

The City of Edinburgh Council

Internal Audit

Arm's Length External Organisations (ALEO) Final Report

2nd August 2021

CW2001

Overall report rating:

**Significant
Improvements
Required**

Significant and / or numerous control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks. Consequently, only limited assurance can be provided that risks are being managed and that the Council's objectives should be achieved.

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This internal audit review is conducted for the City of Edinburgh Council under the auspices of the 2020/21 internal audit plan approved by the Governance, Risk and Best Value Committee in September 2020. The review is designed to help the City of Edinburgh Council assess and refine its internal control environment. It is not designed or intended to be suitable for any other purpose and should not be relied upon for any other purpose. The City of Edinburgh Council accepts no responsibility for any such reliance and disclaims all liability in relation thereto.

The internal audit work and reporting has been performed in line with the requirements of the Public Sector Internal Audit Standards (PSIAS) and as a result is not designed or intended to comply with any other auditing standards.

Although there are a number of specific recommendations included in this report to strengthen internal control, it is management's responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the City of Edinburgh Council. Communication of the issues and weaknesses arising from this audit does not absolve management of this responsibility. High and Critical risk findings will be raised with senior management and elected members as appropriate.

1. Background and Scope

Background

Arm's Length External Organisations

Audit Scotland describes Arm's Length External Organisations (ALEOs) as organisations that are 'formally separate to the Council but are subject to its control or influence.' Ownership, provision of funding, and significant shareholdings in a company all constitute significant control or influence, and therefore constitute an arm's length relationship with external organisations.

The Council is responsible for ensuring that Audit Scotland's ['Following the Public Pound'](#) principles are consistently applied by any ALEOs that it provides funding to, and must ensure that ALEOs can demonstrate value for money.

Reporting arrangements for ALEOs will vary depending on the structure of each entity for example, Limited Liability Partnerships; Limited Companies; Charities; and Charitable Trusts. However, the Council has a duty to include details of the financial performance of any ALEOs where it holds a controlling interest, in its annual accounts.

The Standards Commission Scotland (the Commission) is an independent body responsible for encouraging high ethical standards in public life through the promotion and enforcement of Codes of Conduct for Councillors and those appointed to the boards of devolved public bodies.

The Commission's July 2018 [Code of Conduct for Councillors](#) includes a section on Appointments to Partner Organisations that confirms Councillor's responsibilities to declare any potential conflicts of interest where they have been appointed as a director of a company or a charitable trust as a nominee.

The following external reports and guidance is also available to support Council's with their ongoing governance and scrutiny of ALEOs. These include:

- [Council's Use of Arm's Length Organisations](#) - Audit Scotland (2018)
- [Advice for Councillors on arm's Length External Organisations](#) - The Standards Commission for Scotland (2016);
- [Inquiry into Arm's Length External Organisations](#) - Scottish Parliament (2016)
- [Arm's Length external organisations \(ALEOs\): are you getting it right?](#) - Audit Scotland (2011); and
- [Report on Arm's Length External Organisations](#) - Office of the Scottish Charity Regulator (2015).

Council ALEOs

Details of ALEOs where the Council has an established interest or relationship are maintained on a register. The current version of the register (June 2019) confirms that the Council has arm's length relationships with 30 external organisations and 37 associated subsidiary companies that deliver a varied range of services including the provision of public transport services; leisure facilities; cultural venues and trusts; property development; pension investment and management.

Each ALEO is aligned with a relevant Council directorate and should have established service level and / or funding agreements in place that cover any services delivered to or received by the Council and any funding provided by the Council.

Current governance arrangements

A Council Governance Hub chaired by the Chief Executive was established in 2016 to scrutinise delivery of services by ALEOs; to ensure that the Council is aware of any new and emerging risks; confirm the ongoing independence of elected members as directors of ALEOs; review ALEO annual assurance statements; and confirm that there is adequate ongoing reporting by ALEOs to both Council executive committees and the Governance, Risk and Best Value Committee. The Hub also provides an opportunity for ALEOs to raise any issues or concerns directly with the Council.

To support the Council's ongoing scrutiny of ALEOs, Council Officers are appointed as independent observers at ALEO boards. The Council Observer (CO) is essentially a representative of the Council with no voting rights, and attends meetings to confirm ongoing compliance with any agreements between the Council and the ALEO, and to identify any potential risks to the Council. Observers should escalate any immediate concerns to their line manager.

The Council also requires elected members to declare any potential conflicts of interest, and these are recorded and maintained in a register. Any relevant conflicts of interest are also declared at the beginning of any Council executive committee meetings, including the Governance, Risk and Best Value Committee.

The Corporate Governance section of the Council's 2018 financial statements (refer page 145) included two actions (actions 11 and 13) to improve governance arrangements in relation to ALEOs. These were:

- Reporting of ALEOs has gone to executive committees and the Chief Executive but not all ALEOs are also reporting to the Governance, Risk and Best Value Committee. Work will be undertaken with directors and the Governance Hub to improve awareness and compliance with the reporting process
- A review of arrangements is underway to ensure ALEOs have a service level agreement or funding agreements.

Future Governance Arrangements

A paper titled [Arms' Length External Organisations – Reporting to Committee](#) was presented to the Council's Policy and Sustainability Committee in February 2020 that outlines a revised reporting approach for ALEOs to relevant Council Committees. This included proposals for:

- Council Executive Committees to scrutinise ALEO future direction; performance and service delivery; and progress against relevant agreements (including service level agreements)
- The Governance, Risk, and Best Value Committee to scrutinise ALEO financial performance, and risks.
- Reports to include annual financial statements and a section prepared by the Council's observer detailing any comments they have in relation to performance and risk management.
- Representatives from the ALEO's executive management team and the Council observer to be present at committee for consideration of the reports.

Various papers have also been presented to the Council's Committees in relation to the reform of Transport ALEOs. A report to Policy and Sustainability Committee in July 2020 highlighted the current arrangements and challenges for the management of the Council's Transport ALEOs. In November 2020, the Transport and Environment Committee established a short life working group to develop a preferred governance and operating structure for delivery of Council owned public transport.

Previous Assurance Reviews

ALEO governance arrangements was last reviewed by Internal Audit (IA) in April 2016. This review included 1 High and 3 Medium rated findings highlighting that:

1. High - Councillors who are both legal directors of an Arm's Length Company and sit on the scrutinising committee for that entity could be perceived as having a conflict of interest as they may be scrutinising actions that they as directors are responsible for.
2. Medium - Council Observers for EICC & EDI are not attending all the Board or Audit Committee meetings. In addition, we did not identify process documentation for the Council Observer role in any of the Service Directorates.
3. Medium - The Council's annual assurance questionnaire process would benefit from tailoring to ensure that it meets the needs of Arm's Length Companies.
4. Medium – Arm's Length Companies are not always subject to regular scrutiny by the relevant scrutiny Committee.

Additionally, a number of external assurance reviews were completed by the Accounts Commission (2011; 2015; and 2018); and the Office of the Scottish Charity Regulator (OSCR) in 2015.

The conclusions drawn from each of these reviews were that further work was required to realise benefits from ALEOs whilst managing the associated risks, with a number of improvement identified in each review.

Covid-19 Impact on ALEOs

The Covid-19 pandemic has adversely impacted both the operation and financial performance of the majority of the Council's ALEOs as a number of services that they provide (for example cultural venues and leisure activities) have either been closed, or have been subject to a significant decrease in demand (for example transport services) since March 2020.

This will also adversely impact the Council's current and future financial position as ALEOs are unlikely to be able to deliver expected financial returns (for example annual dividend income received from Lothian buses) and may require additional future funding and support to reinstate their services.

It is therefore essential to ensure that ALEOs have taken advantage of all Scottish Government grant funding and support schemes available to them; have accurately recorded the risks and associated impacts on performance (both financial and non-financial); have established appropriate recovery plans; and that the Council has reviewed and scrutinised the approaches adopted by each ALEO.

Scope

The objective of this review is to assess the adequacy of design and operating effectiveness of the Council's established governance and scrutiny arrangements (including appropriate risk management arrangements and Covid-19 impacts and recovery plans) in relation to its ALEOs during the period 1 April to 31 December 2020.

Approach

The following approach was applied across a sample of ten Council ALEOs to support completion of the review:

- Identify the key risks in relation to ensuring the Council has established adequate and effective governance arrangements in relation to its ALEOs;
- Identify the key controls established to mitigate these risks;

- Evaluate the design of the key controls in place to address the key risks. This will involve discussions with elected members and officers appointed to ALEO Boards and also independent observers.
- Assess the operating effectiveness of the key controls;
- Prepare a draft report detailing the findings raised and Internal Audit recommendations;
- Discuss all control gaps identified and agree management actions with key stakeholders at a workshop; and
- Prepare a final report detailing that includes agreed management actions and implementation dates.

Limitations of Scope

There are no specific scope limitations.

Reporting Date

Our audit work concluded on 3 March 2021 and our findings and opinion are based on the conclusion of our work as at that date.

2. Executive summary

Total number of findings: 2

Summary of findings raised

High	1. ALEO Governance Framework
High	2. Conflicts of Interest, Appointments, and Training

Opinion

Our review identified a number of significant control weaknesses in the design and effectiveness of the Council's Arm's Length External Organisations (ALEOs) governance, control, and risk management arrangements. Consequently, only limited assurance can be provided that the risks associated with ALEOs are being managed, and that the Council's objectives of effectively managing and scrutinising ALEO operational performance and risk management processes should be achieved.

Over the years the Council has implemented a number of measures to address the findings raised in previous internal and external ALEO assurance reviews. These include establishing the Governance Hub and providing guidance for Council Observers (2016); clarifying ALEO oversight measures (2018); and more recently (February 2020), approving the refreshed reporting approach to both relevant executive committees and the Governance, Risk and Best Value Committee (GRBV).

However, our review has confirmed that further work is required to strengthen the Council's ALEO governance and risk management arrangements, and ensure that they are consistently applied as management actions implemented to address findings raised in relation to potential conflicts of interest and the role of Council Observers raised in previous assurance reviews have not been sustained.

The annual governance statement (AGS) included in the Council's [2019/20 financial statements](#) also reinforced that the division of scrutiny of the Council's Arm's Length External Organisations (ALEOs) between executive committees and Governance, Risk and Best Value Committee is essential to ensure that potential conflicts of interest are mitigated; confirmed that separation of scrutiny has not always been clear, and that duplication of scrutiny has been common.

Whilst the arrangements included in the [Arms' Length External Organisations – Reporting to Committee](#) paper that were agreed by the Council's Policy and Sustainability Committee in February 2020 should have addressed this concern, our review has confirmed that these have not been consistently and effectively applied.

Consequently, 2 new High rated findings have been raised.

The first High rated finding reflects the fact that the current operational management of ALEOs by the first line is not consistent. Accordingly, there is a need to establish a second line ALEO governance framework that should be applied by first line directorates to ensure consistent and effective ongoing governance and scrutiny of ALEOs, as various inconsistent approaches are currently being applied. This finding also highlights the need to ensure that centralised ALEO details are consistently maintained and reviewed, and the importance of confirming the ongoing financial feasibility of ALEOs as the economic and financial impacts associated with Covid-19 become clearer.

Our second high rated findings reinforces the need to ensure that potential or perceived conflicts of interest in relation to Elected Member appointments to ALEOs are considered and addressed in line with Audit Scotland requirements; and the importance of ensuring that both Elected Members and Council Observers involved with ALEOs have relevant and appropriate skills and experience and complete appropriate training in line with relevant Audit Scotland guidance.

Further detail on these findings is included at Section 3.

3. Detailed findings

1. ALEO Governance Framework

High

Review of the processes established by the Council to support management and scrutiny of Arm's Length External Organisations (ALEOs) confirmed that:

1. **ALEO governance framework** - there is currently no established ALEO governance framework that provides a consistent second line approach to the establishment and ongoing management of ALEOs that can be applied across the Council by first line directorates.
2. **First and second line roles and responsibilities** – second line responsibilities for developing and maintaining an ALEO governance and management framework and first line directorate responsibilities for its consistent application have not been clearly defined and agreed.

It is acknowledged that the Democracy, Governance, and Resilience (DGR) team currently performs elements of this second line role on an ad hoc basis (when required) by drafting service level; funding; or shareholder agreements, or supporting queries about establishing new ALEOs, however, DGR has advised that they are not currently empowered or resourced to perform a second line ALEO oversight or scrutiny role.

At the time of our review, DGR was in the process of developing guidance for incorporating a council company.

3. **Governance Hub** – Following a report to Council in June 2016, the governance hub was established in Oct 2016 with the objective of scrutinising and reporting ALEO performance and identifying and reporting any significant risks to the Council. Review of the operation of the governance hub established that:
- the protocols for determining which ALEOs should attend the Governance Hub have not been documented.
 - the purpose of the governance hub has evolved over time from its originally agreed terms of reference.
 - whilst a standing agenda exists and meeting minutes are prepared, there is no formal action tracker that records agreed decisions, responsibilities, and completion timeframes, and progress with agreed actions is monitored informally.

4. **Inconsistent approaches** – lack of an established ALEO governance and management framework has resulted in various inconsistent approaches being applied to the governance of ALEOs across the Council.

Whilst some variances would normally be expected given the differences in structure, size and risks associated with each ALEO significant variances were identified.

Of the 30 external organisations and 37 associated subsidiary companies listed as ALEOs in the current version of the central ALEOs register (June 2019):

- Only 7 ALEOs are represented in the Governance Hub. It is acknowledged that it may not be appropriate for all ALEOs to be included in the Governance Hub, however criteria for inclusion has not yet been defined
 - Fewer than 10 ALEOs report performance updates to Council committees;
 - Fewer than 20 ALEOs have Council Observers appointed; and
 - Fewer than 25 ALEOs have elected members of Council appointed to their board.
5. **Council Observer (CO) Reports** - ALEO reports provided to Council Committees are not currently supported by reports from COs in line with the revised ALEO reporting approached agreed by the Policy and Sustainability Committee in February 2020.
6. **Central ALEO register** – DGR currently maintains a centralised ALEO register that includes details of Council Observers (Cos); Elected Members (EMs); lead directorates; and details of any established service and funding agreements.

Review of the current register established that it has not been recently updated. Specifically:

- First line directorate responsibilities for ALEOs relationship management have not been consistently recorded.
 - EMs for Capital Theatres, Capital City Partnership and Marketing Edinburgh are not recorded in the register, but are documented in a separate master spreadsheet.
 - the lead officer for each ALEO has not been updated, for example, the Chief Executive for Marketing Edinburgh Limited and for EDI Group Limited.
7. **Ongoing review of the central ALEO register** - whilst a process has been established by DGR to update the ALEO register when notified of a change by Companies House, there is currently no

regular scheduled review of the centralised ALEO register maintained by the DGR team to confirm that it remains up to date.

8. **Financial Sustainability** - in response to Covid-19, the Council's 7 high risk ALEOs were requested to prepare detailed financial scenarios for the next 12 months (2021-22). Whilst this was reported to the Corporate Leadership Team and considered by the Governance Hub, there are currently no plans to request further detailed financial scenarios for review.

Risk

The potential risks associated with our findings are:

- **Regulatory and Legislative Compliance** - management and scrutiny of ALEOs is not performed consistently across the Council by the first line as agreed and in line with relevant Audit Scotland; Standards Commission; Scottish Parliament; and Office of the Scottish Charity Regulator regulations and guidance.
- **Governance and Decision Making** Significant ALEO performance issues and risks may not be identified and addressed.
- **Service Delivery** – lack of clear understanding in relation to the nature and quality of services provided to and from ALEOs by the Council.
- **Financial and Budget Management** – the Council does not have a clear picture of future ALEO financial sustainability and its potential impact on both Council services and finances.
- **Reputational Risk** – adverse publicity associated with ALEO operational performance and service delivery.

1.1 Recommendation: ALEO Governance Framework

1. Second line responsibilities for the design, implementation, and ongoing maintenance of an ALEO governance framework should be agreed.
2. An ALEO governance framework should be designed and implemented. This should include (but not be limited to):
 - A clear definition of Council ALEOs
 - A refreshed terms of reference for the Governance Hub that details who should attend and outlines the governance processes to be applied (where relevant) in meetings;
 - Definition of criteria for ALEOs that should be included in the Governance Hub;
 - Clear allocation of an ALEO or group of ALEOs to first line directorates;
 - Roles and responsibilities for first line directorates and Council Observers (COs);
 - Roles and responsibilities for Elected Members (EMs) including the process to be applied when they are appointed to ALEO boards;
 - Guidance on how ALEO management and scrutiny responsibilities should be performed by both COs and EMs;
 - Standard templates for service level and funding agreements that can be completed by first line teams;
 - ALEO and CO operational performance and risk management reporting requirements to both Council Executive Committees and the Governance, Risk, and Best Value Committee.

- Details of the ongoing central ALEO register maintenance responsibilities, including responsibilities for providing details of changes to be included, and responsibility for confirming its ongoing completeness and accuracy; and
 - First and second line assurance responsibilities in relation to the ongoing management and oversight of ALEOs.
3. The governance framework should be communicated across the Council to all first line teams (including COs) and EMs involved in management and scrutiny of ALEOs. This should be supported by training where required.

1.1 Agreed Management Action: ALEO Governance Framework

1. Second line responsibilities for the design, implementation, and ongoing maintenance of an ALEO governance framework will be agreed; and
2. An ALEO governance framework will be designed implemented, and communicated that incorporates all of the recommendations above.

Owner: Stephen Moir, Executive Director of Corporate Services

Contributors: Nick Smith, Service Director: Legal and Assurance; Gavin King, Head of Democracy, Governance and Resilience; Laura Callender, Governance Manager; Ross Murray, Governance Officer; Layla Smith, Operations Manager, Corporate Services, Michelle Vanhegan, Executive Assistant.

Implementation Date:

30 Sept 2022

1.2 Recommendation: Central ALEO Register

1. The central ALEO register should be reviewed and updated, with confirmation obtained from directorates of the location of relevant supporting documents (for example service and funding agreements).
2. Ongoing review of the central ALEO register should be implemented at an appropriate frequency (for example every six months) to confirm that it remains complete and accurate.

1.2 Agreed Management Action: Central ALEO Register

The recommendations detailed above will be implemented.

Owner: Stephen Moir, Executive Director of Corporate Services

Contributors: Nick Smith, Service Director: Legal and Assurance; Gavin King, Head of Democracy, Governance and Resilience; Laura Callender, Governance Manager; Ross Murray, Governance Officer; Layla Smith, Operations Manager, Corporate Services, Michelle Vanhegan, Executive Assistant.

Implementation Date:

16 December 2022

1.3 Recommendation: ALEO Financial Sustainability

1. Existing quarterly monitoring reports for high risk ALEOs should be updated to include the potential service delivery and financial impacts associated with new and emerging and ongoing ALEO financial risks, including the ongoing impacts of Covid-19).
2. The reports should be reviewed by the Corporate leadership Team (CLT); the Governance Hub; and relevant Executive Committees (as required) to ensure that both service delivery and financial issues and risks have been identified, and appropriate action plans established.

1.3 Agreed Management Action: ALEO Financial Sustainability

Recommendation accepted. Engagement with ALEOs will continue, with the potential service delivery and financial impacts associated with new and emerging and ongoing ALEO financial risks incorporated into the Council's established quarterly monitoring reporting process.

These reports are currently provided to the Corporate Leadership Team; the Finance and Resources Committee; and will also be provided to the Governance Hub.

Owner: Stephen Moir, Executive Director of Corporate Services

Contributors: Hugh Dunn, Service Director, Finance and Procurement; Layla Smith, Operations Manager, Corporate Services; Michelle Vanhegan, Executive Assistant.

Implementation Date:

31 March 2022

1.4 Recommendation: Implementation of ALEO Framework by Directorates

1. Following design, communication and delivery of training on the ALEO governance framework, directorates should ensure that it is implemented and consistently applied to their relevant ALEO relationships.
2. Directorates should also design and implement their own first line assurance activities to confirm that the ALEO framework is being consistently applied, and will take appropriate steps to address any significant variances identified.

1.4a Agreed Management Action: Implementation of ALEO Framework by Place

The new ALEO Governance framework will be implemented within the Place Directorate for those organisations which are defined as an ALEO and for which Place is responsible for the on-going relationship.

This will include Edinburgh Leisure which currently sits within the Education and Children's Services Directorate and will transfer across to the Place Directorate at a future date to be confirmed.

Owner: Paul Lawrence, Executive Director of Place

Contributors: Gareth Barwell, Service Director – Operational Services, Peter Watton, Service Director - Sustainable Development, and Service Directors for Housing, Family Support and Fair Work and Culture and Wellbeing; Operations Manager;

Implementation Date:

30 September 2023.

1.4b Agreed Management Action: Implementation of ALEO Framework by Corporate Services

Recommendations accepted and will be implemented following the rollout of the governance framework at a corporate level. This will also be factored into and considered as a part of first line managerial responsibilities across Corporate Services and as part of first-line assurance arrangements which are in the process of being introduced and should be embedded by the time this framework needs rolled out.

Owner: Stephen Moir, Executive Director of Corporate Services

Contributors: Nick Smith, Service Director: Legal and Assurance; Gavin King, Head of Democracy, Governance and Resilience; Laura Callender, Governance Manager; Ross Murray, Governance Officer; Layla Smith, Operations Manager, Corporate Services, Michelle Vanhegan, Executive Assistant.

Implementation Date:

30 September 2023

2. Conflicts of Interest, Appointments, and Training

High

1. **Conflicts of Interest** - we identified 5 instances where EMs on the board of ALEOs also sat on the relevant Council executive committee responsible for scrutiny and oversight of the ALEOs performance. This issue was also previously highlighted in the April 2016 Internal Audit report.
It is acknowledged that these conflicts may have been highlighted by EMs through the established declaration process when ALEO performance reports were presented to the Council committees for scrutiny.
2. **Elected Member (EM) appointments** – there are currently no established protocols that clearly define the basis for EM and CO appointments to ALEO boards that considers alignment of their skills, experience, and background and clearly defines their roles and responsibilities.
3. **Regular review of ALEO appointments** – no review process has been established to confirm that EM's appointed to ALEOs continue to be the most suitable fit for the role.
4. **Training** – review of training available to both Elected Members (EMs) and Council Observers (COs) involved in ALEOs confirmed that:
 - only code of conduct training is classified as mandatory for EMs, whilst completion of training on director's duties and appointment to outside bodies remains voluntary.
 - training records are not maintained for COs and were incomplete for EMs, as we were unable to confirm whether 9 out of 20 EMs had completed training.

Risk

The potential risks associated with our findings are:

- **Regulatory and Legislative Compliance** – conflicts of interest are not identified and managed in line with Audit Scotland requirements.
- **Regulatory and Legislative Compliance** – Elected Members (EMs) appointed to ALEO boards may not have relevant skills and experience as recommended in Audit Scotland guidance

- **Governance and Decision Making** – poor governance and decision making occurs as EMs and Council Observer (CO) skills gaps are not addressed by completion of relevant training as also recommended in Audit Scotland guidance.
- **Reputational Risk** – adverse publicity associated with potential conflicts of interest and ineffective governance.

2.1 Recommendation: Conflicts of Interest and Appointments

1. Management should consider and confirm whether they are prepared to accept the reputational risks associated with perceived conflicts of interests where Elected Members (EMs) on ALEO boards also sit on the relevant Council executive committees responsible for ALEO scrutiny, and document the outcomes of this decision. Audit Scotland requirements and guidance should be considered as part of this decision making process
2. Where this risk is accepted, the supporting rationale should be recorded in relevant risk registers.
3. Established conflict of interest procedures should be reviewed and refreshed to align with the outcome of the decision noted at point 1 above, and communicated to all Elected Members.
4. The skills, background and experience required for EMs appointed to ALEO boards and Council Observers (COs) who represent the Council's interest at board meetings should be considered; documented; and consistently applied in the ALEO Board appointment process (refer recommendation 1.1 above). This should include consideration on continuing professional development requirements where this is considered appropriate.
5. Skills and experience of both EMs and COs should be reviewed at appropriate intervals to confirm that it remains relevant to support effective discharge of the responsibilities associated with these roles.

2.1 Agreed Management Action: Conflicts of Interest and Appointments

1. and 3 The Democracy, Governance, and Resilience (DGR) team has introduced an ALEO scrutiny process where ALEOs are scrutinised by both relevant executive committees (where conflicts of interest could exist) and the Governance, Risk and Best Value Committee (where no conflicts should exist) to further mitigate this risk.

It is acknowledged that as fewer than ten ALEOs currently report performance updates to Council committees (as highlighted in finding 1), further clarity is needed to confirm that these include all ALEOs where potential EM conflicts of interest exist in relation to executive committee scrutiny.

At the beginning of every new Council term Elected members are allocated to ALEOs, and it is expected that these appointment will remain in place for the duration of the five year Council term.

Following the allocation of EMs to ALEOs, a paper will be prepared and presented to full Council that highlights any potential conflicts of interest between ALEO and Council committee appointments (including the Governance, Risk, and Best Value Committee), with a request that the Council either risk accepts or takes action to address the potential conflicts identified.

This report will also highlight that future potential conflicts could occur if EM appointments to either ALEOs or Council committees are changed, and that this should be considered by political groups as part of any subsequent appointment changes.

2. It is acknowledged that the risks associated with potential EM ALEO conflicts of interest should be recorded and noted as having been risk accepted as part of the Council's risk management framework, together with supporting rationale.

Following presentation of the paper to full Council noted above, Executive directors will be advised of any potential ALEO conflicts of interest that have been risk accepted and requested to ensure that these are reflected in relevant risk registers.

4. A framework will be designed and provided to all ALEOs that makes recommendations for an appropriate composition of both elected members and independent members for inclusion in ALEO boards to ensure that there is an appropriate balance and mix of skills.

The skills, background and experience required for Council Observers (COs) who represent the Council's interest at board meetings will be considered; documented; and consistently applied to all appointments.

5. The DGR team will send reminders to each Group annually about the recommendation that there be an appropriate composition of both elected members and independent members for inclusion in ALEO boards. Each Directorate will be asked by DGR to confirm (at least annually) that the background, skills and experience of each CO remains appropriate.

Owner: Stephen Moir, Executive Director, Corporate Service

Contributors: Nick Smith, Service Director, Legal and Assurance; Gavin King, Head of Democracy, Resilience and Governance; Laura Callender, Governance Manager; Ross Murray, Governance Officer; Layla Smith, Operations Manager, Corporate Services, Michelle Vanhegan, Executive Assistant.

Implementation Date:
30 June 2023

2.2 Recommendation: Training

1. Existing training materials for both Elected Members (EMs) and Council Observers (COs) should be reviewed and refreshed to ensure there is sufficient information on managing ALEOs, including legal responsibilities, scrutiny and oversight, and conflicts of interest, and any recent updates from regulatory bodies such as Audit Scotland; The Standards Commission; the Scottish Parliament; and the Office of the Scottish Charity Regulator.
2. Training materials should be regularly reviewed to confirm that their content remains relevant.
3. Management should consider making training mandatory for both EMs and COs with the requirement to complete refresher training at appropriate intervals (for example, annually). Where training is not mandated, it should be promoted and the need for completion regularly reinforced with both groups.
4. Training records should be established, maintained, and regularly reviewed to confirm completion, with follow up performed where training has not been completed.

2.2 Agreed Management Action: Training

1. and 2 Agreed. Actions will be implemented as recommended.

3. It was agreed at a meeting of full Council in June 2016 that EMs who were directors of Council companies would undertake mandatory training on their duties under the Companies Act. Training will also be made mandatory for COs.
4. Completion of training by both EMs and COs will be monitored and where training has not been completed, Group Leaders will be notified.

Owner: Stephen Moir, Executive Director, Corporate Services

Contributors: Nick Smith, Service Director, Legal and Assurance; Gavin King, Head of Democracy, Resilience and Governance; Laura Callender, Governance Manager; Ross Murray, Governance Officer; Layla Smith, Operations Manager, Corporate Services, Michelle Vanhegan, Executive Assistant.

Implementation Date:

30 June 2023

Appendix 1: Basis of our classifications

Finding rating	Assessment rationale
Critical	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Critical impact on the operational performance; or • Critical monetary or financial statement impact; or • Critical breach in laws and regulations that could result in material fines or consequences; or • Critical impact on the reputation of the organisation which could threaten its future viability.
High	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Significant impact on operational performance; or • Significant monetary or financial statement impact; or • Significant breach in laws and regulations resulting in significant fines and consequences; or • Significant impact on the reputation of the organisation.
Medium	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Moderate impact on operational performance; or • Moderate monetary or financial statement impact; or • Moderate breach in laws and regulations resulting in fines and consequences; or • Moderate impact on the reputation of the organisation.
Low	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Minor impact on operational performance; or • Minor monetary or financial statement impact; or • Minor breach in laws and regulations with limited consequences; or • Minor impact on the reputation of the organisation.
Advisory	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

Please see the [Internal Audit Charter](#) for full details of opinion ratings and classifications.

Appendix 2: Areas of audit focus

The areas of audit focus and related control objectives included in the review were:

Audit Area	Control Objectives
Strategy and Communications	<ol style="list-style-type: none"> 1. The Council has a clear definition of ALEOs and applies this consistently to external organisations that it deals with to determine whether they should potentially be classified as ALEOs. 2. The role of Council independent observer on ALEO Boards has been clearly defined. This should include but not be limited to: <ul style="list-style-type: none"> • monitoring ongoing compliance with any agreements between the Council and the ALEO, including compliance with funding requirements; • review of Board papers to identify any potential operational and financial performance concerns and identification of any potential risks to the Council. • Annual reporting to the Governance Hub (GH); and • escalation of any immediate concerns to their line manager. 3. Guidance has been provided to Directorates and Divisions on ongoing management of ALEOs that includes the requirement to: <ul style="list-style-type: none"> • consider whether any new relationships with external organisations should be classified as ALEOs; • advise Strategy and Communications and also the GH of any new ALEO arrangements; • ensure that appropriate service level agreements have been established detailing services provided to or received from the ALEO and are regularly reviewed; • ensure that appropriate annual funding agreements supported by appropriate funding conditions have been established where funding is provided by the Council to ALEOs; • ensure that appropriate ALEO relationship managers (at Directorate or Head of Service level) have been established and independent observers appointed to ALEO Boards; and • ensure that ALEO performance and annual governance statements are reviewed by the GH and the appropriate Council executive committees (including the Governance, Risk and Best Value Committee). 4. The ALEO register is circulated to Directorates at an appropriate frequency to confirm that all current ALEOs are included; that SLAs and funding agreements are in place; and that ALEO performance has been scrutinised at relevant Council executive and the Governance, Risk and Best Value Committee.

<p>Governance Hub</p>	<ol style="list-style-type: none"> 1. Terms of reference has been established and shared with Council ALEOs that details the role, responsibilities and accountabilities of the Governance Hub (GH) and its ongoing engagement with ALEOs. These should include, but should not be limited to ongoing oversight of ALEO: <ul style="list-style-type: none"> • board composition to ensure that there are no potential conflicts of interest; • strategic planning and decision making; • operational and financial performance; • risk management; • assurance outcomes; • annual governance statements; • financial statements; • reporting to relevant Council executive and Governance, Risk and Best Value Committees; and • annual reports prepared by Council independent observers and any issues raised and escalated to the GH. 2. The GH is also responsible for assessing any new relationships with external organisations to determine whether these should be classified as ALEOs for inclusion in the register and potentially the Council's annual financial statements. 3. GH membership has been clearly defined, including representation from ALEOs. 4. Regular GH meetings are scheduled and are supported by agendas that are aligned with its terms of reference. 5. Actions from GH meetings are allocated to appropriate members with agreed timelines for completion, and implementation progress monitored at subsequent GH meetings. 6. Changes outlined in the January 2020 paper provided to the Policy and Sustainability Committee have been effectively implemented.
<p>Directorates and Independent Observers</p>	<ol style="list-style-type: none"> 1. All new relationships established with external organisations have been assessed to consider whether they should be classified as ALEOs, with Strategy and Communications requested to update the central ALEO register and the GH advised where this is the case. 2. ALEO relationship management responsibilities have been allocated at an appropriate level (Director or Head of Service) and independent observers appointed to each ALEO Board. 3. Service level agreements detailing the services to be provided to or from the Council by the ALEO have been established and are supported by key performance indicators (where appropriate), with performance regularly monitored. 4. Funding agreements (supported by relevant funding conditions) have been established with ongoing compliance with funding conditions regularly monitored.

<p>Training and Guidance</p>	<ol style="list-style-type: none"> 1. There are clear guidelines for elected members and officers who are appointed to the board of an ALEO, including guidelines covering conflicts of interest 2. Training is provided to elected members and officers appointed to ALEO Boards on how to perform effective scrutiny and how to identify and report any potential conflicts of interest. 3. Council observers receive adequate training and guidance to enable them to carry out their role effectively
<p>Councillor Appointments</p>	<ol style="list-style-type: none"> 1. The Council appoints elected members and officers to the boards of ALEOs with reference to their skills and experience. 2. Conflicts of interest are effectively managed by ensuring that elected members do not sit on the board of ALEOs and the relevant Council executive committee responsible for scrutiny and oversight of the ALEOs performance (including the Governance, Risk and Best Value Committee). 3. The Council ensures that there is at least one elected member or Council officer on the board of each ALEO.
<p>Covid-19 Impacts</p>	<ol style="list-style-type: none"> 1. The Council has obtained evidence from ALEOs confirming that they have: <ul style="list-style-type: none"> • taken advantage of all available Scottish Government grant funding and support schemes available to them. • identified all relevant Covid-19 risks; assessed and recorded them; and taken appropriate action to mitigate them where possible. • accurately monitored both the financial and non-financial impacts of Covid-19 on their services, and • Established appropriate service recovery plans 2. The Council has monitored the financial impact associated with reduced income from ALEOs, and reflected this in future financial plans (the Council's budget is due to be completed in February 2021). 3. Appropriate scrutiny has been applied to ALEO recovery plans by both senior management and relevant Council Executive Committees to confirm that they are realistic and achievable, and can be immediately implemented when permitted by the Scottish Government.