REPORT TO: **MORAY COUNCIL ON 5 SEPTEMBER 2018**

SUBJECT: **MORAY LEISURE CENTRE – INTERNAL AUDIT OVERVIEW**

BY: **CHIEF EXECUTIVE**

1. REASON FOR REPORT

1.1 This report provides the Council with a commentary prepared the Internal Audit Manager in respect of the council's relationship with Moray Leisure Centre, following a request for an independent report at the meeting of the Council on 28 June 2018.

1.2 The Council's Administrative Scheme does not apply to this report.

2. RECOMMENDATIONS

2.1 The Council is invited to:

- **Note the findings from this overview of the Moray Leisure Centre's operation over its initial 25 year period and the subsequent interim arrangements agreed with the current Board;**
- **Acknowledge that, with hindsight, 25 years was too long a period to expect the initial funding agreement to operate in a manner acceptable to all parties, all the more so when reflecting on societal changes and the financial downturn and its impact on the public sector during that time;**
- **Give impetus to the wider leisure services review, which has been under consideration for some time, to provide greater certainty and enable planning for and investment in those services that are to remain part of the leisure estate;**
- **Agree that, should the Leisure Centre be retained and operate as an Arms' Length External Organisation, any agreement entered into will need to reflect current circumstances; securing continuity of service while supporting the council's obligations to achieve best value.**

3. REPORT

3.1 The Moray Leisure Centre was constructed in the early 1990’s. It replaced the Munro Baths in North Street, which had reached the end of its useful life and became the flagship leisure facility in Elgin. The centre comprised principally a replacement pool and ice rink together with associated trading facilities including a shop, bar and restaurant.

3.2 The council (then Moray District Council) was unable to fund the construction of the new centre within the capital borrowing consent rules then in force. However, it was able to borrow private funding by separately establishing Moray Leisure Ltd. to construct the centre. Moray Leisure Ltd then leased the premises for a period of 25 years to Moray Leisure (No. 2) Limited, a charitable company limited by guarantee. At the same time Moray Leisure Trading Limited was established to deal with non-charitable activities including a shop, bar and cafeteria facilities.

3.3 Aside from complying with the capital consent requirements then in force, the separate operation of the centre by the charitable company afforded the advantage of exemption from non-domestic rates (an exemption not available to directly managed local authority leisure facilities). This provided a substantial reduction in costs for the centre typically upwards of £200k annually (just under £240k in the current financial year). However, as an organisation provided with funding support by the council, the centre was designated an Arm’s Length External Organisation (ALEO), and this required the establishment of arrangements defining the relationship between the company and the council.

3.4 These arrangements were contained within a formal funding agreement between and among the council, the charitable company and the trading company which specified the respective obligations on each party. The agreement ranged across various headings including the general management of the centre; staffing, finance, record keeping and similar.

3.5 Of note was the council’s commitment to pay to the company an assured grant in the sum of £300k for its first year to 31 March 1994 (essentially guaranteed funding) and a further income related grant of up to £75k annually (the actual amount depending on the level of income generated compared to the approved budget). So there was an understanding at the outset that the centre would require to be subsidised by council funds, without explicit commentary on whether the subsidy would continue for the full 25 year period of the agreement. It is also of interest to note that £375k in 1993 is equivalent in 2017 terms after adjusting for inflation to some £726k, an amount marginally higher than the operational grant paid in 2016/17 of £685k but excluding a capital grant of £60k to cover repairs and maintenance and a further £81k paid as a contribution toward the ice plant.

3.6 Memorandum and Articles of Association were also developed in meeting Companies Act requirements, the memorandum establishing the companies and the articles setting out how the companies would be governed. The articles provide, *inter alia,* for a Board with seven directors, three of whom are elected councillors.

3.7 From inception through to 2016, private sector board members comprised several long serving members (five in number serving between 6 and 22 years) and seven other members who each served for less than two years. Two of the five were initial appointees in 1993 and served until 1999 and 2015 respectively, two others commenced in 1995 and 1997 both serving until 2016 and the fifth joined in 2006 and served to 2017. Councillor appointees numbered 20 in total excluding current incumbents with generally shorter appointments reflecting the cyclical nature of local government elections.

3.8 From an overview of available information, the Centre functioned as intended in its early years having the advantage of all new premises and experiencing high demand for the facilities on offer. The council supported the centre during a period of change in senior management relatively soon after its opening and thereafter a period of relative stability ensued. The Board had representatives from the business community and notably two individuals from the medical profession who had insight and input into the development of the 'wellness' side of the centre's services. Processes for reporting on budgets and actual costs and performance to the council were developed and this formed the basis of a working relationship between the parties through the final years of the District Council to 1996 and for the first ten years after the formation of the Moray Council.

3.9 The centre's business plan for the period 2006 to 2009 reflected on its successes, being the first such centre in Scotland to attain a Scottish Executive led 'health and leisure recognition award', and showing favourable financial performance compared with other similar leisure trusts in Scotland. An independent review (by Quality Leisure Management Ltd) also found the centre had 'a thriving and popular mix of activity' while recognising and acknowledging:

- 'the ongoing enthusiastic support of the local authority, without which Moray Leisure would not have realised the substantial achievements over the last 12 years of operation and would be unable to provide key services which impact so profoundly on people's lives', and that:
- 'the Board and staff would continue to 'listen, consult and engage with their community' in line with the council's Corporate Plan in force at the time.

3.10 The business plan, however, cautioned that the subsidy per head afforded by other councils to comparable leisure centres was considerably higher, and that Moray Leisure was itself experiencing cost pressures, forecasting substantial increases in energy costs; also reporting that 'with the building now over 12 years old, the pressure on the repairs and maintenance budget increases annually.' Separately, by this time the global financial crisis had emerged and this had impacted generally on public sector finances and on the level of funding available to the council.

3.11 The operational grant payable by the council to the Leisure Centre, including any capital grant award, did not see any inflationary or other increases in the three years from 2007/08 and it was then reduced marginally in 2010/11 and again in 2011/12 before being supplemented later in 2011/12 year by an additional £100k grant award. This additional grant reversed a cut of a similar amount and was approved unanimously by the council's Policy and Resources Committee following a decision at the Centre to reduce operating hours and shed staff through natural wastage.

3.12 Around the same time (late 2011) the council formed a cross party working group to prepare a draft Service Level Agreement for consideration by a council committee. *Inter alia*, the requirement of the draft SLA was

- 'to establish a mechanism to ensure grant funding is provided at the appropriate level to enable Moray Leisure to deliver the services and quality specified by the council' further noting that:
- 'the working group will have due regard to the medium term financial situation of the council which is one of declining levels of funding available for the provision of services'.

3.13 A report to the working group also noted the result of a condition survey which indicated likely additional cost pressures in several areas, in particular in relation to the ice plant. It further noted that Moray Leisure did not then budget for major lifecycle maintenance, it appearing that the Council would provide funding for this as and when required. Significantly the report also noted that Moray Leisure had not produced a business plan beyond 2009 given uncertainty over the level of future funding instead 'focusing on seeking to maintain as much of existing service provision as possible'.

3.14 So in the space of a five year period it is evident that the dynamic of the relationship had changed with the council facing funding strictures and seeking to re-negotiate agreements in place with the leisure centre, while the centre was facing additional cost pressures arising as a consequence of deterioration in the fabric of the building which, in turn, had the potential to impact on the footfall and income generated direct from centre users.

3.15 The terms of the draft Service Level Agreement as agreed by the working group were approved at a meeting of the Policy and Resources Committee in March 2012, however as these created additional obligations for the Leisure Centre beyond those contained in the original funding agreement there was little incentive on the part of the Centre to agree to the required terms.

3.16 It is not clear what level of discussion took place around the SLA as Board meetings were relatively infrequent and minutes held lacked detail. However it is understood the Board declined to implement the changes and no progress was made or agreement reached. So notwithstanding the Council making an annual financial contribution to the centre's running costs, there were limits in terms of what could be done to vary the terms of the original agreement and there were issues arising around equipment and plant obsolescence, centre usage, and health and safety policy for service users. It is evident from documentation reviewed that these were challenging times for the Board both financially and operationally and in early 2016 all but one of the private sector board directors resigned.

3.17 From that point forward, the remaining private sector Board member maintained continuity of the Board before also resigning in 2017; as such with newly appointed private sector directors and recently elected councillor appointees a new Board is now in place. Operational support has been sought and obtained from Highlife Highland which delivers arm's length leisure and other services in the neighbouring Authority area. New projections have been made in relation to the centre's financial position in the next three years, a key element of which relates to the introduction of the 'Fit Life' membership scheme already operating within council run leisure facilities. An enthusiasm is evident within the Board to secure the future viability of the Centre and its activities.

3.18 That said, the original 25 year lease agreement period concluded at the end of July 2018, and has been extended from that date for a period of one year and thereafter will continue on a month to month rolling basis. This limits the capacity of the Leisure Centre to plan or fund improvements for the longer term; an inevitable consequence of the council having still to determine future leisure provision across the whole council area, as informed by its Leisure Services Review.

3.19 In 1996 the Accounts Commission for Scotland and the Convention of Scottish Local Authorities published a Code of Guidance on 'Following the Public Pound'. The Code set out principles for good governance of public funds passed to ALEOs such as the Leisure Centre. Since then, there have been many developments in governance and professional practice, notably the legislation placing a statutory duty on councils to secure Best Value. Yet the principles of the Code remain relevant.

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

3.21 The Code sets out six principles that require councils to:

- Have a clear purpose in funding an ALEO
- Set out a suitable financial regime
- Monitor the ALEO's financial and service performance
- Carefully consider representation on the ALEO board
- Establish limits to involvement in the ALEO
- Maintain audit access to support accountability

3.22 The Code was published after the centre opened and the funding agreement concluded but certainly the council had a clear purpose in funding the ALEO as outlined earlier in this report. Through its constitutional documents it had also given consideration to the other points, although it should be noted that the principal focus of the agreement was to enable the centre to function as a separate unit with council oversight but without the day to day involvement that applies to the management of a council run facility.

3.23 Referencing more recent reports by Audit Scotland on this topic it is clear there is a complexity with ALEO arrangements. The benefits around board expertise, ability to secure funding from external sources and savings in non-domestic rates are widely promoted. But recurring themes around elected councillors having to deal with conflicts of interest as councillors and when acting as Board members, the risk and control issues council's retain when funding ALEOs and the requirement for officer time from council leisure, legal and finance teams for ongoing monitoring purposes are noted as being areas of potential difficulty.

3.24 With much having changed in the past 25 years, and with the original lease agreement period now concluded, there is an opportunity to revisit governance arrangements, ensuring these and issues relative to state aid and procurement legislation are considered in terms of meeting the needs of the council and best practice as drawn from Audit Scotland guidance.

3.25 Such arrangements may include:

- Review of the constitutional documents.
- Consideration of the future composition of the board and its role, or of alternative management arrangements
- Updated job descriptions and specifications for senior staff
- A refresh of operational policy documents covering issues including recruitment, training, complaints, data security, equalities etc.
- Enhanced performance reporting covering both financial and operational matters
- Outcomes and planned actions arising from customer surveys
- Reports on processes for management of strategic and operational risks
- A requirement for periodic reporting to council to provide assurances that services delivered align to council objectives for leisure services.

4. SUMMARY OF IMPLICATIONS

(a) Corporate Plan and 10 Year Plan (Local Outcomes Improvement Plan (LOIP))

A strategic decision on the future of Leisure Services in Moray, including those to be provided through Moray Leisure is required before any longer term arrangements for the Leisure Centre are considered.

(b) Policy and Legal

The continuation of Moray Leisure as an ALEO presents opportunities and challenges and, with the initial lease period concluded, fuller consideration of the options for future management and operation of the leisure centre should be progressed.

(c) Financial Implications

There will be financial implications for the council in continuing to provide support for the Moray Leisure Centre. These will be dependent on the decisions taken as part of the current Leisure Services Review.

(d) Risk Implications

The continuing operation of the Leisure Centre as an ALEO leaves the council with non-transferable risks around securing good governance and demonstrating best value in the use of public resources, and this should be reflected in any future arrangements the council wishes to take forward.

(e) Staffing Implications

Council officer time will be required to implement the agreed outcomes from the Leisure Services review; as yet these are unknown.

(f) Property Implications

Any future decisions relative to the Leisure Centre will need to have regard to asset management to ensure it remains fit for purpose relative to any alternative provision made available by the council or in the wider market place.

(g) Equalities/ Socio Economic Impact

Socio economic impacts have changed dramatically the circumstances under which the centre originally operated compared to those applicable at current date, although there are now opportunities to update arrangements as required following the end of the 25 year lease period.

(h) Consultations

The Head of Legal and Democratic Services, the Head of Financial Services, the Educational Resources Manager and the current Chair of the Board of Moray Leisure have been consulted during completion of this review.

5. <u>CONCLUSION</u>

5.1 This report invites the Council to consider the findings of a review by internal audit of the governance and operating arrangements established for the operation of Moray Leisure Centre in the 25 year period to July 2018.

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Background Papers: Internal Audit file
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