The Accounts Commission
The Accounts Commission is a statutory, independent body which, through the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has five main responsibilities:

- securing the external audit
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- reviewing the management arrangements which audited bodies have in place to achieve value for money
- carrying out national value for money studies to improve economy, efficiency and effectiveness in local government
- issuing an annual direction to local authorities which sets out the range of performance information which they are required to publish.

The Commission secures the audit of 32 councils and 34 joint boards (including police and fire services). Local authorities spend over £9 billion of public funds a year.

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.
Accounts Commission’s findings
Page 2

Controller of Audit’s report
Summary
Page 4

Part 1. Introduction
Background
The purpose of this report
Page 6

Part 2. Funding arrangements and governance
Funding arrangements
Page 7

Governance
Page 9

Audit
Page 10

Part 3. Applying the ‘Following the Public Pound’ Code in practice
The Code
The Audit Scotland survey
Page 12

Appendix 1
Accounts Commission/Convention of Scottish Local Authorities Code
Page 20

Appendix 2
The City of Edinburgh Council: Case Study
Page 22
Accounts Commission’s findings

On the basis of this initial review the Commission has concerns about councils’ funding of arm’s length bodies.
On the basis of this initial review the Commission has concerns about councils’ funding of arm’s length bodies, and particularly about the lack of reliable information on the position.

These issues will grow in significance as councils become increasingly involved in partnership working and innovative ways of delivering services and we have therefore asked Audit Scotland to carry out further work as a matter of priority to establish:

- the action taken by councils to apply the Code to funding relationships already in place
- the steps being taken by councils to apply it to new funding relationships
- the extent of implementation of improvements being made by councils in management information systems and controls
- the amounts going to the large number of organisations which receive relatively small individual grants, and the ways in which councils are dealing with both categories.

We will make a further public report when that work has been completed. In the meantime we are asking auditors to follow up the initial results with individual councils.
Controller of Audit’s report

Summary

Introduction
1. Scottish councils provided funding of around £200 million to 12,000 companies, trusts and other organisations in 2001/02, for purposes related to council services and functions. This covers a range of funding arrangements, from relatively small grants to voluntary organisations to payments to trusts set up by councils to manage all of their leisure facilities. The overall amount involved is significant, representing over 2% of the £9 billion spent annually on council services.

2. Where councils fund such arms-length entities it is important to maintain control and accountability over public funds. This requires the ability to ‘follow the public pound’ across organisational boundaries – from the point at which money leaves the council to the point at which it is ultimately spent by the receiving organisation. The Convention of Scottish Local Authorities / Accounts Commission ‘Code of Guidance on Funding External Bodies and Following the Public Pound’ sets out the principles of best practice when councils establish funding relationships of this type.

3. This is a public interest report to the Accounts Commission under s102 (1) of Local Government (Scotland) Act 1973. Its main purpose is to highlight the importance of the principles involved in following the public pound at a time when councils may be reviewing existing approaches and considering options for new ways of delivering services in response to their statutory duties, powers and freedoms under the Local Government in Scotland Act 2003, including Best Value and Community Planning. The report also contains information drawn from an Audit Scotland survey of councils’ involvement in funding agreements.

4. Although the report focuses on the role of councils in funding external organisations, similar types of funding arrangements exist in other parts of the Scottish public sector. It is likely, therefore, that the issues raised in this report will have wider application, in sectors other than local government.

Funding arrangements and governance
5. Councils fund external organisations for a number of reasons, for example to provide important services to the public or to provide social benefits such as creating employment opportunities. They may also consider that an external organisation can provide a better range or quality of service, or services that would otherwise not be provided. External bodies may be able to attract funding from sources not so readily accessible to the council, such as the private or the voluntary sectors. Councils also establish arms-length organisations to deliver services where this may provide economic advantages as compared with direct service delivery arrangements.

6. These types of arrangements are not new. But Best Value encourages councils to review the way in which services are provided and to undertake option appraisals of alternative methods of service delivery. This, in time, may lead councils to develop and expand the use of funding arrangements of the type covered by the ‘Following the Public Pound’ Code.

7. Since the publication of the Code in 1996 there have been significant developments in governance and risk management in both the public and private sectors. My local authority overview reports have highlighted this area and the need for councils to continue to review their governance arrangements so that they are meeting best practice standards. The main tenet of ‘following the public pound’ is that the principles of good governance apply in decisions concerning public money irrespective of whether those funds are spent directly or are transferred to arms-length organisations such as companies, trusts and voluntary organisations.

8. Robust systems for identifying and evaluating all the significant risks associated with planning and delivering services is an important aspect of good governance and applies where councils are considering new and existing funding agreements. In addition to normal business risks such as financial loss and service failure, there is the risk of damage to reputation through association with an external organisation if financial or service delivery problems emerge.

9. Effective governance also requires councils to ensure that funds and resources provided to arms-length organisations are used for the purpose intended. Best Value requires efficiency, effectiveness, economy, equal opportunities and the achievement of sustainable development; these concepts are equally relevant in funding arrangements. Effective monitoring that is commensurate with the value of the funds and assessed risks is therefore essential.

10. The involvement of council members or officers on the boards or management committees of funded bodies does not, in itself, represent a robust monitoring mechanism which enables the council to discharge its stewardship responsibilities. Effective
control requires systematic and regular monitoring of service and financial performance with formal monitoring reports presented to the council, or an appropriate committee, irrespective of council representation on the governing bodies of organisations receiving council funding.

11. Auditors recognise the increasing number and complexity of funding arrangements and can assess councils’ exercise of control with reference to the existing guidance and the new Best Value duties and other responsibilities set out in the 2003 Act.

12. In addition, the audit of Best Value and Community Planning will cover partnership arrangements and may include a review of the council’s performance, with specific focus on that part of the partnership arrangement that the council can influence and for which it is accountable. Barriers to the achievement of Best Value including those that are outwith the council’s direct control may be highlighted in the public audit report produced at the conclusion of the Best Value audit.

Applying the ‘Following the Public Pound’ Code in practice

13. To assess the effectiveness of existing governance arrangements, Audit Scotland surveyed councils’ involvement in funding external organisations. This provides useful contextual information about funding arrangements and identifies strengths and areas where action is required to achieve closer compliance with the Code.

14. The survey confirms that councils provide a significant amount of public money to arms-length organisations to help deliver a range of services, particularly relating to social work, leisure and economic development. Some councils had difficulty in supplying the information requested but the figures provided suggest that the total amount involved was of the order of £200 million in 2001/02. In addition to this, councils also provide non-financial support in terms of administrative resources, premises and staff.

15. Councils were unable in all cases to identify the purpose of the funding provided and the statutory authority under which the expenditure was incurred. This is critical in determining the nature of the financial relationship and the monitoring arrangements required.

16. The Audit Scotland survey also shows that there is scope for councils to review and improve the way they monitor and verify the financial and service performance aspects of funding agreements. Few councils adopt a corporate approach to funding arrangements.

17. Elected members and council officers often participate in the governing bodies of funded organisations, but the survey reveals that often there appears to be no obvious link between council membership and the significance of the funds provided. Councils also need to establish clear limits to the amount of funding that will be provided in each case and to predetermine criteria that would trigger a review of the funding relationship.

18. There is evidence of good practice at a number of councils and examples of this are cited in this report. It is also clear that the process of completing the Audit Scotland questionnaire has prompted some councils to review their arrangements for managing funding relationships. However, the survey also served to highlight areas of weakness where councils should review current practice.

19. In overall terms, the Audit Scotland survey indicates a high level of non-compliance with the Code’s requirements, both among councils and within individual councils. Non-compliance is evident in all services where arms-length funding is used and in most councils to some degree. Current practice should therefore be reviewed with the aim of achieving closer compliance with the Code.

Conclusion

20. This report indicates that there is significant scope for councils to strengthen and improve their arrangements for following the public pound with reference to the good practice and to the weaknesses highlighted from the Audit Scotland survey. Existing and new funding agreements should be reviewed in the light of the Code, recent guidance on corporate governance and emerging guidance on Best Value and Community Planning. This is necessary in view of the need to ensure the most effective use of and control over the substantial public funds currently involved, and the potential for these to increase with the exercise of the new duties, powers and freedoms vested in councils in the Local Government in Scotland Act.
Part 1. Introduction

This part of the report covers:

- background
- the purpose of this report.

**Background**

1.1 Scottish councils provided funding of around £200 million to 12,000 arms-length organisations in 2001/02, for a range of purposes related to council services and functions. This is a significant amount of public money and represents over 2% of the £9 billion spent annually on council services.

1.2 These funding arrangements are often more complex than standard purchase contracts for goods or services and are usually designed to deliver wider public benefits. They involve the transfer of public funds from the direct control of a council to the control of an arms-length organisation such as a company or a voluntary organisation. To ensure that public funds are used properly and to maintain accountability, it must be possible to trace the funds from the point at which they leave the council to the point at which they are ultimately spent by the receiving organisation. In other words, where councils fund arms-length entities it is important to be able to ‘follow the public pound’ across organisational boundaries.

1.3 In response to concerns about councils’ increasing use of arms-length organisations and the need to maintain control and accountability over public funds, COSLA (Convention of Scottish Local Authorities) and the Accounts Commission jointly published the ‘Code of Guidance on Funding External Bodies and Following the Public Pound’ in 1996. This set out the principles of best practice when councils establish significant funding relationships with companies, trusts and other organisations other than on a straightforward contractual basis. Since then, there have been further changes in the pattern of council spending with innovative approaches to service delivery often involving new and diverse arms-length funding relationships. In practice these can range from relatively small grants to voluntary organisations to payments to trusts set up by councils to manage all of their leisure facilities.

1.4 Recent changes to the local government legislative framework, including the new duties relating to Best Value and Community Planning, should lead councils to consider options for service delivery which may result in further and more widespread use of external agencies to achieve service objectives.

1.5 My annual overview reports on local authority audits in recent years have reflected external auditors’ concerns about the arrangements that councils establish to maintain control and accountability over the public funds that they provide to arms-length organisations. More specifically, my statutory report on Fife Council’s involvement with the Third Age Group illustrated the problems that can arise when there are weaknesses in these arrangements. Concern about councils’ financial involvement in arms-length organisations is also one of the most frequently recurring issues raised by the public in correspondence to auditors.

1.6 In view of the concerns over existing funding relationships reported by auditors and the likelihood of further and possibly more complex funding relationships, I have decided to make this public interest report to the Accounts Commission under s102 (1) of Local Government (Scotland) Act 1973. Its main purpose is to highlight this important area of activity at a time when councils may be reviewing existing arrangements and options for new ways of delivering services in response to their statutory duties, powers and freedoms under the Local Government in Scotland Act 2003, including Best Value and Community Planning. The report also contains information drawn from an Audit Scotland survey of councils’ involvement in funding agreements. The survey produced information which enabled the extent of existing funding arrangements to be quantified and considered aspects of the associated monitoring and accountability arrangements which have been established. This provides useful contextual information and helps identify areas where improvements are required.

1.7 Part 2 of the report considers the ‘following the public pound’ concept, including the reasons why councils enter into arms-length funding arrangements and the prospect of these becoming more common. This is then considered in the context of the development of corporate governance in the local authority sector. Part 3 provides details of the existing Code and the information obtained from councils through the Audit Scotland survey about the nature and extent of council funding and compliance with the guidance in the Code. This part of the report contains some examples of good practice identified from the survey.

1.8 Although the report focuses on the role of councils in funding external organisations, similar types of funding arrangements exist in other parts of the Scottish public sector. It is likely, therefore, that the issues raised in this report will have wider application, in sectors other than local government.
Part 2. Funding arrangements and governance

This part of the report covers:

- funding arrangements
- governance
- audit.

Funding arrangements

‘Following the public pound’

2.1 The ‘following the public pound’ concept applies when councils decide to fund external organisations which deliver services that might otherwise be delivered by the councils themselves. In these arrangements, councils agree to provide funds and other resources to companies and other organisations such as trusts or grant aided voluntary organisations. ‘Following the public pound’ means ensuring that there is proper accountability for public funds used in delivering services, irrespective of the means of service delivery.

2.2 The ‘Following the Public Pound’ Code applies when councils’ financial relationships with external organisations are on a basis other than a contract for the purchase of services. These can range from one-off grants to voluntary organisations to large-scale regular contributions to the operating costs of organisations created by councils to provide services previously provided by them directly. Exhibit 1 overleaf contains examples of cases where councils fund external organisations.

Council involvement

2.3 Councils fund external organisations to provide important services to the public, or to provide social benefits, such as creating employment opportunities. They may consider that an external organisation can provide a better range or quality of service, or can provide services that would otherwise not be provided. External bodies may also be able to attract funding from sources not so readily accessible to the council, such as the private sector or from charitable trusts. Councils also establish arms-length bodies to deliver services where this may provide economic advantages as compared with direct service delivery arrangements.

2.4 Councils may perceive, for example, that an arms-length company may be more effective at engaging with the private sector to promote economic development. Voluntary organisations can engage with socially excluded groups, such as drug users and the homeless who may be reluctant to contact statutory agencies to access services. In addition to providing services, funded bodies can bring wider benefits to local communities by, for example, helping people to develop skills and encouraging community involvement.

2.5 The common purpose in councils’ involvement in these arrangements is usually to provide a wider range of services, often in conjunction with other public organisations to provide ‘seamless’ services. Councils also envisage greater choice for service users and general improvements in the quality and cost of service delivery.

2.6 These types of arrangements are not new. However, in recent years councils have been considering
Exhibit 1
Examples of cases where councils fund external organisations

Councils provide funding to a range of organisations mainly in connection with social work, leisure and economic development.

The following examples from councils’ accounts highlight the range of activities funded by councils.

Aberdeen City Council has a majority shareholding in a company set up to provide buildings for exhibitions, conferences and other events. In 2001/02 the Council provided a funding grant of £650,000.

Edinburgh Leisure Limited is a non-profit-distributing company limited by guarantee and registered as a charity. It was incorporated to manage sport and leisure facilities on behalf of the City of Edinburgh Council. In 2001/02, the Council provided revenue funding of £7.4 million to Edinburgh Leisure Limited.

Fife Council’s annual accounts disclose that the Council provides funding to a number of organisations that provide the Council with a degree of influence over their operations. In addition to funding for leisure and environmental related services, the Council provided funding totalling £2.8 million to 35 organisations for social work activities in 2001/02.

Glasgow City Council is represented on the Greater Glasgow and Clyde Valley Tourist Board. During 2001/02 the Council contributed £2.1 million to the Tourist Board.

The Time Capsule (Monklands) Trust Ltd was formed to manage a leisure facility. North Lanarkshire Council provides financial support and in 2001/02 provided £1.5 million as a contribution to operating costs.

Orkney Islands Council owns Orkney Ferries Limited. During the year the Council provided subsidy payments totalling £4 million to the company in support of ferry services.

Renfrewshire Council’s accounts disclose payments to voluntary organisations in excess of £60,000. These include payments to organisations providing services relating to regeneration, mental health, alcohol counselling and support for carers.

Source: Councils’ audited accounts 2001/02
innovative approaches to service delivery and this has led to an increase both in the number of such arrangements and range of activities to which they apply, with associated changes in the scope of responsibilities.

**Best Value and Community Planning**

2.7 The Local Government in Scotland Act 2003 (the Act) establishes new statutory duties on councils to make arrangements that secure Best Value, defined as continuous improvement in the performance of their functions. Councils are also required to maintain a Community Planning process for consultation and cooperation in the provision of public services in their area. Among other provisions, the Act also gives councils a new power to promote or improve the well-being of their area and persons within their area.

2.8 Scottish Ministers have issued statutory guidance that sets out what councils are expected to demonstrate in fulfilling their new statutory duties. This highlights the need for sound governance at a strategic, financial and operational level. The guidance also states that a council that secures Best Value will also be able to demonstrate the use of review and options appraisal. In considering opportunities for improvements in services, councils are expected to take a fair and open approach in evaluating alternative forms of service delivery irrespective of whether the service providers are from the private or public sectors. Councils are also required to have regard to any recognised, published code such as the current COSLA/Accounts Commission ‘Following the Public Pound’ Code.

2.9 The new wide ranging powers and duties are designed to encourage councils to review their approach to providing services and consider innovative approaches to service delivery. These could include new arms-length agencies and closer partnership working between councils and other organisations, as they respond to the needs of the communities they serve. This, in time, may lead councils to develop and expand the use of funding arrangements of the type covered by the ‘Following the Public Pound’ Code.

**Governance**

**The governance agenda**

2.10 The term ‘corporate governance’ came into common use following the publication of the Cadbury Report in 1992. Cadbury defined corporate governance as ‘the system by which organisations are directed and controlled’. Since then there have been significant developments in governance and risk management in both the private and the public sectors.

2.11 In recognition of the need to draw together the principles identified by Cadbury and others, including the Committee on Standards in Public Life, into a single framework of corporate governance for use in councils, CIPFA (Chartered Institute of Public Finance and Accountancy) and SOLACE (Society of Local Authority Chief Executives) produced ‘Corporate Governance in Local Government – A Keystone for Community Governance’. This considers corporate governance in the local government context and identifies the underlying principles as openness and inclusivity; integrity; and accountability.

2.12 The CIPFA/SOLACE paper is designed to assist councils in developing and improving their corporate governance arrangements. Service delivery arrangements, risk management and standards of conduct are highlighted among the areas which should be reviewed.

2.13 My overview report on the 2001/02 local authority audits noted that while they are making progress in this area, councils need to continue to review their governance arrangements to ensure that they are meeting best practice standards of governance – to check that these arrangements are sound and are seen to be sound.

**Governance and ‘following the public pound’**

2.14 The main tenet of ‘following the public pound’ is that the principles of good governance apply in decisions concerning public money irrespective of whether those funds are spent directly or are transferred to arms-length organisations such as companies, trusts and voluntary organisations.

2.15 The ‘Following the Public Pound’ Code supports these principles. The approach is also reflected in other guidance. For example in its publication ‘A Statement on the Role of the Finance Director in Local Government’, CIPFA recognises that ‘the statutory role of the finance director does not stop at the boundaries of the local authority but extends into its partnerships, devolved arrangements, joint ventures and companies in which the authority has an interest’.

2.16 In considering whether to enter into a funding arrangement or to continue funding under an ongoing agreement, governance arrangements within the funded organisation should be assessed. The aim should be to ensure that these meet the standards that councils expect in agreeing resources for services provided directly. Where a new company or trust is being established, the council can influence the form of the management arrangements from the start.
2.17 Corporate governance arrangements should reflect the requirement to develop and maintain robust systems for identifying and evaluating all the significant risks associated with planning and delivering services. This applies in cases where councils are considering new ‘following the public pound’ financial relationships and where they are continuing with existing arrangements. In addition to normal business risks such as financial loss and service failure, councils need to consider the risk of damage to reputation through association with an external organisation if financial or service delivery problems emerge.

2.18 Financial risks in ongoing ‘following the public pound’ arrangements can often be complex. Where, for example, a council’s relationship with an external organisation involved significant investment in the form of start-up capital or the delivery of a key service, the council may be exposed to greater than normal business risk. In this and other situations, the council may find itself in a position of being the ‘funder of last resort’ in the event of financial problems within the external organisation. This implies the need to set out clear limitations at the start of the agreement and identify ‘exit strategies’ or other courses of action which will be taken if problems arise.

2.19 Effective governance requires councils to ensure that funds and resources provided to arms-length organisations are used for the purpose intended. Councils will also wish to ensure that the public money used in the provision of services is subject to the same requirements that apply to them under Best Value in relation to efficiency, effectiveness, economy, equal opportunities and the achievement of sustainable development. In order to achieve this and meet their accountability obligations, councils need to establish robust monitoring arrangements that are commensurate with the value of the funds and other resources provided to the arms-length organisation and with assessed risks.

2.20 The involvement of council members or officers on the boards or management committees of funded bodies does not, in itself, represent a robust monitoring mechanism to enable the council to discharge its stewardship responsibilities. Effective control requires systematic and regular monitoring of service and financial performance with formal monitoring reports presented to the council, or an appropriate committee, irrespective of council representation on the governing bodies of funded organisations.

2.21 The Councillor’s Code of Conduct, issued by Scottish Ministers under the Ethical Standards in Public Life etc. (Scotland) Act 2000, recognises the potential for conflicts of interest when elected members sit on the governing bodies of external organisations (Exhibit 2).

2.22 External auditors review councils’ arrangements for following the public pound. Although there has been limited reporting on this topic, in recent years auditors have highlighted cases where councils have been faced with unanticipated liabilities arising from their

---

**Exhibit 2**

Membership of governing bodies – guidance for councillors

If you become a director of a company as a nominee of the Council you will assume personal responsibilities under the Companies Acts. It is possible that a conflict of interest may arise for you as between the company and the Council. In such cases it is your responsibility to take advice on your responsibilities to the Council and to the company. This will include questions of declarations of interest.

\[\ldots\ldots\ldots\]In relation to service on the boards and management committees of limited liability companies, public bodies, societies and other organisations, you must decide, in the particular circumstances surrounding any matter, whether to declare a non-financial interest. Only if you believe that, in the particular circumstances, the nature of the interest is irrelevant or without significance, should it not be declared. You must always remember that the public interest points towards transparency and, in particular, a possible divergence of interest between the Council and another body.

Source: The Councillor’s Code of Conduct
involvement in external organisations and where there are weaknesses in monitoring arrangements. These findings have been included in my annual overview reports on local authority audits.

2.23 As indicated previously, in establishing funding relationships with external organisations councils should stipulate how they intend to monitor the relationship. As part of that process councils should ensure that their external auditors have the right of access to information that they may require in connection with the audit of the council, including access, through the council, to the external auditors of the organisation. In the event that audit access is needed and cannot be arranged in any other way, the external auditor may rely upon statutory rights of access.

2.24 Auditors recognise the increasing number and complexity of ‘following the public pound’ arrangements and can assess the arrangements in place at councils with reference to the existing guidance in the Code and the new Best Value duties and other responsibilities set out in the 2003 Act.

2.25 In addition, the approach to the audit of Best Value and Community Planning will cover partnership arrangements and may include a review of the council’s performance with a specific focus on that part of the partnership arrangement that the council can influence and for which it is accountable. The council will include its views on the partnership arrangement as part of its self-assessment submission under the Best Value audit. Barriers to the achievement of Best Value including those that are outwith the council’s direct control may be highlighted in the public audit report produced at the conclusion of the Best Value
Part 3. Applying the ‘Following the Public Pound’ Code in practice

This part of the report covers:

• the Code
• the Audit Scotland survey.

The Code
3.1 In 1996 the Accounts Commission and COSLA jointly published the ‘Code of Guidance on Funding External Bodies and Following the Public Pound’ (the Code). The Code sets out the principles of best practice when councils establish significant funding relationships with companies, trusts and other bodies other than on a straightforward contractual basis. The Code was published in response to concerns about councils’ increasing use of arms-length organisations and the need to maintain control and accountability over public funds. It reflects the self-regulatory approach adopted in Scotland and has recently been given more formal status under the Local Government in Scotland Act 2003 which requires councils to have regard to generally recognised, published codes in pursuing Best Value. Exhibit 3 opposite provides a brief overview of the Code; it is reproduced in full in Appendix 1. The Code was supplemented by operational guidance issued by COSLA in 1998.

3.2 The remainder of this part of the report considers the findings from the Audit Scotland survey as they relate to the requirements of the Code.

The Audit Scotland survey
Survey approach
3.3 Audit Scotland undertook a survey of all Scottish councils to establish the nature and extent of their financial involvement with external bodies and how councils respond to the guidance on management provided in the Code.

3.4 Questionnaires were issued to all 32 Scottish councils requesting information about their financial relationships with external bodies. The questionnaires sought to establish the total funding awarded by councils in the financial year 2001/02, the types of bodies receiving funding and the statutory powers under which funding was awarded. Information was also requested on how funding arrangements are monitored and controlled to ensure that funds are used properly and to achieve the intended outcomes. (It should be noted that while councils act as the accounting bodies for amounts awarded to local Social Inclusion Partnerships, overall accountability for these funds lies with the Scottish Executive and for this reason these arrangements were outwith the scope of this survey).

3.5 Council staff completed the questionnaires and external auditors reviewed the information. Questionnaires were returned for all 32 councils, although the quality of information varied; the auditors of several councils identified shortcomings in the information provided, either because not all the information requested was provided or because there was a lack of evidence to support councils’ responses.

3.6 The survey did not seek to provide an overview on all the points councils should take into account in
The ‘Following the Public Pound’ Code highlights that the principles of openness, integrity and accountability which apply to councils in their decisions on spending public money apply equally to funds or other resources which are transferred by councils to arms-length bodies. The guidance is intended to ensure proper accountability for public funds and that the principles of regularity and probity are not circumvented.

The Code seeks to ensure that:

- councils are clear about the reasons for their involvement in any arms-length funding arrangement
- the extent of the financial commitment and the nature of the financial relationship are clearly specified
- appropriate financial and performance monitoring and reporting arrangements are in place from the start
- provisions are made for the council and its external auditors to have access to the records of the funded body
- councils carefully consider the question of their representation in the arms-length body
- councils establish limitations in the funding relationship and an ‘exit’ strategy.

Exhibit 3
A brief overview of the Code

The ‘Following the Public Pound’ Code applies the Code but identified the most commonly occurring issues faced by councils. In so doing, examples of good practice were identified and are included in the report. A more comprehensive case study referring to the City of Edinburgh Council’s approach is set out in Appendix 2.

3.7 There was evidence that the process of completing the questionnaire had prompted some councils to re-consider their arrangements for monitoring funded bodies.

Council spending on external funding

3.8 The Audit Scotland survey sought to identify the total amount of funding provided by councils to arms-length organisations. The survey revealed that some councils experience difficulties in determining the types of arrangements to which the Code applies. The figures provided by councils may, therefore, include some arrangements that are essentially service purchase contracts. Against this, it is probable that some councils may have excluded funding agreements that are subject to tightly specified service level agreements.

3.9 Of the £200 million identified as awarded to external bodies in 2001/02, the amount awarded by individual councils ranged from £42 million (Glasgow City Council) to £0.6 million (South Ayrshire Council). Funding for external bodies expressed as a percentage of service expenditure by each council varied between over 5% to less than 1%.

3.10 Exhibit 4 overleaf shows that councils funded arms-length organisations across a range of policy areas with the highest proportion (38%) relating to social work. Culture and leisure provision and economic development attracted 20% and 16% of funding respectively.

3.11 Councils provide funding to many different types of organisations, from small-scale voluntary bodies to large companies. Among the highest individual funded bodies were leisure trusts (City of Edinburgh Council awarded £7.4 million to Edinburgh Leisure) and tourist boards (Glasgow City Council awarded £2.1 million to Greater Glasgow and Clyde Valley Tourist Board).

3.12 The Audit Scotland survey asked councils to provide a breakdown of funding to external bodies by value of funding awarded. About a quarter of councils had difficulty in providing this information. An analysis of the information which was provided shows that 44% of the total funding awarded goes to 97 external organisations, each receiving in excess of £250,000. In contrast, approximately 9,000 external organisations received awards of less than £50,000, representing 25% of total funding awarded (Exhibit 5 overleaf).

3.13 The true cost of funding may exceed the value of the funds transferred to the arms-length organisation. In responding to the Audit Scotland survey, some councils identified cases where staff were seconded to funded bodies (particularly during the start-up phase) or premises were leased at nominal rents. Some councils also provide finance and accounting services to arms-length organisations.
Exhibit 4
Analysis of expenditure on external bodies by policy area

Source: Audit Scotland

Exhibit 5
Funding by amount of award

Source: Audit Scotland
Exhibit 6

Establishing the legal and financial framework

Renfrewshire Council maintains a central data base, which includes checklist screens to ensure that the following documents have been obtained from funded bodies:

- Constitution
- Deeds of Trust
- Last audited accounts
- Memorandum and Articles of Association
- Bank statements
- Signed undertakings from members of management committees.

Source: Renfrewshire Council’s response to Audit Scotland survey

Management arrangements

3.14 The Code emphasises that in transferring funds to an external organisation councils should be clear about the reasons for doing so and the objectives they are trying to achieve. It recommends that councils should set out the purpose for the funding at the time the funding decision is made and that this should be included in any documentation relating to the funding agreement.

3.15 The Audit Scotland survey asked councils to state the purpose of funding for specific bodies. In response some councils cited the statutory powers relied on for making the payment, or gave a general response such as ‘social inclusion’ without identifying a specific council policy objective that the funding was intended to meet.

3.16 Returns from several councils did not specify the statutory powers under which significant amounts of funding were awarded to individual bodies. This suggests that officers may be unclear about the legal basis of expenditure. While this does not imply that the payments were illegal, it does point to the need for improvements in the way council funding decisions are documented.

3.17 The legal framework within which an organisation operates determines the financial regime which will apply as well as the role that council officers and elected members may adopt and where liability lies in the event of financial mismanagement or non-compliance with the terms of funding agreements. Responses to the Audit Scotland survey showed that several councils had difficulty in providing information on the legal form of organisations to which they provided financial support. Of the 32 councils, only about one half provided an analysis of funding by the type of body funded. This may point to weaknesses in information systems or may be indicative of a lack of awareness about the legal form of the arms-length organisation receiving funding.

3.18 The Audit Scotland survey identified examples of good practice in identifying the legal and financial framework (Exhibit 6).

3.19 Funding agreements should incorporate provisions to enable the council to monitor the way its funds are being used by external bodies. These provisions may include monitoring reports to the council on financial matters, achievement of targets and future plans.

3.20 In response to the Audit Scotland survey about two thirds of councils indicated that their funding agreements included standard conditions reflecting the guidance on monitoring arrangements set out in the Code.

3.21 Results from the survey show that in many cases councils rely heavily on audited accounts and annual reports submitted by arms-length organisations as the main monitoring mechanism. These provide assurance on the financial position and provide a useful indicator of the organisation’s view of its performance, but are of limited use in monitoring the overall...
performance of funded organisations. Other councils recognise the need to request more detailed financial information in addition to reviewing the annual accounts of funded bodies. Most commonly, councils requested reports showing actual expenditure against budget.

3.22 The involvement of council officers with suitable financial qualifications or expertise in reviewing financial information will help ensure that technical aspects of the information are properly interpreted. However, few councils indicated that financial information was passed to the council’s finance department, or was reviewed by officers with a financial background (Exhibit 7).

3.23 Non-financial measures are necessary to ensure that specified results are being achieved and that the level and quality of service is in line with the funding agreement. In responding to the Audit Scotland survey about two thirds of councils indicated that they have standard conditions in funding agreements specifying defined outcomes from funding. However, when asked to identify the measures in place, responses tended to focus on measures not directly related to service outcomes. For example, an arms-length organisation offering welfare rights advice recorded a high number of clients but this does not provide assurance that the clients received good advice – this could be measured by client satisfaction surveys or by the amount of additional welfare benefits secured as a result of the advice. There is, however, some evidence from the Audit Scotland survey that councils recognise the need to improve aspects of their non-financial monitoring, as demonstrated in Exhibit 8.

3.24 In some cases measures of effectiveness are monitored to ensure that the broader purposes of funding are met. This may involve longer-term impact studies, as shown in Exhibit 9.

3.25 When asked to indicate how monitoring information was verified, councils appear to be less clear about how to check the information provided by funded organisations. Some councils appeared to make little or no attempt to verify the information provided. Others stated this was achieved by attendance at board or committee meetings, or that the reports themselves provided verification. Exhibit 10 overleaf contains an example of good practice drawn from the survey.

3.26 The process of verifying information provided by funded organisations will be assisted by including a condition in the funding agreement giving the council a right of access to records held by the body. The Audit Scotland survey indicated that about two-thirds of councils included this as a standard condition in funding agreements.

3.27 There was evidence from the survey that some internal audit departments had recently undertaken a review of councils’ general arrangements for funding external bodies. Councils reported that internal audit departments were also involved in investigating organisations when problems had come to light.

3.28 The survey showed that only five councils exercised central control of funding arrangements with the majority of councils delegating this to departments. A central database provides a key control mechanism, particularly where more than one council department may award funding. The survey indicated that a small number of councils maintain a central database of funding arrangements and that others are reviewing arrangements. An example is included in Exhibit 11 overleaf.

3.29 Written guidance which is available to all officers responsible for monitoring procedures will help ensure clarity in roles and responsibilities. Guidance issued at a corporate level also promotes a consistency of approach in monitoring and financial control procedures. Just over half of councils indicated that they had written guidance and specified procedures for monitoring funding arrangements, either at corporate level or for all departments awarding funding. Survey responses suggest, however, that in some councils written procedures are available to only some of the departments awarding funding.

3.30 Evidence from the Audit Scotland survey shows that council officers and members regularly sit on the governing bodies (boards or management committees) of funded bodies. Councils identified membership of governing bodies as contributing to their monitoring and control arrangements. However, the survey results also suggest that, in some councils, council members and officers are as likely to sit on the governing bodies of organisations which receive small amounts of annual funding as on those where the council has a more significant, long term financial relationship. In other words, there is often no obvious link between council membership on governing bodies and the significance of the funding awarded.

3.31 The Code emphasises that clear limits should be laid down at the outset of funding arrangements on the extent to which the council will become involved financially with the arms-length organisation and its affairs. The council should also
Exhibit 8
Improving performance monitoring

The survey indicated that councils recognise the need to improve performance measures. The following references are taken from the survey returns.

[Organisations]… ‘are not formally set specific performance indicators. They are monitored through regular meetings and dialogue…However…[the] Council has approved a decision to pilot Service Level Agreements…to introduce new measurable performance indicators to assist with monitoring in the future’.

‘A formal Service Level Agreement is being developed which will formalise monitoring arrangements’.

‘Annual business plan targets and objectives have been introduced from 2002/03’.

Source: Responses to Audit Scotland survey

Exhibit 9
Taking the broader view

West Lothian Council awarded £263,000 to a project providing supported accommodation for young people. Quarterly financial returns and annual accounts are submitted to the Council and are used to monitor actual expenditure against budget, identifying significant variances. The services are subject to a service level agreement and local quality inspections are carried out. Monthly occupancy rates are monitored and year on year comparisons are made.

A detailed Best Value review in 2000 assessed the organisation in terms of its fit with Council and community priorities, as well as the organisation’s effectiveness and efficiency. The Best Value review process involved a detailed self-assessment, Council officer assessment and external independent assessment.

The project’s services are linked to the Council’s objectives to maximise the potential for children and young people to lead full lives and to address unemployment and economic and social exclusion.

Source: West Lothian Council’s response to Audit Scotland survey
Exhibit 10
Verifying information

Dundee City Council awarded funding of £154,000 to a community education project run by a charitable company. The funding was related to the Council’s corporate objectives of:

- providing learning and cultural development
- building an informed, involved and active citizenship; and
- making efficient and effective use of resources.

The Council has no representation on the company’s board but two officers and a councillor have the right to attend board meetings as observers. Financial monitoring reports comparing budget with actual income and expenditure are produced for board meetings. Monitoring statements are supported by reports from the company’s financial system.

The Council has access to the organisation’s financial system and records. The Council undertakes annual system analysis visits, reviewing the systems and procedures in operation and testing information on a sample basis.

The service level agreement requires details of service delivery including work targets. The company’s annual report details usage figures and other performance information and includes an action plan for the next year.

Advice and guidance is available to the organisation from dedicated Council officers, including an assistant finance officer.

Source: Dundee City Council’s response to Audit Scotland survey.

Exhibit 11
Central control

Within North Lanarkshire Council six different departments managed grants to voluntary bodies, each with different internal controls. The Council’s Internal Audit department conducted a value for money study in 2001/02 and recommended that the current system should be replaced with a corporate system, together with appropriate guidelines and monitoring arrangements applicable throughout the authority.

In response to the report, the Council’s Chief Executive established a working group to address the issues and recommendations that were identified.

Source: North Lanarkshire Council’s response to Audit Scotland survey.
establish ‘exit strategies’ setting out circumstances that would trigger a review of the agreement and specific events that could lead to the termination of the agreement and protection of the council’s financial interest.

3.32 The survey results show that funding agreements are generally time limited, usually covering a period matching the council’s budget cycle. However, other examples were identified, often involving the council in ‘deficit funding’ agreements, where the council is committed to cover any losses in the arms-length organisation. This effectively represents an unlimited liability to be met from public funds.

**Concluding comments on the survey**

3.33 The Audit Scotland survey confirms that councils provide a significant amount of public money to organisations outside their direct control to deliver a range of services, particularly relating to social work, leisure and economic development. While some councils had difficulty in supplying the information requested, the survey suggests that the total amount involved is of the order of £200 million in 2001/02. In addition to this direct funding, councils provide other non-financial support in terms of administrative resources, premises and staff.

3.34 The survey indicates that councils were unable in all cases to identify the purpose of the funding provided and the statutory authority under which the expenditure was incurred. This is critical in determining the nature of the financial relationship and the monitoring arrangements required.

3.35 Appropriate mechanisms are required to maintain control and accountability over public money provided under funding agreements. The Audit Scotland survey shows that there is scope for councils to improve the way they monitor and verify the financial and service performance aspects of funding agreements. The survey also highlights that few councils adopt a corporate approach to funding arrangements.

3.36 The survey reveals that elected members and council officers often participate in the governing boards or managing committees of funded bodies, but often there appears to be no obvious link between council membership and the significance of the funds provided.

3.37 The survey also indicates that councils need to set clear limits to the amount of funding that will be provided in each case and to predetermine criteria that would trigger a review of the funding relationship.

3.38 There is evidence of good practice at a number of councils and examples of these are cited in this report. It is also clear that the process of completing the Audit Scotland questionnaire has prompted some councils to review their arrangements for managing funding relationships. However, the survey also served to highlight areas of weakness where councils should review current practice.

3.39 In overall terms, the Audit Scotland survey indicates a high level of non-compliance with the Code’s requirements, both among councils and within individual councils. Non-compliance is evident in all services where arms-length funding is used and in most councils to some degree. Current practice should therefore be reviewed with the aim of achieving closer compliance with the Code.
Appendix 1

Accounts Commission/Convention of Scottish Local Authorities Code

Code of Guidance on Funding External Bodies and Following the Public Pound

1 Objective
It is important to ensure clear public accountability for public funds at the same time as supporting initiatives for securing quality local authority services in the most effective, efficient and economic manner. The principles of openness, integrity and accountability apply to councils in their decisions on spending public money which are subject to public record and external audit. These principles should also apply to funds or other resources which are transferred by councils to arms-length bodies such as companies, trusts and voluntary bodies. This guidance is intended to ensure proper accountability for such funds and that the principles of regularity and probity are not circumvented. It has the support of the Convention of Scottish Local Authorities.

2 Scope
The guidance which follows sets out a framework for councils’ relationships with bodies through which they seek to carry out some of their functions other than on a straightforward contractual basis. The principles of the guidance apply to companies and other bodies such as trusts or grant aided voluntary organisations both where such bodies are subject to local authority control or influence and where they operate at arm’s length. Councils will wish to have their own rules setting out procedures appropriate to their local circumstances and internal processes, and those rules should be based on this guidance. The guidance should apply to any new substantial funding relationships entered into by councils and to existing substantial funding relationships at the earliest possible review date. What is ‘substantial’ will vary according to circumstances. When interpreting ‘substantial’ councils should have regard to the significance of the funding in relation to their own budgets and its significance in relation to the budget of the external body. We do not, for example, intend this guidance to apply to the many small revenue grants which councils make to community groups annually. ‘Funding’ is intended to include all resources which councils may transfer.

3 Purposes
When agreeing to transfer funds to an external body a council must be clear about its reasons for doing so. Proper considerations should always apply and the prime purpose of involvement with external bodies should be the achievement of the council’s objectives in the most effective, efficient and economic manner and not the avoidance of controls or legal restrictions which are designed to secure probity and regularity in the use of public funds. The reasons should be related to a strategy or policy of the council and that link should be demonstrable. An overall statement of purpose should be contained in any council decision to establish the funding relationship and should be expressed in any establishing documents or written agreements or understandings between the council and the body. The council should set out its expectation of the use of the funding. This should contain a broad and general statement of aims or goals and should also contain clear targets with timescales and methods of measurement whenever possible, as well as any conditions and reporting requirements.

4 Financial regime
The council should spell out clearly the extent of its financial commitment to the external body and the nature of the financial relationship eg shareholding, grant, loan, contractual payments. Criteria for making and receiving payments should be specified. The transfer of any assets should be clearly regulated in a written agreement and the end destination of any such assets should be specified. The council’s entitlements to any financial return should be stipulated and commitments to financial contributions by councils should not be open-ended in duration or amount. The written agreement should refer to the minimum standard of management arrangements which need to be in place and any specific or additional responsibility and accountability which is being vested in a board or management committee. The minimum accounting and audit requirements should also be included.

5 Monitoring arrangements
The council should make clear any requirements which it has of external bodies to operate in a particular way. This might include proper employment practices, recruitment and selection processes, equal opportunities requirements, wages and conditions of service of employees and purchasing policies. The council should also stipulate how it intends to monitor the relationship between itself and the external body. For example, the council may wish to stipulate that it will have appropriate access to records held by the body. The council may require the body to take appropriate advice on its actions and to make frequent monitoring reports to the council on such matters as:
- income, expenditure, profitability, liquidity and other financial matters
- achievement of targets
- future plans.
Regardless of representation on committees or boards, the council should insist on regular monitoring and reporting back by such bodies. Where the council designates a member of staff in a supervisory officer or equivalent capacity it should ensure that such officers are clearly aware of their responsibilities and of the relevant monitoring procedure. It is not the intention of this guidance to try to put the external auditors of the council in the place of the auditors of external bodies. However, the council must ensure that its external auditors are given a right of access to such records, and, if appropriate, accounts and financial arrangements of the external body so that they may follow the trail of public money from the council through the body. They should be able to seek, through the council, any explanations which they consider necessary from representatives of the body. The external auditors of the council should also have access, through the council, to the external auditors of the body.

6 Representation
The council should consider very carefully the question of representation on the boards of companies which are subject to its control and, to an even greater extent, on bodies which are not subject to its control. For example, members or officers who become directors will assume personal responsibilities under the Companies Act. It is possible that conflicts of interest can arise for such members and officers as between the company and the council. The council must ensure that members and officers are properly advised of their responsibilities to the council and to the company. This should include questions of declarations of interest.

7 Limitations
In entering into a substantial funding commitment with an external body the council should lay down a timetable for the achievement of the objectives. If the purpose is a continuing one then provision should be made for regular review of achievements and of the relationship between the body and the council. Arrangements should include regular reporting to an appropriate council committee, if necessary in private if issues of commercial confidentiality arise. Clear limits should be set on the extent to which the council will become involved financially with the body and its affairs. Clear rules should be laid down at the outset for terminating the funding agreement and separation of the council’s interest from that of the body. Councils should consider whether particular events should trigger a review eg, change of leading personnel in the external body.

8 Accountability
The external auditors appointed by the Accounts Commission will be required to review as part of the annual audit the arrangements which councils have made for such substantial funding agreements and will measure councils’ compliance with this guidance. In cases where they have concerns over issues of probity and regularity they will make these known to the council and the Controller of Audit.
Appendix 2

The City of Edinburgh Council: Case Study

In 2001/02 the City of Edinburgh Council awarded £30 million to external bodies for a range of purposes. This represents 5% of the overall (net) amount the Council spent on providing services to the public.

The Council has regularly reviewed the effectiveness of its procedures for monitoring its financial involvement with external bodies and has revised its approach in the light of experience. For example, the findings from the Controller of Audit’s report on Fife Council’s financial involvement with the Third Age Group were fed in to an on-going review of the City Council’s corporate management of grant awards.

In keeping with its large financial commitment to funding external bodies, the Council demonstrates a number of areas of good practice:

- Each funded body has a nominated lead department within the Council that coordinates monitoring functions and grant payments.

- Training is offered to council members or staff who sit on boards or committees on behalf of the council.

- The Council has written procedures and guidance to ensure compliance with the main requirements of the Code.

- The Council has standard conditions of funding which reflect the Code requirements for monitoring arrangements, access to records, and defined outcomes.

- The Council has produced a guide for funded organisations and Council staff setting out good practice in financial administration and management.

- The Council’s internal audit department undertakes a ‘health check’ of a sample of funding relationships for a minimum of ten organisations each year.

In addition, the Council maintains a strict division of duties between officers responsible for monitoring and evaluating external organisations funded by the Council (Reporting Officers) and officers who offer support and advice to funded organisations (Support Officers). This contributes to objectivity in monitoring arrangements.

The Council recognises that Council officers or elected members who sit on the governing bodies of external organisations must act solely in the interest of the external organisation and a distinction should be maintained between them and Reporting Officers, who are responsible for protecting the interests of the Council. When attending board or committee meetings of external organisations, Reporting Officers are required to make clear that their attendance is as an observer and they are instructed not to participate or offer advice to the body. The Council takes a graduated approach to the role of the Reporting Officer related to the extent of its financial involvement with a funded body.

The role of Support Officers is to assist in the development of funding agreements and offer advice and support to funded bodies in the achievement of objectives specified by the Council. Support Officers contribute technical information, data and background knowledge to assist Reporting Officers in their functions.

Source: City of Edinburgh Council