

The Highland Council

Report to those charged with governance on the 2012/13 audit



Prepared for members of The Highland Council Audit and Scrutiny Committee and Director of Finance

September 2013

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 Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Introduction

1. International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires auditors to report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action.
2. This report sets out for the Audit and Scrutiny Committee's consideration the matters arising from the audit of the financial statements for 2012/13 that require to be reported under ISA 260. We are drawing to your attention those matters we think are worthy of note, so that you can consider them before the financial statements are approved and certified. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management, however this does not relieve management of their responsibilities in this respect. This report has been prepared for the use of The Highland Council and no responsibility to any third party is accepted.

Status of the Audit

3. Our work on the financial statements is now substantially complete. The issues arising from the audit were included in matters arising schedules issued to the Central Services Finance Manager on 9 and 16 September. The more significant issues arising were discussed with the Director of Finance at a meeting on 11 September.
4. We received the unaudited financial statements on 26 June 2013, in accordance with the agreed timetable. Overall, the working papers were of an acceptable standard although, as noted at paragraph 14, capital accounting working papers require improvement in future years. We completed our on-site fieldwork on 30 August 2013.

Matters to be reported to those charged with governance

Conduct and scope of the audit

5. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan presented to the Audit and Scrutiny Committee on 28 March 2013, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.
6. As part of the requirement to provide full and fair disclosure of matters relating to our independence we can confirm that we have not undertaken non-audit related services. The 2012/13 agreed fee for the audit was disclosed in the Annual Audit Plan.

Fraud

7. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In presenting this report to the Audit and Scrutiny Committee we seek confirmation from those charged with governance of any instances thereof that have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud has been included in the draft letter of representation.

Audit opinion & representations

8. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of financial statements for final review, we anticipate being able to issue an unqualified auditor's report on 27 September 2013. The proposed report is attached at [Appendix A](#). There are no anticipated modifications to the audit report.
9. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature which we regard as errors less than £1,000.
10. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with senior finance officers who agreed to amend the unaudited financial statements. The effect of these adjustments is to decrease net expenditure on the provision of services by £3.239 million and increase taxation and non-specific grant income by £0.674 million in the Comprehensive Income and Expenditure Statement. Net assets (and reserves) as recorded in the Balance Sheet have increased by £3.913 million.
11. A number of monetary errors were identified which were not processed through the financial statements by management. If adjusted these would have a net effect of increasing the surplus on the provision of services, and the net assets (and reserves) on the Balance Sheet by £0.165 million. It is our responsibility to request that all errors be corrected although the final decision on this matter rests with those charged with governance taking into account advice from officers and materiality. Management explained that these adjustments were not material to the financial statements.
12. As part of the completion of our audit we seek written assurances from the Accountable Officer on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at [Appendix B](#). This should be signed and returned by the Accountable Officer with the signed financial statements prior to the independent auditor's opinion being certified.

Accounting and internal control systems

13. Last year we reported that, following the setting up of separate bank accounts for the Pension Fund, the council's processes had not been amended to ensure that all of the Pension Fund's transactions were banked / paid through the Pension Fund's bank accounts. As at September last year, work was still ongoing to match the £208,000 of the creditors balance due to the Highland Council to individual pension fund transactions. This work was completed during 2012/13 and work continued to ensure that current year transactions were correctly accounted for and that cash was held in the correct bank account.
14. We previously highlighted our concerns about the council's arrangements for capital accounting. Considerable additional work was required to be done by finance staff and ourselves before we were able to reach an agreed position and certify the 2011/12 accounts. This year we again encountered difficulties with the council's arrangements for capital accounting including a lack of audit trail of how key figures in the accounts tied back to the council's asset registers, and a lack of internal consistency in disclosures within the financial statements. In addition, considerable work was again required to resolve issues identified with the operation of the revaluation reserve. The council acknowledges that further improvement is required and has agreed to work with us to ensure that this is achieved.
15. The audit process did not identify any other material weaknesses in the accounting and internal control systems which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Significant findings from the audit

16. In our view, the following issues require to be brought to your attention regarding the appropriateness of accounting policies or accounting estimates and judgements, the timing of transactions, the existence of material unusual transactions or the potential effect on the financial statements of any uncertainties.
17. **Bank Reconciliation:** our review of the council's year end reconciliation of its general income account identified an error which had resulted in the understatement of the cash & cash equivalents figure (bank balances) and the overstatement of the short term debtors figure by £11.425 million in the unaudited accounts.

Resolution: the council has agreed to amend the audited accounts to correct this misstatement. There is no impact on the council's surplus on the provision of services.

- 18. Police requisitions:** the Police and Fire Reform (Scotland) Act 2012 wound up Northern Joint Police Board on 31 March 2013 and transferred the Board's functions to the new Scottish Police Service. Under guidance issued by the Scottish Government and agreed by Audit Scotland, all usable reserves held by the Police Board as at 31 March 2013 were returned to constituent authorities. The council accounted for some of these balances as a creditor due to the Scottish Government rather than as an increase in its General Fund balance within the unaudited financial statements. This is not in line with the agreed guidance and, as a result, police requisitions and creditors are overstated, and the general fund balance is understated by £3.913 million.

Resolution: the council has agreed to amend the audited accounts to correct this misstatement. As the council's revenue support grant will be reduced by a similar amount in 2013/14, the Director of Finance proposes that this should be an earmarked part of the general fund balance.

- 19. Grants to third parties:** our review of non-enhancing capital expenditure identified that the council had treated grants to third parties incorrectly in the unaudited accounts. As a result, gross expenditure and gross income are understated by £4.764 million, and capital expenditure and capital grants are overstated by £4.764 million.

Resolution: the council has agreed to amend the audited accounts to correct this misstatement. There is no impact on the council's surplus on the provision of services.

- 20. Business Rates Incentive Scheme:** the council has included £1.3 million of income due from the Business Rates Incentive Scheme within its 2012/13 accounts. The council has based its accrual on a revised target provided by the Scottish Government in line with the scheme that was previously agreed with COSLA. We understand that COSLA has yet to accept the Scottish Government's proposed change, and will not do so until the submission of the audited Non Domestic Rate Income Returns in February 2014.

Resolution: the council has earmarked £1.3 million of its general fund balance in case it does not receive all of the BRIS income it has accounted for.

- 21. Retention of pension liabilities for High Life Highland staff:** the council agreed to retain the pension fund liabilities earned up to the date of transfer (circa £5 million) for all staff that transferred to High Life Highland in October 2011. However, these were erroneously written out of the council's balance sheet last year.

Resolution: the council has written the amount back on to its balance sheet as part of the current year's actuarial gains/losses figure. We have considered the need to treat this as a prior year adjustment but have concluded that the amount is not material enough to warrant that. We have however, asked the council to ensure that the accounting treatment is clearly set out in the 2012/13 accounts.

- 22. Equal pay compensation costs:** we have requested and received a specific representation from the Director of Finance that actual and potential claims in relation to equal pay legislation have been reviewed and the amount recognised as a provision (£0.546 million) is the best estimate of the expenditure likely to be required to settle the present obligation at the balance sheet date. A contingent liability has also been recognised for claims coming forward additional to the types of claims which have been considered to date. While there remain uncertainties over the actual costs that will be incurred to settle these cases, we are satisfied that the council has taken a reasonable approach.

Resolution: provision has been made in the accounts and the Director of Finance has provided management representation that this is the best estimate of the likely liability.

- 23. Job evaluation provision:** we have requested and received a specific representation from the Director of Finance that actual and potential appeals in relation to grading on the new pay scheme arising from the job evaluation introduced in February 2009 have been reviewed, and the amount recognised as a provision (£0.512 million) is the best estimate of the expenditure likely to be required to settle the present obligation at the balance sheet date. While there remain uncertainties over the actual costs that may be incurred to settle these appeals, we are satisfied that the council has taken a reasonable approach.

Resolution: provision has been made in the accounts and the Director of Finance has provided management representation that this is the best estimate of the likely liability.

Outstanding matters

- 24.** Finance staff are still working through the impact on the financial statements of the findings from our audit of the capital accounting entries. The Director of Finance has confirmed that all material findings will be corrected within the audited accounts.
- 25.** We are still awaiting sight of a sample of title deed documents for assets held by the Common Good Funds.

Acknowledgements

- 26.** We would like to express our thanks to the staff of The Highland Council for their help and assistance during the audit of this year's financial statements which has enabled us to provide an audit report within the agreed timetable.

Appendix A: Proposed Independent Auditor's Report

Independent auditor's report to the members of The Highland Council and the Accounts Commission for Scotland

I certify that I have audited the financial statements of The Highland Council and its group for the year ended 31 March 2013 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the group and authority-only Movement in Reserves Statements, Comprehensive Income and Expenditure Statements, Balance Sheets, and Cash-Flow Statements, the authority-only Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Council Tax Income Account, the Non-Domestic Rate Account, the Common Good Funds Accounts, the Charitable, Educational and Other Trust Funds Accounts, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 (the 2012/13 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Director of Finance and auditor

As explained more fully in the Statement of Responsibilities for the Statement of Accounts, the Director of Finance is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the council's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the statement of accounts to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2012/13 Code of the state of the affairs of the group and The Highland Council as at 31 March 2013 and of the income and expenditure of the group and the Council for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2012/13 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 1985; and
- the information given in the Explanatory Foreword by the Director of Finance for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Corporate Governance Assurance Statement does not comply with Delivering Good Governance in Local Government; or
- there has been a failure to achieve a prescribed financial objective.

I have nothing to report in respect of these matters.

Stephen Boyle CPFA
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Audit Scotland
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8 Nelson Mandela Place
Glasgow G2 1BT

27 September 2013

Appendix B: ISA 580 - Letter of Representation

Stephen Boyle

Date

Assistant Director

Audit Scotland

4th floor South Suite

8 Nelson Mandela Place

Glasgow G2 1BT

Dear Stephen

The Highland Council

Annual Accounts 2012/13

1. This representation letter is provided in connection with your audit of the financial statements of The Highland Council and its group for the year ended 31 March 2013 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of The Highland Council and its group, as at 31 March 2013 and its income and expenditure for the year then ended.
2. I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the Chief Executive and Directors and the Council, the following representations given to you in connection with your audit of The Highland Council for the year ended 31 March 2013.

General

3. I acknowledge my responsibility and that of The Highland Council for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by The Highland Council have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all management and other meetings.
4. The information given in the Annual Report to the financial statements, including the Explanatory Foreword and Remuneration Report, presents a balanced picture of The Highland Council and is consistent with the financial statements.

5. I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those identified in the auditor's report to those charged with governance (ISA260).

Financial Reporting Framework

6. The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13, and in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Government in Scotland Act 2003 and the Local Authority Accounts (Scotland) Regulations 1985 including all relevant presentation and disclosure requirements.
7. Disclosure has been made in the financial statements of all matters necessary for them to show a true and fair view of the transactions and state of affairs of The Highland Council and its group for the year ended 31 March 2013.

Accounting Policies & Estimates

8. All material accounting policies adopted are as shown in the Statement of Accounting Policies included in the financial statements. The continuing appropriateness of these policies has been reviewed since the introduction of IAS 8 and on a regular basis thereafter, and takes account of the requirements set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.
9. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. There are no changes in estimation techniques which should be disclosed due to their having a material impact on the accounting disclosures.

Related Party Transactions

10. All transactions with related parties have been disclosed in the financial statements. I have made available to you all the relevant information concerning such transactions, and I am not aware of any other matters that require disclosure in order to comply with the requirements of IAS24, as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

Events Subsequent to the Balance Sheet Date

11. There have been no material events since the date of the Balance Sheet which necessitate revision of the figures in the financial statements or notes thereto including contingent assets and liabilities.

12. Since the date of the Balance Sheet no events or transactions have occurred which, though properly excluded from the financial statements, are of such importance that they should be brought to your notice, except for the decision by the Council, in June 2013, to write-off part of the loan (£390k) made to Nairn Common Good which has already been communicated to you and will be included as a non-adjusting event in the post balance sheet events note within the financial statements.

Corporate Governance

13. I acknowledge as Section 95 Officer my responsibility for the corporate governance arrangements. I confirm that I have disclosed to the auditor all deficiencies in internal control of which I am aware.
14. The corporate governance arrangements have been reviewed and the disclosures I have made are in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13. There have been no changes in the corporate governance arrangements or issues identified, since the 31 March 2013, which require disclosure.

Fraud

15. I have considered the risk that the financial statements may be materially misstated as a result of fraud. I have disclosed to the auditor any allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

Assets

16. The assets shown in the Balance Sheet at 31 March 2013 were owned by The Highland Council, other than assets which have been purchased under operating leases. Assets are free from any lien, encumbrance or charge except as disclosed in the financial statements.

Liabilities

17. All liabilities have been provided for in the books of account, including the liabilities for all purchases to which title has passed prior to 31 March 2013.

Carrying Value of Assets and Liabilities

18. The assets and liabilities have been recognised, measured, presented and disclosed in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13. There are no plans or intentions that are likely to affect the carrying value of classification of the assets and liabilities within the financial statements.

Provisions

19. Provisions have been made in the financial statements for all material liabilities which have resulted or may be expected to result, by legal action or otherwise, from events which had occurred by 31 March 2013 and of which The Highland Council could reasonably be expected to be aware. The amounts recognised as provisions are the best estimates of the expenditure likely to be required to settle the present obligations, as at 31 March 2013, in relation to outstanding equal pay (£0.564 million) and single status (£0.512 million) claims.

Commitments

20. All commitments under capital contracts have been disclosed in Note 28 to the Accounts. Any other significant commitments or obligations which might adversely affect the Council have been disclosed.

Leases

21. All leasing arrangements have been reviewed and correctly classified as operating or finance within the financial statements. Lease arrangements granted by the Council have been classified and disclosed within the financial statements.

Loans Fund

22. All borrowings have been confirmed as being compliant with the provisions of the Local Government (Scotland) Act 1975.

Other Matters

23. Except as disclosed in the financial statements, the results for the period were not materially affected by:
- transactions of a sort not usually undertaken by the Council
 - circumstances of an exceptional or non-recurrent nature
 - charges or credits relating to prior periods
 - any change in the basis of accounting

Yours sincerely

Derek Yule

Director of Finance & Section 95 Officer