

However, points to bear in mind:

There are uncertainties about whether new sources of income will continue over the longer term. For example:

- Taxation benefits, eg NDR and VAT are subject to change.
- Future income is affected by market forces.
- Grants and new funding tend to be one-off, time limited or project specific; and there is increasing competition for them.

ALEOs bring strong identity, focus and responsiveness



Direction through an ALEO board can be more immediate and responsive than through a larger council body that has competing demands for attention. An ALEO's defined purpose, separate identity, and contractual obligations give a clear focus on performance. ALEO boards bring greater diversity and specialist expertise; ALEOs can compete to attract workforce talent.

However, points to bear in mind:

Councils can achieve similar benefits when ALEOs are not involved:

- Councils can create a service identity and focus, for example through setting up separate business units with a distinct brand.
- Councils already attract external expertise, eg through partnership working, and joint boards or committees.
- Outsourcing can also bring expertise and specialisms to the benefit of the service.

ALEOs can bring workforce flexibility and efficiencies



ALEOs have brought new and improved practice in areas of workforce deployment. They have negotiated more flexible employment terms, for example to extend opening hours; and make use of casual staff and volunteers.

However, points to bear in mind:

- The best performing councils also demonstrate good workforce management and practice. These features are not unique to ALEOs.
- Planned changes in an ALEO may be limited by expectations over workforce terms and conditions.
- Financial pressures in an ALEO may impact on its ability to uphold terms and conditions including access to pensions.
- If an ALEO is brought back into the council any differences in terms will need to be harmonised.

Councils' use of arm's-length organisations

This report is available in PDF and RTF formats, along with a podcast summary at:

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