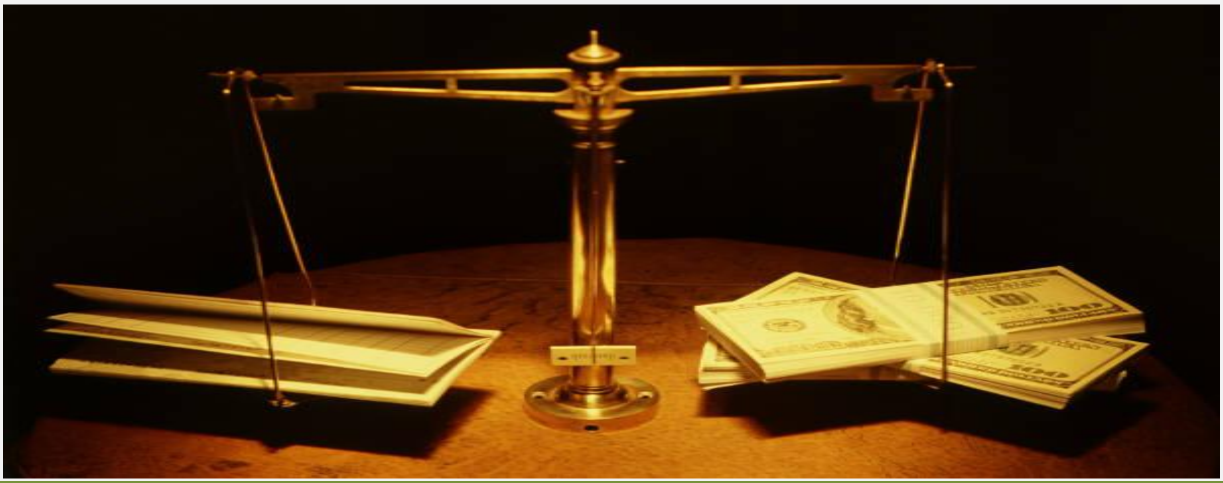
CIPFA WALES

Certificate in Corporate Governance Project

An assessment framework for Denbighshire County Council to gain assurance on governance and performance from its 'arms-length' organisations



Submitted by – Ivan Butler

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Introduction

Background

While government funding to local authorities has reduced year on year, the public's expectations for good quality services has increased and there has also been an increasing interest from stakeholders in the governance of local authorities. Welsh local government also faces a period of change following the publication in January 2014 of the *'Commission on Public Service Delivery'* report (commonly called the 'Williams review'), which examined public service provision in Wales. The main message from this review is that things must change for public services to survive, as they cannot cope with the financial pressures and increasing demand on their resources, but that this change cannot be incremental. The report stresses that organisations need to look at new delivery models, for example, collaboration and third party delivery but also insists that scrutiny of governance and performance needs to improve.

Denbighshire County Council (DCC) has already recognised the need to change and has recently introduced a concept called '*Sharpening our Act'*, which recognises that the public's expectations of its services are increasing and that performance in some areas needs to improve. DCC realises that it must become better at focusing on what is really important, accepting that some services and functions will stop or be transferred to others who may be able to deliver them at lower or no extra cost.

This is not a new way of delivering services, as DCC has funded external service providers for several years in various guises, e.g. through trusts, grants, and general funding assistance but it has not set up robust and consistent processes for establishing and monitoring these arrangements. In the last few months, the most significant of these arrangements came under close scrutiny and significant media and public interest when the 'arms-length' body faced financial pressures. My redacted follow up report of an external due diligence report is included as *Appendix 1*and highlights a lack of a robust governance framework and questionable HR policies and practices, which finally contributed to DCC withdrawing its funding support and the organisation ceasing trading and closing its facilities.

To put this risk into context, a Wales Audit Office (WAO) report into *'The Welsh Government's relationship with the All Wales Ethnic Minority Association'* (known as AWEMA) highlighted AWEMA's significant and fundamental failures in financial control and governance and ended up in a criminal case. It is a good example of poor governance and control at government level and in monitoring of arms-length organisations. The WAO report criticised the Welsh Government for its poor management and coordination of grant funding of over £7m to AWEMA, poor performance in some of its units, poor monitoring of AWEMA's spending and failure to act on concerns raised over the organisation. AWEMA eventually went into liquidation, owing the Welsh Government over £500k, which it could not recover and was found to be almost totally reliant on the Welsh Government for its funding. The WAO report includes recommendations that this CIPFA project is taking account of in developing a governance framework in that DCC should:

- make sure that it and the funding recipient understand their roles and responsibilities, building this into the funding award process;
- ensure that the purpose and objectives of the funding are clear from the outset;
- establish monitoring arrangements proportionate to the level of funding and type of organisation funded to ensure that the purpose and objectives are achieved;
- consider risks associated with the funding arrangement;
- seek annual assurance on the funded body's governance arrangements;
- undertake regular financial and operational reviews of the funded organisation; and
- ensure that robust legal and contractual arrangements are in place from the outset of the arrangement.

The above case, and the potential changing service delivery methods in public sector organisations, mean that DCC's elected members need to be aware of and understand their accountabilities and responsibilities when scrutinising and representing DCC on 'arms-length' body boards, committees etc., including conflicts of interest. DCC's Performance Scrutiny Committee has asked for assurance on the performance of other 'arms-length' organisations but, during the development of DCC's 'annual governance statement', subsequent discussions and committee reports, it has become clear that DCC cannot be fully assured that bodies that it funds and which deliver services on its behalf have robust governance arrangements in place. This has now been raised as a significant governance issue in DCC's 'annual governance statement' as recognition that it cannot transfer this accountability. *Appendix 2* provides extracts from DCC's draft 'annual governance statement' relating to monitoring of 'arms-length' organisations.

Project Scope

Appendix 3 shows the original brief for this CIPFA course project, which was to cover the three main 'arms-length' organisations referred to in DCC's Statement of Accounts to develop a basic framework for them to provide an annual self-assessment of their governance arrangements for DCC to consider when agreeing future funding. The project was also to include a review of the current monitoring arrangements for these bodies and the legal arrangements in place; however, following subsequent discussions with DCC's Corporate Executive Team and Corporate Governance Committee, it became clear that DCC needs to apply its governance principles to a wider range of council-funded organisations providing services on its behalf and that a framework needs to be developed to cover a wider range of organisations. This CIPFA course project and report therefore forms part of a larger DCC project shown in *Appendix 4*, which means that some parts of the original project brief will not now form part of this CIPFA course project report, although they will still be carried out within the larger DCC project in the coming months.

The organisations within the scope of this course project are not necessarily defined as ‘arms-length’ organisations, as these are normally organisations set up by the funder to provide services. This review will cover all organisations receiving funding to provide services on DCC’s behalf other than contractors, suppliers and partners, which will be subject to separate reviews during 2014/15. For the purpose of this review, the organisations within its scope will be referred to as ‘Council funded service providers’ (CFSPs). The definition used is that they *‘…are separate from the Council but are subject to Council control or influence, either through having representation on the board and/or through being a major funder or shareholder in the organisation.’*

Outcome of research

Desktop review

In developing the scope for this project, reviewing DCC's arrangements for monitoring CFSPs and assessing them against good practice, the main research sources have been:

- **Accounts Commission/Convention of Scottish Local Authorities *'Code of Guidance on Funding External Bodies and Following the Public Pound'*** – this document provides guidance to local authorities in Scotland on how to maintain public accountability when using public money to provide services through 'arms-length' bodies.
- **Audit Scotland's *'Following the Public Pound'*** - reports on its review of local authority progress in implementing the above code of guidance. The report concluded that the Commission had concerns about councils' funding of 'arms-length' bodies, in particular the lack of information available to inform their survey.
- **Audit Scotland's '*Arms-length external organisations (ALEOs): are you getting it right?'*** – this document is aimed at promoting and encouraging good practice in councils that are planning on setting up new ALEOs to deliver services as well as those with existing ALEOs.

The above documents are particularly useful, as they highlight the risks and provide useful guidance on how to get the governance arrangements right from the start and then maintain them effectively. This project aims to use and, where relevant, adapt guidance from these documents to develop specific guidance for DCC on how to implement, monitor and review such arrangements consistently, to prevent a repeat of the problems DCC has recently faced. In summary, the guidance states that local authorities must ensure that:

- they are clear about the reasons for delivering services in this way;
- they receive assurance that the objectives of the service are delivered;
- they understand the financial commitment they are making and the risks involved;
- they have effective financial and operational performance monitoring arrangements in place;
- the funding is used for the intended purposes;
- all necessary legal and contractual arrangements are in place, including an exit strategy;
- roles and responsibilities of both organisations are defined;
- they have audit access to the third party organisation; and
- where they appoint elected members or officers to the third-party's board etc., they understand their role and responsibilities.

Areas of good practice

The above three research documents and further documents researched relating to specific Scottish local authorities highlighted some specific examples of good practice for inclusion in the DCC framework for setting up and monitoring CFSPs:

- Consider establishing a nominated lead department for each CFSP that coordinates monitoring functions and grant payments.
- Provide training to elected members or members of staff who sit on boards or committees on behalf of DCC.
- Develop written procedures and guidance to ensure compliance with the main requirements of DCC's framework.
- Develop standard conditions of funding that reflect DCC's framework requirements for monitoring, access to records, and defined outcomes.
- Produce a guide for CFSPs and DCC staff setting out good practice in financial administration and management.
- Ensure that all substantial funding relationships are subject to a formal written agreement.
- Internal audit should undertake a 'health check' of a sample of funding relationships each year.
- Maintain a central database of funded bodies, including a checklist of documents required/seen e.g. Constitution, Deeds of Trust, last audited accounts, Memorandum and Articles of Association, bank statements, and signed undertakings from members of management committees.
- Financial vetting should be undertaken by a qualified accountant, for example, DCC could designate an accountant to each funded body depending on funding level.
- DCC policy should be not to pay elected members representing it on a CFSP board or committee (other than expenses).
- DCC should consider a policy that no officer will hold a trustee or directorship position in a CFSP.
- Designate one committee to scrutinise performance of CFSPs – including performance, risks, financial management, partnership working, contractual compliance and equalities compliance.
- The designated 'scrutiny' committee could receive themed reports across CFSPs, e.g. complaints handling, sickness absence.

Recommendations for developing a governance framework

Using a risk-based approach

Under CFSP arrangements, delivery of a service becomes the responsibility of a separate organisation and DCC loses direct control over day-to-day management of the service but remains accountable for how public money is spent and the quality of services delivered. There are also on-going financial and reputational risks if things go wrong. In *'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'.

This means that not only does DCC need to have good governance arrangements in place itself, but it needs to ensure that CFSPs also have robust governance arrangements. It is also important that DCC can provide assurance to its stakeholders that the funding it is providing to third parties is being used for the intended purpose and is delivering the required objectives. However, it is important that the level of monitoring introduced is commensurate with the risk involved, which is mainly linked to the level of funding provided and the impact that failure of the service would have on DCC's reputation and on the public.

To develop a risk-based approach to monitoring CFSPs, the first task was to identify all DCC payments in excess of £1,000 to such bodies during 2013/14 to establish the level of funding and what services the CFSP is providing. This analysis identified 71 CFSPs with payments ranging from £1,700 to over £175,000. Further discussions identified that several of these payments were for grants that may be monitored through external regulators such as Estyn, but these remain within the scope of this project, as DCC still needs to ensure that it receives assurance on these CFSPs, even if it comes from an external source.

Given the range of payments and the fact that several will only require assurance that the external regulators have inspected the CFSP, the organisations have been stratified based on risk as shown in *Appendix 5*, together with a summary of suggested set up, approval and monitoring arrangements. However, this proposal will be subject to Corporate Executive Team (CET) and elected member consideration and approval as part of the larger DCC project on CFSP governance.

Getting it right from the start

Given the pressures on DCC's funding and the need to concentrate on statutory services and corporate priority delivery, it is critical that agreements are only entered into with CFSPs to help DCC deliver in these core areas and that the CFSPs share DCC's vision, priorities and values. This means that both parties need to have a shared purpose, building good relationships and understanding each other's needs and priorities, particularly in the more significant CFSP arrangements.

DCC should therefore have an overarching policy statement that sets out its stance and strategic approach to using CFSPs, supported by a framework to provide guidance to officers, elected members and CFSPs that takes account of the suggested risk-based approach in *Appendix 5*. DCC already has guidance for elected members as part of its Constitution, but this will need to be reviewed to take account of the outcome of this project and the good practice identified in the research mentioned above. This elected member guidance should be supported by training to ensure that elected members understand their roles, not only in scrutinising CFSP arrangements but when representing DCC on CFSP boards and committees, in particular relating to potential conflicts of interest.

To ensure that arrangements for considering and setting up CFSPs are robust, the following points are crucial:

- DCC's officers and elected members must comply with its guidance when considering use of and developing arrangements with CFSPs.
- DCC's officers and elected members must base any decision to use a CFSP on a sound options appraisal and an approved business case, including risk assessment and EQIA (Equality Impact Assessment). *Appendix 6* provides guidance on options appraisals and business cases.
- CFSPs should only be used to help meet a statutory need or to help deliver DCC's corporate priorities (there may be exceptions, e.g. where Welsh Government provides grant funding that DCC administers on its behalf).
- Governance arrangements should be considered at the outset (based on the risk stratification in *Appendix 5*) to ensure that DCC and the CFSP can effectively scrutinise performance and be held accountable; monitor costs, performance and risk; and engage service users and citizens.
- DCC's officers and elected members must clearly understand the role of boards, committees and DCC in the articles of association or other constitutional documents of the CFSP.
- DCC must set clear criteria for appointing representatives to boards of CFSPs, including skills, experience and payment.
- All CFSPs should be subject to some form of legal agreement, the level and type of which will again be based on the risk stratification shown in *Appendix 5*. Suggested content for a comprehensive legal agreement is shown in *Appendix 7* and must include clauses to terminate or review delivery arrangements at the outset, taking into account the impact on services and their users, employees and assets.

In addition to the above, there are some critical governance questions that CET and elected members need to ask when considering use of a CFSP and when approving business cases for their use:

- Are we clear about our overall expectations of the CFSP?
- Do these expectations align with DCC's corporate priorities?
- How well do we understand the financial commitment and risks flowing from the decision to use the CFSP?

- How do we ensure that the governance arrangements in the CFSP are sound and that those with an active role receive adequate training and advice?
- How will we safeguard our interests, such as assets and other resources made available to the CFSP?
- How will we know how well the CFSP is doing, through our scrutiny of both operational and financial performance?

Keeping it right – monitoring CFSPs

Appendix 5 shows the suggested monitoring arrangements for each type of CFSP; however, monitoring of CFSP governance arrangements will inevitably be more difficult than assessing DCC's governance arrangements, not just in accessing information but in assessing leadership, values, culture and other intangible elements of governance. The suggested arrangements are therefore largely based on the tangible elements of governance, such as policies, procedures, financial accounts, performance reports etc.

To enable effective monitoring of CFSPs performance, DCC should set out its expectation of the use of the funding from the outset. 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.

Formal agreements with CFSPs should also provide DCC's internal and external auditors with access to CFSP records and personnel if required. In particular, internal audit should review the overall arrangements for using CFSPs regularly to ensure that the process remains robust, effective, the overall risk is being well-managed and the framework is complied with. This review should contribute to DCC's 'annual governance statement' as part of the Internal Audit Annual Report on DCC's governance, risk and internal control arrangements. Internal Audit should also review a sample of specific CFSP arrangements on a risk basis each year.

DCC should consider very carefully the question of representation on CFSP boards or committees. For example, members or officers who become directors will assume personal responsibilities under the Companies Act and it is possible that conflicts of interest will arise for such members and officers between the company and DCC. It is crucial for DCC to ensure that elected members and officers are properly advised of their responsibilities to DCC and to the CFSP. In particular, they should be fully aware of their respective codes of conduct within DCC's Constitution, which state that they have a duty to act in DCC's interests as a whole but outline the impact of becoming a director or trustee of a CFSP where they must act in the interests of the CFSP.

One very important point to stress is that having elected members or senior managers on CFSP boards or committees does not constitute adequate monitoring and there should be systematic and regular monitoring of service and financial performance of CFSPs with formal reports to the relevant DCC committee. In particular, DCC representatives on CFSPs must:

- be aware of how well corporate priorities are being met by the EFSP;
- carry out scrutiny or management roles effectively, taking action on shortcomings or under-performance;
- be risk aware and satisfied that risks to DCC and the CFSP are identified and managed effectively;
- act quickly on potential conflicts of interest;
- take action to ensure that funding is withheld or reviewed or the agreement terminated, particularly where services or public money are at risk;
- take action where the intended objectives of the CFSP are not being met, or diverge from DCC's corporate priorities;
- periodically review delivery arrangements to ensure that best use is made of resources and that robust governance is in place;
- take action to ensure that CFSPs are reviewed or wound up where they are no longer active or effective, or contribute to DCC priorities.

Final thoughts

This CIPFA project forms only a small part of a larger DCC project to improve its assurance on governance arrangements in CFSPs. There is still a lot of work to do to develop the governance framework, but this project provides a foundation for the larger project, with examples of good practice, a recommended approach and a firm basis on which to develop a robust governance framework for the future. In fact, DCC will be able to develop the way forward suggested in this project report in other areas such as partnerships and Town and Area Plans, where services and/or projects are delivered by other bodies on DCC's behalf.

One particular difficulty in implementing the new framework will be dealing with relationships with current CFSPs that have been delivering services for several years without being asked to report regularly on performance and possibly not having formal legal agreements in place. DCC will have to manage this change carefully to maintain good relationships and its reputation, highlighting the benefits and need for the new arrangements.

However, the new framework will ensure that DCC addresses the following key risks, particularly if it adopts the suggested toolkit adapted from the research documents shown in *Appendix 8*:

- Having guidance and consistent arrangements for setting up and recording CFSPs means that it will be fully aware of all CFSPs that it deals with.
- Having regular and robust monitoring arrangements means that it will not fund CFSPs that do not deliver intended outcomes and will be aware of CFSPs that perform poorly, operationally and/or financially.
- Having robust governance arrangements over CFSPs reduces the likelihood of failure in its stewardship of public funds.
- Having early warning mechanisms through regular monitoring information reduces the likelihood that it will suffer financial loss due to a CFSP ceasing to exist and should not have to step in with contingency arrangements to deliver services.
- Having robust business cases for approval of CFSP arrangements means that it can ensure that CFSPs share DCC's values and should not bring the Council into disrepute through its behaviour.
- Having robust legal agreements and service level agreements ensures that both organisations understand their roles and responsibilities and strengthens DCC's position in the event of dispute.
- Providing robust guidance and support to its elected members who sit on outside bodies protects their interests, improves the likelihood of robust scrutiny and clarifies the legal position and conflicts of interest relating to directorships and trustees.
- Overall, the framework means that DCC should not suffer significant damage to its reputation due to failure of a CFSP.

In conclusion, a new framework for monitoring CFSPs will contribute significantly to DCC's own governance arrangements and address a significant governance weakness highlighted in its 'annual governance statement' so that its stakeholders are assured that public money is fully accounted for and used for its intended purpose in delivering DCC's corporate priorities and statutory duties.

Appendix 1 – Head of Internal Audit's report on [redacted] Ltd

Denbighshire Internal Audit Services

Caledfryn, Smithfield Road, Denbigh, LL16 3RJ

Report to: Corporate Director: Customers
Head of Finance & Assets
Head of Legal & Democratic Services
Head of Communications, Marketing & Leisure

Report By: Ivan Butler: Head of Internal Audit

Date: 12 November 2013

Subject: Internal Audit Follow Up to Due Diligence Report on [redacted] Ltd

Introduction:

1. [redacted] recently carried out a due diligence exercise on [redacted] Limited to identify risks and opportunities relating to the possible takeover of the Company by the Council. This exercise concentrated on four key areas:

   - legal matters appertaining to the Council taking over the Company;
   - HR and finance matters;
   - a property and plant survey; and
   - an assessment of the implications for Leisure Services if the Council was to operate these facilities from April 2014 onwards.

2. At the conclusion of the due diligence exercise, there were still some queries outstanding and further detailed checks required, which I was asked to review as a matter of urgency.

Outcome & Conclusions:

Directors & Corporate Governance

3. There are currently 10 Directors of the Company and one Secretary, who is also an employee of the Company. Each Director may claim a set fee of £350 for 'reasonable expenses' but does not have to provide evidence of actual expenditure. These expenses include telephones, printing etc. Not all Directors claim these expenses but, for those that do, there may be tax implications from this arrangement as there is no proof of expenditure.

4. **There are no formal terms of reference, contractual arrangements or terms of appointment for the Directors. The Council will need to clarify the terms and timescale of any continued liability for Directors after they cease that role if the Council takes over the Company.**

5. During the course of my work, it became clear that there are inadequate governance arrangements and that the Board of Directors is not carrying out its role properly and effectively. There is no governance framework, no formal policies and procedures, financial regulations, risk management framework, performance management framework, codes of conduct etc. that should be in place for such an organisation. The Company does not produce an annual governance statement.

6. **The Council will need to consider what governance arrangements need to be put in place if it takes over the Company. The majority of these arrangements can be tied in with the Council's own governance framework, but there will be specific areas needed if there is to be a board structure and there may be a need for a separate annual governance statement.**

HR Issues

Staffing & Payroll

7. I was provided with two staffing lists - one for the summer season and a current list now that most of the seasonal employees have completed their contracts for the season. The list for the summer season included 149 employees, which reduces to 84 in the current list. There are two more posts due to terminate in November at the end of their contract.

8. At present the breakdown of staffing is as follows:

    - 16 employees work 37 hours per week
    - 22 employees work between 20-31 hours per week
    - 24 employees work less than 20 hours per week
    - 22 others had no hours on the list provided, therefore I assume these may be variable

9. During the summer season, the main change is in the variable hours contracts, where there were 83 employees on the list provided.

10. **There are a significant number of employees being paid the minimum wage - approximately 30 currently and 70 during the summer season. The Council needs to consider the impact of potential equal pay claims if it takes over the Company, as it is likely that its own leisure staff are paid higher rates than those at [redacted].**

11. [redacted] were provided with a list of employees due to receive an increment in the coming months; however, this list did not take into account the recent increase in the minimum wage or the fact that some employees will move from one age category to the next, which increases their minimum wage. It is difficult to calculate the exact impact of the minimum wage change, as the employee list provided did not show the hours worked by several of the employees who are on the minimum wage.

12. **Including the known increments provided to [redacted] and the impact of the increased minimum wage on the employees where I was provided with hours worked, there is an increased payroll cost of over £5k for 2014/15 (not including on-costs).**

Sickness Absence

13. There are currently no employees on long-term sickness absence at the Company. One employee who had recently been on long-term absence has now returned to work and I was informed that this was a work-related absence.

Policies & Procedures

14. The Company has no HR policies and procedures of its own. I was informed that, when needed, they use the Council's current arrangements. This includes recruitment, disciplinary and redundancy policies. The Company has no 'enhanced policies', over and above the Council's own policies.

15. **When recruiting new employees, there are no checks carried out to ensure that the person is eligible to work in the UK. The Company cannot be 100% certain that all employees have permission. They always get a National Insurance number before employing anyone, but there are no checks on the validity of these. The Council therefore needs to consider whether this is a significant risk, although the main risk is in the employment of seasonal employees, which the Council will carry out using its own recruitment procedures that require eligibility checks.**

Other Terms & Conditions

16. From the current staffing list, 21 employees receive a straight 28 days annual leave per year (pro rata for part-time employees), while the remaining 63 employees receive 20 days basic leave, plus 5 days after 5 years' service, then one additional day after 10, 15 and 20 years (28 days total). During the summer season, all additional employees receive the latter arrangements.

17. The Company also operates different sickness pay for employees, where the majority receive no sick pay if they are absent. Although I did not confirm this at the time, I assume the employee split is the same as for holiday entitlement, as these 21 employees appear to be on different terms and conditions.

18. **There are anomalies in the terms and conditions of employees, as the Company has adopted a 'two-tier' approach in relation to sick pay and holiday entitlement. This could give rise to claims of unfair treatment by the Company and claims for equality if the Council takes over the Company.**

Employee Contracts

19. I was unable to access employees' personal files during my visit due to concerns raised over Data Protection. The Company has consulted its legal advisors to see whether it can grant access. I was therefore unable to check whether all files contained contracts of employment, job descriptions or CRB checks and whether there are any issues of concern on the files, such as outstanding disciplinary issues or other disputes.

20. **I was informed that it is unlikely that all current employees have a contract of employment and that some establishments ([redacted]) are much more efficient at this that others ([redacted]).**

21. I was also informed that the Company recently undertook a major exercise with the Council's HR services to ensure that all relevant employees have CRB checks in place. I have not confirmed this with HR, but there will need to be robust arrangements in place throughout the year, particularly when appointing seasonal employees.

Financial Issues

22. I reviewed the current year's budget and actual performance to date and have no issues to highlight on financial arrangements that have not already been discussed. The only points to consider are:

    - There will be some savings on support staff as it is unlikely that all employees will transfer across, although there shorter-term costs associated with this.
    - There could be some savings on the financial services budget of £27k, which covers payroll, banking charges and accountants, depending on what new arrangements are put in place.
    - The pension deficit repayment of £36k is likely to increase once the reassessment is received.
    - There is nothing in the budget for major works to the buildings etc., just £35k for routine maintenance.
    - The Company does not carry out any formal cash flow analysis, but there is a monthly bank reconciliation and they use a main interest earning bank account that all subsidiary accounts flow into, so there have been no cash flow issues. This main account holds approximately £650k on average.

Appendix 2 – Extracts from DCC's 'annual governance statement'

Review of effectiveness

We are required to review the effectiveness of our governance arrangements each year, which includes:

- maintaining an on-going evidence framework showing how we can give assurance on our governance arrangements;
- regularly reviewing the effectiveness of the Council's Constitution;
- reviewing governance arrangements within services delivered on our behalf by partnerships, arms-length organisations etc.;

Significant Governance Issue 1

In future, we accept that some services and functions will stop or be transferred to others who may be able to deliver them at lower or no extra cost. We need to review our governance arrangements to take account of this, ensuring that public money is spent wisely and the public continues to receive good services and value for money.

Proposed action to address the issue	We will be implementing new monitoring arrangements during 2014 to ensure that any third party or arms-length service providers have robust governance arrangements, and will implement scrutiny arrangements to monitor their financial and operational performance.
Responsibility for the action	Initial review by Head of Internal Audit, which will lead to further action plan for implementation of new arrangements
Timescale for improvement	Preliminary report by 31 May 2014, with further action plan for implementation of new arrangements to be agreed

Appendix 3 – Original project brief

Denbighshire County Council's Performance Scrutiny Committee has raised the question of how it can gain assurance that the Council's Arms-Length organisations (ALMOs) are performing effectively. I was asked to review this area but have taken the opportunity to agree an increased scope with the Committee and relevant Corporate Director to cover corporate governance assurance, which will include financial and operational performance.

This project is particularly important, as one ALMO has recently folded, significantly affecting the Council's reputation. In addition, the Council provides a significant level of funding to these organisations, so needs to protect its interests and use public money wisely. I am hoping to extend the framework to develop arrangements for the Council to use for agreeing funding to any external organisation, but this work falls outside the scope of this project.

The project will cover three ALMOs but will not include a review of their governance arrangements, as I have no rights of access into the organisations. The project aims to develop a basic framework for the ALMOs to provide an annual self-assessment of their governance arrangements to the Council to consider when agreeing future funding.

The key areas of work will be:

- Develop an information report to Performance Scrutiny Committee for mid-March 2014 outlining the scope of the project.
- Hold discussions with the relevant Corporate Director to evaluate the level of assurance sought, weighing up the burden of work this poses on the ALMOs.
- Hold discussions with the Council's Head of Legal & Democratic Services to ascertain the current legal and funding agreements with ALMOs.
- Review the Council's own Corporate Governance Framework and identify the key governance areas where ALMOs need to provide assurance.
- Design and develop an easy to use self-assessment framework to gather evidence of good governance in the ALMOs (a mini Annual Governance Statement)
- Present the draft self-assessment to the relevant Corporate Director for comment and agreement.
- Present the framework to the relevant committee for approval, outlining its responsibilities when scrutinising self-assessments that ALMOs will provide.

The key risks faced are:

- Legal and funding arrangements may need to be changed before the self-assessment framework can be introduced.
- The Council may refuse funding in future if a self-assessment is not received or is not robust, therefore media interest is likely. My work during this project will need to remain confidential, so I need to ascertain the best way to report progress and present the self-assessment to the relevant committee.

Cyngor sir ddinbych denbighshire County Council

Denbighshire Internal Audit Services

Caledfryn, Smithfield Road, Denbigh LL16 3RJ

Internal Audit Project Scoping Document

Project area: Governance assurance from externally funded bodies providing services on the Council's behalf	**Project no. D141505**

Prepared By	Ivan Butler	**Date**	06/05/14
Agreed With	Chief Executive	**Date**	12/05/14

Reason for Project
Initial request by Performance Scrutiny to review how the Council receives assurance on the performance of 'arms-length' external organisations (ALEOs). During development of 'annual governance statement', subsequent discussions and Corporate Committee reports, it is clear that the Council cannot be fully assured that bodies that it funds and which deliver services on the Council's behalf have robust governance arrangements in place. This project now forms part of the governance action plan and will also include the role of elected members on outside bodies. Despite researching guidance on managing ALEOS, this review does not solely cover ALEOs, as these are normally organisations set up by the funder to provide services. This review will cover all organisations receiving funding to provide services on the Council's behalf other than contractors and partners. This will include ALEOs and those organisations receiving grant funding and contributions to assist their service provision. For the purpose of this review, these organisations will be referred to as 'Council funded service providers' (CFSPs). The definition used is that they *'…are separate from the Council but are subject to Council control or influence, either though having representation on the board and/or through being a major funder or shareholder in the organisation.'*

Scope of Project
• Desktop review to learn lessons from elsewhere and identify areas of good practice: - *the Accounts Commission/Convention of Scottish Local Authorities 'Code of Guidance on Funding External Bodies and Following the Public Pound'* - *Audit Scotland's 'Following the Public Pound'* - *Audit Scotland's 'Arms-length external organisations: are you getting it right'* • Identify CFSPs to be reviewed (not Partnerships, contractors or suppliers) • Identify the level of funding provided to CFSPs and stratify to provide 'risk groups' • Identify the current monitoring arrangements for CFSPs • Identify the legal arrangements for CFSPs • Develop governance assurance requirements for each risk group • Develop a clear and concise process and identify responsibilities for recording, monitoring and scrutinising governance assurance from each risk group • Contribute to the protocol for elected members sitting on outside bodies

Anticipated 'Added Value' of Project
The Council will receive regular assurance that CFSPs have robust governance arrangements in place, commensurate with the risk that it faces in funding these organisations. This will address a significant governance weakness in the Council, highlighted in its 'annual governance statement' and will provide assurance that CFSPs are using the money for its intended purpose and providing value for money.

Estimated Project Days

Auditor	Project Role	Estimated days
Ivan Butler	Scope, deliver project and report	10
	Totals	**10**

Risks to be Reviewed
The Council: 1. Is not fully aware of all CFSPs 2. Funds CFSPs that do not deliver intended outcomes 3. Is deemed to have failed in its accountability over public funds 4. Is not aware of CFSPs performing poorly, operationally and/or financially 5. Loses funding because of an CFSP ceasing to exist 6. Funds CFSPs that have different values that bring the Council into disrepute 7. Has to step in to deliver services where CFSPs fail or cease to exist 8. Does not have robust service level agreements or legal arrangements with CFSPs 9. Does not provide robust guidance and support to its elected members who sit on outside bodies 10. Suffers significant damage to its reputation due to failure of an CFSP

Areas Identified as Well-managed from Scoping Meetings
The Council already has a protocol for elected members sitting on outside bodies, which will be taken into account during this review.

Review Completed By:	Ivan Butler	Date:	May 2014

Appendix 5 – Suggested risk-based approach to CFSPs

CFSP type	Set up arrangements	Approval arrangements	Monitoring arrangements
Funding level >£50,000	Full business case, full legal agreement, service level agreement and review of financial soundness of the CFSP	DCC Cabinet	• Annually – 'Annual governance statement' style report (standard format stipulated by DCC to include equalities; sustainability; HR practices; data protection and handling; FOI principles; standards and behaviour; and arrangements for engaging citizens and service users). • Quarterly – financial and operational performance report to include how agreed aims and objectives being met, how standards and targets set by DCC being met (Reports to be collated and summary report provided to DCC's Corporate Governance Committee)
Funding level £10,001-£50,000	Medium business case, legal terms and conditions, and service level agreement	Corporate Executive Team	• Quarterly – financial and operational performance report to include how agreed aims and objectives being met, how standards and targets set by DCC being met (Reports to be collated and summary report provided to DCC's Corporate Governance Committee)
Funding level £1,001-£10,000	Mini-business case, legal terms and conditions and service level agreement	Head of Service	• Quarterly – financial and operational performance report to include how agreed aims and objectives being met, how standards and targets set by DCC being met (Reports to be collated and summary report provided to DCC's Corporate Governance Committee)
Externally monitored CFSPs	As stipulated by regulatory body or main funding body	As stipulated by regulatory body or main funding body	Collation of external regulator reports and annual summary report to DCC's Corporate Governance Committee

Appendix 6 – Assessing options and developing a business case

There should be a robust options appraisal before entering into funding arrangements so that DCC:

- is clear on the aims and objectives of the service being provided;
- knows the market and identifies all service delivery options;
- involve stakeholders (service users and community); and
- is clear about risks – long and short-term.

It is imperative that officers and elected members are objective and impartial when assessing options and that the process is overseen by elected members if there is a major service shift.

Checklist for reviewing options appraisals and business cases
• Was the assessment independent, objective and competent? • Have any financial/technical estimates been verified? • Have any forecasts of future performance been verified as realistic? • Is there evidence of all other affected parties and contributors being appropriately consulted? • Has all available information been pooled? • What is the nature of DCC's financial contribution? • What is the limit of DCC's contribution? • What mechanism will trigger payments/receipts? • Will there be an assessment/valuation at each payment stage? • Will there be an assessment of the management/control regime? • Are there any special arrangements for start-up funding? • What are the arrangements for assets/liabilities i.e. ownership, destination? • What is DCC's exit strategy? • Will there be any recurring liabilities? • What accounts will be kept? - frequency, type • What audit access to information/personnel has been agreed?

Examples of governance & operational issues to consider in options appraisal	
Legal & governance	**Business & operational**
• Is there a clear statutory basis for undertaking the activity? • How will governance work – including the means of DCC control and representation? • How will the CFSP ALEO be accountable to the community and the service user? • How will DCC demonstrate that the CFSP offers best value for money and assure that it accounts for all public money provided to the CFSP? • What are the implications of EU and other procurement law, e.g. on the award of the contract or service delivery agreement? • How will obligations including equal opportunities, sustainable development, data protection and freedom of information be observed? • How will the delivery method be reviewed, and what is the basis for withholding funds or terminating the arrangement? • How will DCC employees and assets be treated, including transfer arrangements and pensions? • What are the statutory financial reporting and auditing requirements?	• Does the activity fit in with DCC's corporate priorities? • What are the service implications, e.g. quality, access, marketability, pricing? • How will services users be involved and customer satisfaction measured? • What are the financial implications, e.g. taxation, treatment of profits, ability to attract investment and residual liabilities for DCC? • What is the payback time, allowing for initial set-up costs? • Are there benefits in sharing services with other councils or partners? • What will be the impact on demand, including DCC's ability to subsidise any increase? • How will flexibility or changes to delivery be allowed for? • What are the operational risks, including future changes in legislation or the marketplace? • What management information will be shared by the CFSP to demonstrate financial control and value for money?

Appendix 7 – Suggested content of a comprehensive legal agreement

A formal agreement should be entered into with each CFSP where there is deemed to be a substantial funding relationship. In drafting this document, consideration must be given to various aspects of the arrangement to ensure that all relevant areas are covered.

Key areas to be included in a formal legal agreement
Expectation of the use of funding
• General statement of aims and goals of the CFSP • Annual plans of the CFSP • Targets, including timescales to be achieved by the CFSP • Any specific conditions and/or reporting requirements of the CFSP
DCC representation of elected members and officers
• Level of representation from DCC i.e. elected members and/or officers • Name, designation/status within the CFSP
Financial regime
• Extent of DCC's financial commitment • Nature of financial relationship, e.g. loan, grant, shareholding • Criteria for making and receiving payments • Details of any transfer of assets and destination of such assets • Accounting and reporting procedures to be adopted • DCC policies to be adhered to by the CFSP, e.g. procurement policy • DCC's exit strategy • Formal risk assessment requirements • DCC's criteria and arrangements for terminating the funding agreement with the CFSP • Procedures to be put in place to alert DCC should any problem arise between formal monitoring stages
Accounting, reporting and audit requirements
• Minimum standard of management arrangements and accounts required by DCC • Responsibility and accountability of the 'management committee' of the CFSP • Access to records and accounts of the CFSP by DCC representatives • Access to records and accounts of the CFSP by DCC's internal and external auditors • Arrangements for accessing the CFSP's external auditor

Financial and performance monitoring requirements
• Proposed methods of measurement for inclusion in the relevant service level agreement • Frequency and content of monitoring reports to DCC from the CFSP • Reporting of achievement of targets by the CFSP • Details of the annual budget and comparison with actual spend • Methodology of the reporting of future plans of the CFSP • Notification to DCC of criteria that may trigger a review of the arrangements with the CFSP • Details of the reporting requirements for DCC committees
Expectation in terms of employment and other practices
• Policy regarding equal opportunities • Recruitment and selection policies and procedures • Policies regarding conditions of employment
Other practices
• Any other relevant information, e.g. insurance arrangements
Complaints
• Procedures for DCC to obtain information in respect of complaints made to the CFSP

Appendix 8 – Toolkit for improving governance of CFSPs

How well does DCC ensure that effective governance and accountability is maintained when it delivers services through CFSPs?			
	Best Practice	**Better Practice**	**Advanced Practice**
How clear is DCC about its reasons for delivering services through CFSPs?	The decision to set up or engage with CFSPs is within DCC's powers, follows an appraisal of options for service delivery and is linked to its corporate priorities. DCC establishes from the start clear limits to its involvement, a timetable for achieving objectives and the circumstances in which the agreement will be terminated.	An overall statement of purpose is expressed in key documents. A regular review is carried out to ensure that the services provided by the CFSP remain aligned with DCC current priorities. DCC identifies specific circumstances that will trigger a review of its involvement, e.g. changes in key personnel in the CFSP.	Where services are delivered through CFSPs, DCC has a well-developed and soundly based strategy for the delivery of services in this manner that is clearly linked to DCC's wider strategic objectives and priorities.
How well does DCC understand the financial commitment and risk to which it is exposed through CFSPs?	DCC defines the nature of the financial relationship, its commitment to the CFSP (shareholding, grant, loan, guarantee, etc.) and contributions are not open-ended in duration or amount. There is a written agreement about the transfer of public assets that safeguards their title and use. Minimum accounting and auditing arrangements are stated in the agreement.	Before entering into an agreement with CFSP, DCC assesses risks and documents the results. Service level agreements or equivalent are in place to specify the financial arrangement. A corporate register of all financial commitments to CFSPs allows DCC to assess its overall commitment to its CFSPs.	Risk assessment extends beyond financial risks to other areas, e.g. reputational risk. DCC identifies specific governance, finance and performance indicators that give early warning of potential problems and acts when required. Contingency plans are in place to ensure that service delivery is maintained if the agreement ends.
How effective are DCC's arrangements for monitoring the financial and service performance of CFSPs, maintaining accountability and for ensuring audit access?	DCC stipulates how and at what intervals it intends to monitor financial and service performance. DCC has identified members of staff who will monitor CFSPs' performance. DCC ensures that its external auditors have right of access to key records of the CFSP and to any explanations they consider necessary from representatives of the CFSP. There are no significant performance or financial concerns about the CFSP that are not being actively managed.	Targets and methods of measurement are agreed and documented at the start. Monitoring reports provide timely and good-quality information about CFSPs' performance in delivering services and impact. DCC scrutinises monitoring reports and follows up where performance does not meet agreed standards. DCC officers responsible for monitoring the CFSP are clear about their role and are supported in it. Those involved in monitoring financial performance are suitably qualified. Access rights for internal and external audit are covered in the agreement.	Monitoring extends beyond financial and service performance to employment practices, equality requirements, purchasing policies and sustainability. DCC receives and scrutinises forward plans, takes a risk-based approach to monitoring and targets resources accordingly. Where there is more than one public organisation involved in the CFSP, DCC ensures that liaison and monitoring of the CFSP is coordinated. The reasons for providing services through an CFSP and the impact are clear in reports to stakeholders, including the public.

How well does DCC ensure that effective governance and accountability is maintained when it delivers services through CFSPs?			
	Best Practice	**Better Practice**	**Advanced Practice**
Where elected members or senior officers are appointed to the board or equivalent of CFSPs, how clear are they about their role?	DCC has considered the question of representation, is clear about why it wants representation and is transparent in its decision about which elected members or senior officers will be involved and why. DCC has a clear policy for any payments to board members. Elected members and senior officers are properly advised of their responsibilities to DCC and the CFSP, including questions of declaration of interests. They exhibit this understanding through their behaviour and performance.	Training and support is provided to DCC representatives so they are clear about their responsibilities to DCC and the CFSP. DCC has a register of interests that records potential conflicts of interest that may arise from elected member or senior officer involvement in the CFSP. Elected members and senior officers are effective in performing their role as board members.	DCC safeguards itself from risks incurred by elected members/senior officers in their dealings with the CFSP, e.g. liability insurance. Specialist training is provided to elected members/senior officers, e.g. on company or trust law. Training continues over the period of the elected member/senior officer involvement and impact of training is measured. DCC reviews representation in CFSPs, makes changes in light of experience and considers rotating representation.