AUDIT SCOTLAND

The Highland Council

Annual report on the 2013/14 audit

Prepared for the members of The Highland Council and the Controller of Audit

October 2014

Contents

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Key messages

Financial statements	• Unqualified auditor's reports on the 2013/14 financial statements of the council and charitable trusts. • Aspects of the final accounts processes require to be reviewed and amended in response to our audit findings.
Financial position	• An underspend of £3.819 million (0.6%) against service budgets. • Usable reserves have increased by £3.891 million to £85.334 million. • The general fund balance has increased by £2.450 million to £40.340 million, of which £17.134 million is unallocated. • Financial management remains effective with close budget monitoring and regular reporting to members.
Governance & accountability	• The council had sound governance arrangements in place. • Appropriate systems of internal control are in place except for those relating to the operation of the intercomapny accounts with the pension fund and housing revenue account reconciliations. • The council has an effective internal audit function and sound anti-fraud arrangements.
Best Value, use of resources & performance	• The council has a well developed framework in place for monitoring and reporting performance against strategic priorities. • The council's annual performance report highlighted that 96% of the council's commitments were either complete, progressing well or performance was being maintained.
Outlook	• Councils face rising demands for services and continued funding pressures alongside managing major reforms in welfare and health and social care. Effective partnership working will be essential to make the best use of available resources as well as continued strong governance and leadership.

Financial statements

1. We have given an unqualified audit opinion that the financial statements of The Highland Council for 2013/14 give a true and fair view of the state of the affairs of the council and its group as at 31 March 2014 and of the income and expenditure for the year then ended.
2. We have also given an unqualified audit opinion on the 2013/14 financial statements of those charities registered by The Highland Council and audited under the provisions of The Charities Accounts (Scotland) Regulations 2006.
3. Aspects of the final accounts processes require to be reviewed and amended in response to our audit findings. In particular, capital accounting working papers and housing revenue account reconciliations require improvement in future years.

Financial position

4. The Highland Council recorded an underspend of £3.819 million against service budgets (general fund and housing revenue account) in year, representing 0.6% of net service expenditure. This was mainly due to underspends within Transport, Environment and Community Services (£1.194 million) and on loan charges (£2.438 million).
5. Financial management remains effective with close budget monitoring and regular reporting to members.
6. The closing balance at the year end on usable reserves was £85.334 million representing a net increase of £ 3.891 million from 2012/13.
7. The net movement in the general fund balance for 2013/14 was £2.450 million, increasing the general fund balance to £40.340 million as at 31 March 2014. This balance is made up of earmarked commitments of £23.206 million and an unallocated balance of £17.134 million, or 3.3% of net cost of services. This is in line with the council's policy of holding minimum unallocated reserves of at least 2.5% of net service cost.
8. The council's 2014/15 financial plan requires cost savings of £15.709 million. There is a £63.700 million funding gap over the four years to 2018/19 and services have been asked to consider options for delivering 6% savings in the period 2015-19. The financial year 2015/16 will prove particularly challenging, and officers have identified that additional service reductions on top of those already requested may be required.

Governance and accountability

9. In 2013/14, the council had sound governance arrangements in place, including a number of strategic committees and an Audit and Scrutiny Committee overseeing key aspects of governance.

10. The council's two charitable trusts are governed by trustees. No trustee meetings were held during the year, and it is, therefore, unclear how trustees are able to adequately demonstrate proper stewardship of the funds.

11. The council's internal audit service generally operates in accordance with the Public Sector Internal Audit Standards. An action plan has been prepared to address the areas of non-compliance. Key controls within the council's main financial systems were operating satisfactorily except for those relating to the operation of the intercompany accounts with the pension fund, and housing revenue account reconciliations.

Best value, use of resources and performance

12. The council has a strong focus on performance management and has a sound framework for monitoring and reporting performance against the council's priorities. Corporate performance is reported annually covering the performance for the previous financial year.

13. The 2013-14 Corporate Performance Report shows continued progress in delivering the commitments set out in the 2012-17 Corporate Plan. The council's 2014 performance survey results were positive with 87% of respondents satisfied with council services.

14. In June 2013 the Highland Community Planning Partnership published a revised Highland single outcome agreement covering the five years to 2018/19. Positive feedback was received from the Scottish Government on the revised SOA and on the partnership itself which was described as mature and results orientated. The partnership has recently completed a self assessment exercise which concluded that it was performing well in the areas of leadership, outcome focus, use of evidence, governance arrangements, impact, scrutiny and community engagement. Scope for improvement was identified in performance management and reporting, and the allocation and use of resources. The partnership recently agreed a development plan to address these priorities for improvement.

Outlook

15. Demands on services and resources continue to increase and these need to be managed alongside major reforms to welfare systems and health and social care. This underlines the need for strong governance, leadership and decision making based on good cost and performance information. Effective working with partners will be required to make the best use of available resources as well as innovation and vision to design and deliver the services needed to serve the future needs of citizens.

Introduction

16. This report is a summary of the findings arising from our 2013/14 audit of The Highland Council. The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.

17. Our responsibility, as the external auditor of The Highland Council, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

18. The management of The Highland Council is responsible for:

- preparing financial statements which give a true and fair view
- implementing appropriate internal control systems
- putting in place proper arrangements for the conduct of its affairs
- ensuring that the financial position is soundly based.

19. This report is addressed to the members of The Highland Council and the Controller of Audit and should form the basis of discussions with the elected members as soon as possible after it has been issued. Reports should be made available to stakeholders and the public, as audit is an essential element of accountability and the process of public reporting.

20. This report will be published on our website after it has been considered by the council. The information in this report may be used for the Account's Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

21. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, shown at Appendices I and II, include recommendations for improvements. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of The Highland Council.

22. The concept of audit risk is of key importance to the audit process. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. We set out in our annual audit plan the related source of assurances and the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix III sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

23. Appendix IV is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response".

24. We recognise that not all risks can be eliminated or even minimised. What is important is that The Highland Council understands its risks and has arrangements in place to manage these risks. The council and the Director of Finance should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and monitor outcomes.

25. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

26. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Financial statements

Net service budget expenditure £595.554m	Planned capital expenditure £129.813m	Planned usable Reserves £79.738m	Savings target £7.9m
Service outturn £591.735m	Outturn capital spend £127.524m	Outturn usable reserves £85.334m	Savings achieved £7.921m
Service budget underspend £3.819m	Capital underspend £2.289m	Movement in usable reserves £3.891m	

Audit opinion

27. We have given an unqualified opinion that the financial statements of The Highland Council for 2013/14 give a true and fair view of the state of the affairs of the council and its group as at 31 March and of the income and expenditure for the year then ended.

28. The council's statutory trading organisation made an aggregate surplus in the three years to 31 March 2014 and thus met the statutory requirement to break even over the three year rolling period.

Other information published with the financial statements

29. Auditors review and report on other information published with the financial statements, including the explanatory foreword, corporate governance assurance statement and the remuneration report. We have nothing to report in respect of these statements.

Legality

30. Through our planned audit work we consider the legality of the council's financial transactions. This includes obtaining written assurances from the Director of Finance. There are no legality issues arising from our audit which require to be reported.

The audit of charities financial statements

31. The Charities Accounts (Scotland) Regulations 2006 (the 2006 Regulations) sets out the accounting and auditing rules for Scottish charities. These required, for the first time in 2013/14, a full audit of all registered charities accounts where a local authority or some members are the sole trustees.

32. The Highland Council had two charitable trusts which were subject to the full charities financial statements audit for 2013/14.

33. Auditors of registered charities' statement of accounts have responsibilities to:

- audit and express an opinion on whether the charity's financial statements give a true and fair view and are properly prepared in accordance with charities legislation
- read the trustees' annual report and express an opinion as to whether it is consistent with the financial statements
- report on other matters by exception to the trustees and to the Office of the Scottish Charity Regulator (OSCR).

34. We have given an unqualified opinion on these matters with respect to the 2013/14 financial statements of the two charities registered by The Highland Council.

Group accounts

35. Local authorities are required to prepare group accounts in addition to their own council's accounts where they have a material interest in other organisations.

36. The Highland Council has accounted for the financial results of three subsidiaries and two associates in its group accounts for 2013/14. The overall effect of consolidating these balances on the group balance sheet is to increase total reserves and net assets by £34.039 million.

37. The net assets of the group at 31 March 2014 totalled £916.709 million, compared to a position of £676.124 million in 2012/13. The positive movement in the closing net worth balance is mainly due to the transfer of Police and Fire functions to the new authorities from 1 April 2013 and the removal of the pension liabilities of Police and Fire from the group accounts.

Accounting issues arising

Presentational and monetary adjustments

Council financial statements

38. A number of presentational and monetary adjustments were identified in the council's financial statements during the course of our audit. These were discussed with management who agreed to amend the unaudited financial statements. The effect of these adjustments was to decrease the deficit on the provision of services by £10.629 million and increase the deficit on the revaluation of non-current assets by £11.252 million in the comprehensive income and expenditure statement. Net assets (and reserves) as recorded in the balance sheet have decreased by £0.622 million.

39. A few 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 by £0.0310 million, and the net assets (and reserves) on the balance sheet by £1.609 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.

Charitable trusts' financial statements

40. A number of presentational adjustments were identified within the financial statements of the Highland Council Charitable Trusts during the course of our audit. These were discussed with officers who agreed to amend the unaudited financial statements. There was no impact on the surplus for the year but the statement of balances increased by £0.100 million due to the omission of a property. There were no adjustments required to the financial statements of the Highland Charities Trust and no unadjusted misstatements which were identified during the course of our audits of the charitable trusts.

Whole of government accounts

41. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. The council submitted the consolidation pack for audit by the deadline. This has been audited and the audited return submitted to the Scottish Government.

42. The WGA process requires the consolidation pack to be reviewed by management prior to submission to Audit Scotland. This is an essential part of ensuring the quality of the packs submitted and provides assurance that the information submitted is in line with the body's financial statements. In the council's case the Director of Finance signs the management review checklist to confirm that *'I have reviewed the checklist below and I am satisfied that it has been properly completed and that there is appropriate evidence of the checks undertaken'*.

43. The council's original WGA submission failed the initial (gateway) checks undertaken by Audit Scotland as the gross assets and liabilities included in the consolidation pack did not agree to the unaudited financial statements. We drew this to the council's attention and the revised pack, updated to include the changes made to the audited accounts, passed the gateway checks.

Refer Action Plan Point 1

Report to those charged with governance

44. We presented our report to those charged with governance (ISA 260) to the Audit and Scrutiny Committee on 14 September 2014. The primary purpose of the report is to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. The main points are set out in the following paragraphs:

Council findings

Intercompany accounts

45. The council's ledger system uses intercompany accounts to complete the double entry for all transactions that cross between the council and the pension fund. Our audit of the pension fund's accounts raised a number of queries about the make up of these balances which took significant time for officers to resolve. In particular, senior officers were not aware that the council had been paying the income tax deducted from the pensioners' payroll (£4.3 million) on behalf of the pension fund throughout 2013/14.

46. The council's March 2014 pension contributions (£2.4 million), strain on the fund contributions (£0.6 million), and central support costs due to the council (£1 million) were also included in the intercompany accounts together with items paid by the pension fund on behalf of the council (£0.7 million) leaving an unexplained balance of £0.3 million which was not material to our opinion.

47. The audited accounts were amended to include these amounts as gross debtors and creditors. Officers are investigating why the council is not reimbursing the fund for all of the strain on the fund costs paid on its behalf as part of the monthly transfer and to identify the make up of the unexplained balance.

Refer Action Plan Point 2

Capital accounting

48. A number of adjustments were required to the non-current assets figures included in the unaudited balance sheet due the omission of depreciation from some assets, the erroneous inclusion of depreciation for other assets, the misclassification of capital expenditure as non-enhancing expenditure, and inconsistencies between the fixed asset register and the accounts. Adjustments were also required between the revaluation reserve and capital adjustment account to correct prior year misstatements and to remove negative balances from the revaluation reserve. The overall impact of these adjustments was to increase property, plant and equipment by £0.387 million, increase assets held for sale by £0.010 million, increase the revaluation reserve balance by £2.400 million and reduce the capital adjustment account balance by £2.002 million.

49. A number of areas have been carried forward for further discussion with officers in 2014/15. These include how the council accounts for non-enhancing capital expenditure, the need to account for investment properties within the council's balance sheet and the importance of internal consistency in disclosures within the financial statements.

Refer Action Plan Point 3

Housing revenue account

50. The unaudited balance sheet included a debtor balance of £1.372 million described as 'rent debtor to carry forward the balance on the rent control account'. This was additional to arrears due from current and former tenants shown separately in the unaudited balance sheet. We asked officers who was due to pay the council this money and subsequent investigation found that the £1.372 million debtor resulted from the erroneous inclusion of income lost on void properties within the housing information system. As a result, debtors were overstated by £1.372 million and housing expenditure (in the comprehensive income and expenditure statement) and other expenditure in the housing revenue account were understated by £0.400 million and £0.972 million respectively. The audited accounts were amended to correct this error.

51. Reconciliations between the financial ledger and housing information system provide assurance that rents, voids, cash received from tenants and write offs are correctly recorded in the financial statements. The reconciliations provided to audit contained small differences between the ledger position and that recorded in the housing information system for which satisfactory explanations could not be provided. While we were satisfied that the closing figures included in the financial statements were not materially misstated, the council's processes need to be amended to ensure that differences are investigated and resolved throughout the year.

Refer to Action Plan Point 4

Accounting for cut-off

52. During our audit we identified a number of instances where the council's balance sheet included both a debtor and a creditor for the same transaction. The largest of these related to an invoice from Scottish Water for £1.547 million for services relating to 2014/15. This had been included as both a creditor (when the invoice was received) and as a prepayment thus overstating both creditors and debtors. The audited accounts were amended to correct this error.

Refer Action Plan Point 5

Classification of investments

53. Cash and cash equivalents were overstated and short term investments were understated by £31.092 million due to the misclassification of investments in the unaudited balance sheet. The audited accounts were amended to correct this misclassification.

Refer Action Plan Point 5

Capital fund

54. The council has established a capital fund into which it pays developers' contributions and council tax income from second homes. Schedule 3 of the Local Government (Scotland) Act 1975 specifies that a capital fund can only be used to finance capital expenditure or the repayment of loans principal. The council had not correctly accounted for £1.540 million of capital expenditure funded from the capital fund in the unaudited accounts. The audited accounts were amended to correct the accounting treatment.

Refer Action Plan Point 6

Building dilapidations

55. The council leases a number of buildings which will require to be returned to their original leased condition at the end of the lease. The council currently does not recognise the costs associated with this future reinstatement work within its financial statements.

Refer Action Plan Point 7

Common good funds

56. A number of presentational adjustments were required to the common good fund accounts in order to account for investment properties and stock market investments in compliance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14. As a result, revaluations gains of £0.025 million previously held in the revaluation reserve were moved to the capital adjustment account and an available for sale financial instruments reserve was created to hold the unrealised gains on the stock market investment portfolio (£4.125 million) previously treated as capital funds.

57. The common good funds' heritage assets were valued by Sothebys in 2013/14. Their valuation report included a bust of Sir John Gordon (valued at £1.400 million) which had previously been included as an asset of the Invergordon common good fund. This asset was written out of the common good fund's balance sheet during 2013/14 when it emerged that it was a council asset but was not included in the council's balance sheet in 2013/14. Sothebys' report also included assets within Wick Town Hall with a value of £0.178 million. As Wick does not have a common good fund, these assets should also be included on the council's balance sheet. As a result, the council's net assets and reserves are understated by £1.578 million.

Refer Action Plan Point 8

Charitable trusts' findings

Highland Council Charitable Trusts

58. The unaudited statement of balances omitted a property (Rhind House, Wick) which is used to generate income for the trusts. This asset was valued at £0.100 million by the council's valuer. The audited accounts were amended to correct this omission.

59. The trust deeds of three Educational Trusts (Inverness-shire Educational Trust, Ross and Cromarty Educational Trust, and County of Sutherland Educational Trust) included within the Highland Council Charitable Trusts limit the amount of revenue surpluses which can be carried forward to the following year to £500, £1,000 and £400 respectively. Audit testing identified that this condition had not been adhered to in previous years. As a result, unrestricted funds were overstated and permanent endowments understated by £0.221 million. The audited accounts were amended to correct this failure to comply with the trust deeds' conditions in previous years.

60. The governance documentation for three trusts included within the Highland Council Charitable Trusts could not be located as a consequence of the age of these trusts. The disclosures in the accounts were amended to highlight for which trusts governance documentation is not held and on what basis the trustees account for and use these funds.

61. The council relies on custom and practice to inform any decisions by the trustees in respect of the trusts' expenditure and use of assets. We are not aware of any matters which would materially impact on the financial statements.

Outlook

62. The financial statements of the council are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The main new standards adopted in 2014/15 include:

- IFRS 10 Consolidated financial statements
- IFRS 11 Joint arrangements
- IFRS 12 Disclosures of interests in other entities
- IAS 28 Investments in associates and joint ventures.

63. These standards effect the group financial statements and include a change to the definition of control. This is likely to require a reassessment of the group boundary and potentially further consolidations and disclosures.

64. The revised Local Authority Accounts (Scotland) Regulations 2014 apply from 2014/15 onwards. The regulations set out what is required in respect of financial management and internal control, and the annual accounts themselves. The changes include the requirement for the unaudited accounts to be considered by the Audit and Scrutiny Committee. This can take place after submission to the auditor and up to 31 August if necessary. The audited accounts must also be considered and approved for signature by the committee by 30 September with publication on the council's website by 31 October.

Refer Action Plan Point 9

65. Highways assets are currently carried within infrastructure assets in the balance sheet at depreciated historic cost. The 2016/17 Code requires highways to be measured for the first time on a depreciated replacement cost basis. This represents a change in accounting policy from 1 April 2016 which will require a revised opening balance sheet as at 1 April 2015 and comparative information in respect of 2015/16. This is a major change in the valuation basis for highways and will require the availability of complete and accurate management information on highway assets. The council should ensure it is planning ahead to allow full compliance with the Code.

Financial position

66. The council's financial statements reported a deficit of £2.676 million on the provision of services in 2013/14. After adjusting this balance to reflect the statutory funding arrangements in place, and transfers to its other statutory reserves have been taken into account, the council increased its general fund and housing revenue account balances by £2.450 million and £0.524 million respectively.

67. The council's original general fund budget for 2013/14, approved in February 2013, was £548.436 million. During the year the budget was increased by £1 million to include expenditure funded by ring fenced grant and preventative spend funded by earmarked balances. The council's housing revenue account budget was £46.116 million in 2013/14. The council underspent against its revised service budgets (including HRA) by £3.819 million (0.6%) in 2013/14. Key variations in performance against budget include:

- an underspend of £1.194 million within Transport, Environment and Community Services due to lower than expected road maintenance due to the mild winter and higher than expected income from capital works
- an underspend on loan charges of £3.316 million due to lower than expected borrowing, continued favourable short term interest rates and changes to the borrowing profile.

68. The 2013/14 budget included a planned contribution to the capital fund of £2.600 million from council tax income on second homes. Actual income (and the contribution to the capital fund) was slightly less than expected at £2.585 million.

69. Usable reserves are part of a council's strategic financial management and councils will often have target levels of reserves. Exhibit 1 shows that the council's overall level of usable reserves increased by £3.891 million to £85.334 million as at 31 March 2014.

Exhibit 1: Usable reserves

Description	31 March 2013 £ million	31 March 2014 £million
General Fund	37.890	40.340
Housing Revenue Account	6.804	7.328
Repair and Renewal Fund	1.667	1.669
Insurance Fund	2.394	2.409
Capital Fund	31.171	31.703
Capital Receipts Fund	1.517	1.885
Total Usable Reserves	**81.443**	**85.334**

Source: The Highland Council 2013/14 financial statements

70. From an analysis of Scottish councils' unaudited 2013/14 accounts, over half of councils utilised reserves brought forward, with around half of all councils ending 2013/14 with lower levels of reserves than they had at the start of 2012/13. This was in part due to the retention of certain reserves associated with police and fire joint boards and the consequent reduction in general revenue grant from the Scottish Government in 2013/14.

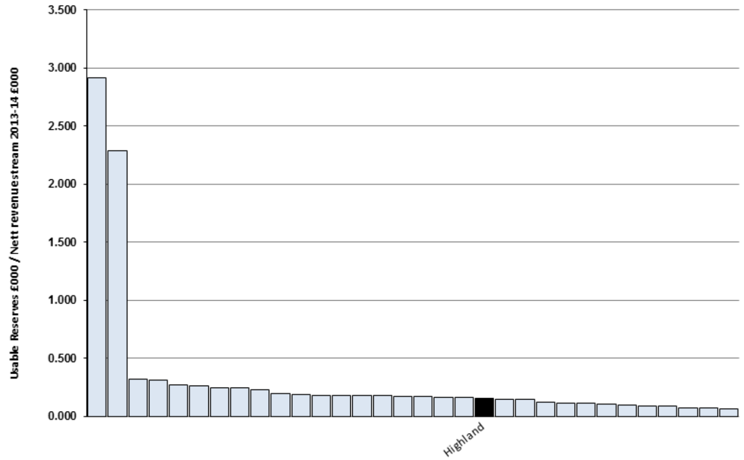
71. The general fund balance increased by £2.450 million during the year. The closing balance at 31 March 2014 is made up of earmarked commitments of £23.206 million and an unallocated balance of £17.134 million, or 3% of annual running costs. (2012/13: 3%). This position is in line with the council's policy which is to maintain uncommitted reserves at a minimum of 2.5% of the revenue budget over the medium term.

72. The most significant earmarked balances include:

- Strategic Change and Development Fund - £4.628 million
- NHS Adult Care - £3.500 million
- IT Investment Fund - £2.797 million

73. Exhibit 2 shows that the council's usable reserves position in relation to its net revenue stream (including dwelling rents) for the year is lower than the median of all Scottish councils. The council needs to continue to ensure that it strikes a balance between meeting current obligations and preparing for future commitments and possible reductions in funding.

Exhibit 2: Total usable reserves as a proportion of net revenue stream



Source: Scottish councils' unaudited accounts 2013/14

Integration of adult health and social care

74. The Public Bodies (Joint Working) (Scotland) Act 2014 received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland and offers some flexibility on the partnership arrangements for the governance and oversight of integrated health and social care services.

75. New partnership arrangements between the council and NHS Highland to provide integrated health and social care services became operational on 1 April 2012, two years ahead of any other council. Over 1600 staff transferred from the council to NHS Highland as a result of the partnership agreement and around 200 transferred from NHS Highland to the council.

76. The first two years of the partnership have been financially challenging for both partners as demand for adult care services continues to increase. Acknowledging the need for future budgets to be on a sounder financial footing, the council agreed to provide NHS Highland with additional recurring funding of £3 million in 2014/15, £1.3 million in 2015/16 and £0.4 million in 2016/17. Additional non-recurring funding of £1.5 million is also being provided in 2014/15. The council plans to use £2 million of its balances to fund its additional contribution in 2014/15, together with £1 million from its preventative spend budget in 2014/15 and 2015/16. The council will consider how it will fund the remainder of its additional contributions as part of the work required to deliver a balanced budget for 2015-19.

Refer Action Plan Point 10

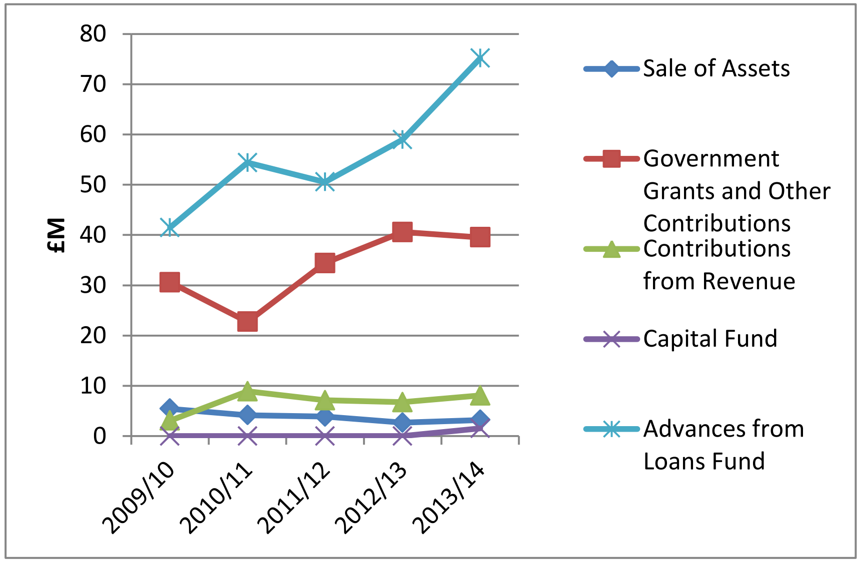
Capital investment and performance 2013/14

77. The council's general service capital spend for 2013/14 was £85.3 million against a budget of £88.8 million, resulting in an underspend of £3.5 million (4%). The council has a history of slippage within its general fund capital programme and so includes more projects within the programme than funding available to provide flexibility in managing the scheduling of projects to maximise expenditure in the year. The most significant slippage against the enhanced programme occurred in Education, Culture and Sport (£4.663 million), Chief Executive's Office (£3.463 million) and Transport, Environmental and Community Services (£2.435 million).

78. The housing capital programme includes expenditure on the provision of new council housing stock and improvements to existing stock to meet the Scottish housing quality standard. Actual spend in 2013/14 was £42.2 million against a budget of £41 million, resulting in an overspend of £1.2 million (3%) due to acceleration of the new build programme to meet housing needs. Current estimates are that 678 (5%) dwellings will not meet the Scottish housing quality standard by April 2015.

79. The trend in sources of funds for capital investment over the last five years is set out in Exhibit 3. This shows a decline in the funds received through the sale of assets. Advances made to services from the council's loans fund remains the most significant source of funds for the council's capital programme.

Exhibit 3: Sources of finance for capital expenditure 2009/10 – 2013/14



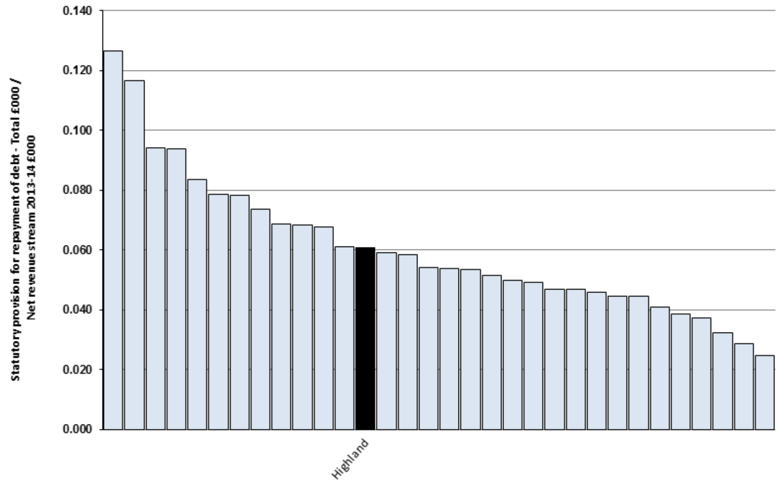
Source: The Highland Council Annual Accounts 2009/10 to 2013/14

Treasury management

80. High levels of debt may reduce a council's budget flexibility going forward as revenue resource has to be set-a-side to service that debt. The impact that debt levels have on net revenue expenditure will be affected by interest rates and repayment periods.

81. In the current financial climate, many councils have relatively high levels of internal borrowing, utilising available cash balances and deferring external borrowing. The council's level of borrowing in 2013/14 increased by 6% from the previous year. As shown in Exhibit 4, the council's net external debt as a proportion of net revenue stream is in the middle range relative to other Scottish councils.

Exhibit 4: Net external debt as a proportion of net revenue stream



Source: Scottish councils' unaudited accounts 2013/14

82. As at 31 March 2014 the council had total borrowings of £750.881 million (2012/13 £707.984 million), of which 94.3% is at a fixed rate of interest and is a repayable over the long term.

83. Audit Scotland has, on behalf of the Accounts Commission, recently completed a national review of borrowing and treasury management in councils. This involved discussions with members and officers as well as audit visits to a number of selected fieldwork councils. The review focused on the affordability and sustainability of borrowing and governance arrangements and considered how councils demonstrate best value in their treasury management functions. The national report is planned for publication in January 2015.

Outlook

84. In December 2013 the council approved its revenue budget for 2014/15. The net service expenditure budget set for 2014/15 was £563.697 million, an increase of 2.8% on that originally set for 2013/14 (£548.436 million). In setting its revenue budget the council identified the need for savings of £15.709 million to be delivered in 2014/15.

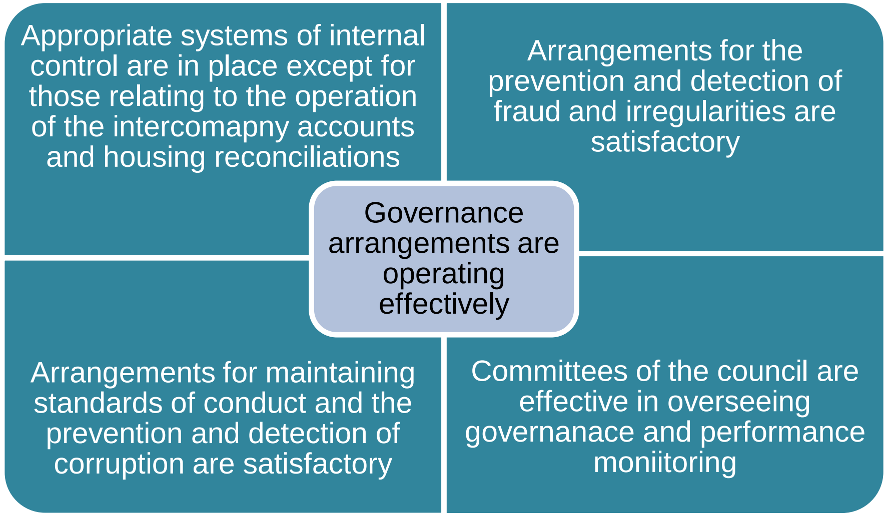
85. Since the budget was set the council has received additional government funding of £1.798 million and increased service budgets by £8.407 million funded by earmarked balances, resulting in a revised budget for 2014/15 of £572.953 million. The latest revenue monitoring report, based on the position as at 30 June 2014, projects that the estimated outturn will be £1.322 million (0.23%) more than the revised budget at 31 March 2015 as a result of overspends within the Care and Learning Service. The service is working to reduce its budget pressures and address the overspend position. The housing revenue account is forecast to break even as at 31 March 2015.

86. The council will continue to operate in a funding environment which is subject to sustained pressure to deliver more with less. The level of flexibility within expenditure budgets is considerably reduced by the release of cost savings in previous years. Current estimates are that the council has a £63.7 million funding gap over the four years to 2018/19. Services have been asked to consider options for delivering 6% savings in the period 2015-19. Financial year 2015/16 will prove particularly challenging, and additional service reductions on top of those already requested may be required.

87. The council has recently concluded an initial series of budget consultation meetings across the Highlands, and launched a Budget Blog. The feedback from the consultation is being analysed and will inform the consideration of budget options.

88. The council’s ten year capital programme includes three significant projects: Ness Flood Alleviation Works, West Link Road and replacement schools. The capital programme is currently being refreshed to reflect updated costs for these projects and how expenditure on these will be phased and funded in the coming years.

Governance and accountability



89. Members of the council and the Director of Finance are responsible for establishing arrangements for ensuring the proper conduct of the affairs of The Highland Council and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

90. The corporate governance framework within The Highland Council is centred on the council which is supported by the following strategic committees.

Community Services Committee

Education, Children & Adult Services Committee

Planning, Development & Infrastructure Committee

Resources Committee

91. Other committees include the Audit and Scrutiny Committee which meets regularly to receive reports from internal and external audit and scrutinise performance.

92. Based on our observations and audit work our overall conclusion is that the governance arrangements are operating effectively.

93. The council's two charitable trusts are governed by trustees. We noted that there had been no trustee meetings during the year, nor for a number of years prior to this. It is, therefore, unclear how trustees are able to adequately demonstrate proper stewardship of the funds.

Refer Action Plan Point 11

Internal control

94. As part of our audit we reviewed the high level controls in operation in a number of the council's systems that impact on the financial statements. This audit work covered general ledger, payroll, trade payables, trade receivables, cash and cash equivalents, non domestic rates, council tax, housing rents, housing benefit and treasury management. Our overall conclusion was that the key controls within the council's main financial systems were operating satisfactorily except for those relating to the operation of the intercompany accounts with the pension fund (see paragraphs 45 to 47), and housing revenue account reconciliations (see paragraph 50).

Internal audit

95. Internal audit provides members of the council and the Proper Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where appropriate.

96. Our review of internal audit concluded that the council's internal audit service generally operates in accordance with the Public Sector Internal Audit Standards. An action plan has been prepared to address the areas of non-compliance. We placed formal reliance on the work of internal audit in several accounting systems including creditor payments, cash income and banking, and on focussed testing of the main accounting systems undertaken to support the Head of Internal Audit and Risk Management's opinion on the internal control system.

ICT audit

97. The council's information systems are currently provided by Fujitsu Services as part of a five year contract which commenced on 1 April 2010. During 2013/14, the contract was extended for the majority of services provided by Fujitsu for a further 18 months.

98. A dedicated ICT procurement team has been set up to evaluate opportunities for future ICT provision in the year ahead. With the development of national ICT infrastructure and services, the council is moving towards a more diverse model of ICT delivery. The council's ICT strategy was reviewed and updated to reflect the national strategy for local government ICT in October 2013.

99. The Public Services Network (PSN) allows the council to share electronic data with other public bodies, such as the Department of Works and Pensions. In order to use the network the council must comply with the strict security measures of the PSN Code of Connection which, if fully met, results in the issue of a compliance certificate.

100. The application and approval process is subject to annual review and could result in a disruption to operations and service delivery if there were any non compliance issues. The council achieved PSN accreditation in December 2013 and further work is underway to ensure accreditation is retained at the next assessment in April 2015. The overall cost of the work was estimated at around £0.320 million in 2013/14 and a further £0.595 million is estimated in 2014/15.

101. Business continuity planning is an essential part of an organisation's response planning. In 2013/14 internal audit followed up on progress made to address the recommendations resulting from their previous audit of the council's business continuity arrangements. The follow up found that the majority of the agreed actions had not been completed. As a result of internal audit's findings, the lack of appropriate business continuity planning has been recognised as a risk within the council's corporate risk register. We will continue to monitor progress in this area as part of our 2014/15 audit.

Arrangements for the prevention and detection of fraud

102. The council's arrangements in relation to the prevention and detection of fraud and irregularities were satisfactory. The Highland Council participates in the National Fraud Initiative (NFI). The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error. Overall, we concluded that the council has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

103. The arrangements for the prevention and detection of corruption in The Highland Council are satisfactory and we are not aware of any specific issues that we need to record in this report.

Correspondence referred to the auditor by Audit Scotland

104. Part of Audit Scotland's duties as the council's external auditors is to consider concerns raised by members of the public about the council. If appropriate, we may investigate them further.

105. During 2013/14 we received correspondence relating to one of the council's major capital projects, the Inverness West Link. This major section of road is aimed at removing traffic congestion from Inverness city centre and allowing completion of the city's outer neighbourhoods. The council spent £1.9 million on this project in 2013/14.

106. The planning application for the Inverness West Link was submitted on 17 October 2013, and granted in April 2014. Compulsory purchase orders were published on 12 November 2013, with supplementary orders published in September 2014 to correct minor anomalies.

107. The council has received four objections to its compulsory purchase orders. As a result, a public local inquiry or hearing will be held, before an independent reporter appointed by Scottish Ministers, to consider these objections.

108. The reporter will consider all objections, representations and material presented at the inquiry or hearing and then weigh up how the council's proposals would benefit the public against the interests of the owners and other people affected. The reporter will then write a report for Scottish Ministers setting out his/her conclusions and recommendations.

109. The timetable for the inquiry or hearing has still to be agreed but it is unlikely to commence until early 2015. Until it is concluded, no material progress can be made with this project.

110. In last year's report on the audit we highlighted that, given the scale of investment required in the project, it was important that members continue to receive regular updates on cost so that they could effectively monitor developments. The last update members received on the project was more than a year ago, in September 2013. We have been advised by the council that there has been little progress to update members on as a the planning process has taken longer than anticipated.

Refer to Action Plan Point 12

111. Accurate cost estimates are important from the outset of major capital projects as weak estimating can undermine the successful delivery of a project and its potential to achieve value for money. The September 2013 report noted that the estimated cost of the project had increased from £27.2 million in 2011 to £34.4 million (at July 2013 prices).

112. The council has acknowledged that it needs to improve the way it estimates costs for major capital projects so that these reflect what it expects to pay when it delivers the project rather than what it would cost to deliver the project at today's prices. As noted at paragraph 88, the council's ten year capital programme is currently being refreshed to reflect updated costs and how these will be funded in the coming years. The Director of Finance has confirmed that these updated costs will be based on what projects are anticipated to cost when they are to be delivered.

113. We will continue to monitor progress with this major capital project during 2014/15.

Welfare reform

114. The council recognises the impact that the changes to the UK welfare system could have on resources and service provision. 2013/14 was a period of significant change with council tax benefits being replaced by the new Council Tax Reduction Scheme and the introduction of the Scottish Welfare Fund. Councils continue to face uncertainties over the roll out of the Universal Credit and there is the potential for even further reforms.

115. A report from the Scottish Parliament's Welfare Reform Committee in June 2014: *The Local Impact of Welfare Reforms* highlighted that each working adult in receipt of benefits within the Highland area lost an average of £400 of income per annum compared to the Scottish average of £460.

116. The council is responding well to the challenges of these reforms. Officers have participated in discussion and working groups with both the Scottish and UK Governments and Inverness is the only Jobcentre in Scotland to administer claims for Universal Credit. The Director of Finance reports quarterly to the Resources Committee on welfare reform and other welfare initiatives.

Audit of housing benefit

117. As part of Audit Scotland's housing benefit risk assessment programme the council was selected for a review in 2013/14. The results of the risk assessment were reported to the Resources Committee in November 2013.

118. The assessment concluded that the council had delivered continuous improvement in most operational areas since the previous risk assessment in August 2010. The council achieved an improved speed of processing at the same time as maintaining a strong accuracy performance and continuing to reduce local authority error overpayments. More work was required in monitoring overpayment performance and ensuring an effective and efficient intervention programme.

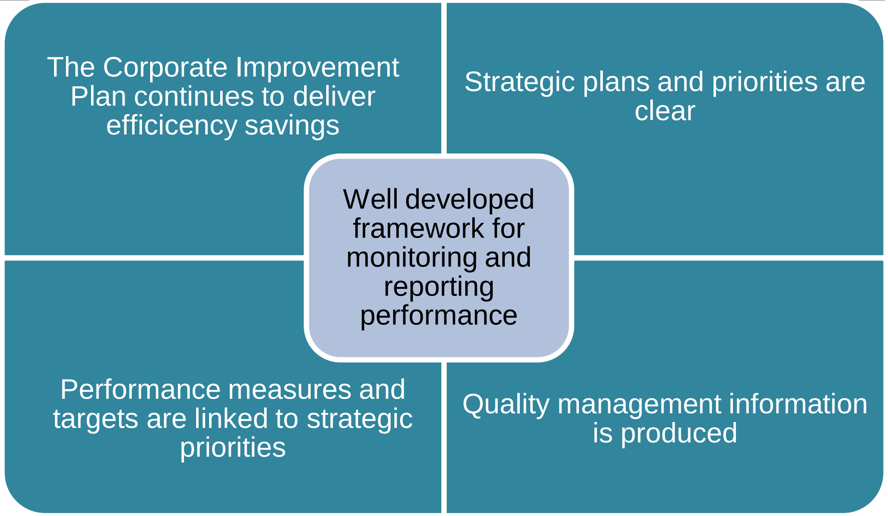
Outlook

119. Councils continue to face rising demands for services alongside managing major reforms in welfare and health and social care. There is now a greater need than ever for strong governance and leadership.

120. The integration of health and social care is a complex and challenging process. The financial position for the lead agency arrangement with NHS Highland is likely to continue to be a challenge for both organisations going forward and will require close monitoring to ensure the aims and objectives of the lead agency agreement are delivered.

121. There are to be major changes in councils' responsibilities for the investigation of fraud. The new Single Fraud Investigation Service (SFIS) is a national fraud investigation service within the Department for Works and Pensions which will take over the responsibility for the investigation of housing benefit frauds. The investigation of the Local Council Tax Reduction Scheme and corporate frauds will remain within councils. The SFIS will be implemented across councils on a phased basis during the period July 2014 to March 2016 and may see the transfer of staff from councils to the DWP. There is a risk that councils' arrangements for the prevention and detection of fraud may be weakened due to the loss of experienced investigators to the SFIS.

Best value, use of resources & performance



122. Local authorities have a statutory duty to provide best value in those services they provide directly as well as those provided through agreements with Arms Length External Organisations. This requires continuous improvement while maintaining a balance between quality and cost and having regard to value for money, equal opportunities and sustainability. There is also the duty to report performance publicly so that local people and other stakeholders know what quality of service is being delivered and what they can expect in the future.

Arrangements for securing best value

123. Continuous improvement in public service and governance lies at the heart of best value and community planning. Local authorities must develop an improvement culture across all service areas. Elected members and officers have to focus on policy objectives and the needs of service users communities. They must be driven by a desire to achieve the highest possible standards in service delivery. This requires a culture where areas in need of improvement are identified and openly discussed, and in which service performance is constructively challenged.

124. The council was one of five 'pathfinder' sites for the best value 2 audit in 2009/10. The audit concluded that the council demonstrated that it was improving and was well placed to deliver future improvements. Effective partnership working and community engagement were highlighted as areas of strength. The improvement plan developed to address the areas for improvement raised by the audit is now substantially complete, with any remaining elements incorporated into the corporate improvement programme and the workforce development plan.

Use of resources

Service restructure

125. In October 2013, the council approved a revised service structure, reducing the number of services and Directors from 7 to the following 5:

- Care and Learning
- Finance
- Corporate Development
- Development and Infrastructure
- Community Services

126. The restructure aims to further improve the efficiency, effectiveness and performance of the council's services by embedding a culture of collaboration and integration across the council.

127. The restructure will deliver recurring savings of £0.350 million from 2014/15. Since April 2007 the council has reduced its management structure by 44 posts and produced annual savings of £3.250 million.

128. The council acknowledges the risks associated with this latest reduction in management capacity but believes that these can be mitigated by a clearer and more focused structure. Any short term performance risks will be mitigated by leadership and training.

Corporate improvement plan

129. The corporate improvement plan (CIP) continues to be the main focus of the council's efficiency strategy. The CIP delivered £2.9 million of savings in 2013/14 against a target of £3.6 million. This was mainly due to slippage in savings from the business support project (£0.7 million) and asset management planning projects (£0.2 million), offset by overachievement of procurement savings (£0.3 million). This slippage has been added to the 2014/15 target for CIP savings resulting in a revised target of £2.981 million. Developments in some of the major projects are highlighted below.

Asset management, flexible working, and managing information

130. The council is working with staff to reduce its office estate in Dingwall from 9 properties to 5. The project will incorporate flexible working practices into the redesigned office accommodation including improved management of information, and reduced reliance on paper files.

131. Work has also started on rationalising the office estate in Fort William with the preferred option being to co-locate the council's main administrative offices, democratic services, service point and registration offices to a council owned site.

132. A strategy for the further deployment of mobile technology within the council is currently being developed. Interest in the use of mobile technology was raised through a demonstration of the council's Total Mobile system in July 2014.

Business support

133. The business support project aims to develop new processes and service delivery models to make best use of resources in delivering business support. Work is ongoing to develop self service processes within council's payroll system (e.g. online expenses and annual leave requests), and a new service delivery model for school support is also being developed.

Transport programme

134. The council is working in partnership with Highland and Islands Transport Partnership, Highland Third Sector Interface, the Scottish Ambulance Service, NHS Highland, the Community Transport Association and Voluntary Action Lochaber to improve transport provision whilst securing savings. Areas which will be examined include: local bus services, taxi contracts, home to school transport, supporting community transport solutions and exploring the potential for joint logistics operations with the NHS. The Transport Programme's overall target is to deliver savings of £2.246 million by 31 March 2019.

Performance management

135. The council has a number of performance measures in place: service specific indicators, council wide indicators, single outcome agreement (SOA) outcome indicators and statutory performance indicators.

136. Performance information is recorded and reported on an electronic performance and risk management system, with service performance reviewed through quarterly performance reviews where service directors and senior managers are held to account. The council has a strong focus on performance management and has a sound framework for monitoring and reporting performance against the council's priorities.

Overview of performance targets in 2013/14

137. The council produces an annual report of performance against the council's commitments and the corporate performance indicators set out in the performance framework for the council programme 'Working together for the Highlands 2012-17'. The council's programme was refreshed in December 2013 resulting in the addition of a further 10 commitments. The performance framework was updated to include these in May 2014.

138. Performance against the council's 139 commitments continued to be monitored through the performance and risk management system during 2013/14. As at 31 March 2014, 133 (96%) of these commitments were either complete, progressing well or performance was being maintained. For the remaining 6 (4%) commitments performance was mixed. Key commitments delivered or progressing well in 2013/14 include:

- building 134 council homes in 2013/14 exceeding the target of 120
- renewable energy capacity has increased to 5080MW in 2013/14, well in excess of the target of 2908MW by 2017
- an additional £2 million funding for early year services has enhanced the support available to young children and families.

139. In June 2013 the Highland Public Services Partnership (PSP), the community planning partnership for the area, published a revised Highland single outcome agreement (SOA). The SOA covers a five year period from 2013/14 to 2018/19 and is structured around seven national priority areas:

- economic recovery and growth
- employment
- early years
- safer and stronger and reducing offending
- health inequalities
- physical activity
- outcomes for older people.

140. Feedback received from the Scottish Government on the SOA has been positive. It describes the Highland Community Planning Partnership as mature and results orientated and the SOA, in covering all six national priorities, as a genuine plan that can be delivered. Areas for further development and improvement of the SOA include ensuring that sufficient details about delivery, measures and the performance framework are captured against which progress can be evaluated.

141. Each priority area is lead by a different community planning partner. Baseline performance data has been collected and analysed for each priority area. A new partnership group has been established to oversee the development of a partnership strategy for community learning and development.

142. The partnership, supported by the Improvement Service, recently completed a self assessment exercise which found that the partnership was performing well in the areas of leadership, outcome focus, use of evidence, governance arrangements, impact, scrutiny and community engagement. Scope for improvement was identified in performance management and reporting and the allocation and use of resources. The partnership has recently agreed a development plan to address these priorities for improvement.

Statutory performance indicators

143. The Accounts Commission has a statutory power to define performance information that councils must publish locally and it does this through its annual statutory performance information direction. Since its 2008 Direction, the Accounts Commission has moved away from specifying individual indicators and has focused on public performance reporting and councils' requirement to take responsibility for the performance information they report.

144. The audit of statutory performance indicators in 2013/14 is a two stage process. The first stage requires auditors to ascertain and appraise councils' arrangements for public performance reporting and the completion of the local government benchmarking framework indicators. This focuses on three statutory performance indicators (SPIs) namely :

- SPI 1: covers a range of information relating to areas of corporate management such as employees, assets and equalities and diversity
- SPI 2: covers a range of information relating to service performance
- SPI 3: relates to the reporting of performance information as required by the local government benchmarking framework.

145. Our review of the council's arrangements for public performance reporting and producing the SPIs concluded that the council has developed a structured approach to PPR and that plans are in place to publish the SPIs once the comparative information from the local government benchmarking framework becomes available. Guidance has been issued to all staff involved in the preparation of SPIs and internal audit undertake a rolling programme of checks on their accuracy. The council plans to further develop its website to allow the public to drill down on performance measures to a more detailed level.

146. The second stage involves an assessment of the quality of the information being reported by the council to the public. An evaluation of all Scottish local authorities' approaches to public performance reporting (PPR) was carried out by Audit Scotland's performance audit and best value section, the results of which were reported to the Accounts Commission in June 2014.

147. Individual assessments were also reported to councils' Chief Executives, Leaders and Chairs of Audit Committees. These highlighted the extent to which their PPR material either fully, partially or did not meet the criteria used in the evaluation. The results for The Highland Council were mixed, with 43% fully and 57% partially meeting the criteria. A further evaluation of councils' approaches to PPR is due to be carried out by Audit Scotland in Spring 2015.

Assurance and improvement plan 2014-17

148. The assurance and improvement plan (AIP) covering the period 2014 to 2017 was the fifth AIP for The Highland Council prepared by the local area network of scrutiny partners for the council since the introduction of the shared risk assessment process. It was published on Audit Scotland's website and was submitted to the both the Council meeting on the 8 May 2014 and the Audit and Scrutiny Committee on 19 June 2014.

149. Although the shared risk assessment process did not identify any specific additional scrutiny for the council, there were some areas which required ongoing monitoring by scrutiny bodies. These are homelessness, integrated care, criminal justice services, self-evaluation in primary and secondary schools and community learning and development.

150. A supported self-assessment of criminal justice social work and an inspection of adult social work services is planned for 2014/15. Education Scotland continues to monitor self-evaluation arrangements in primary and secondary schools and community learning. We will revisit these areas as part of the 2015-18 shared risk assessment.

151. Audit Scotland followed up two national performance audits during 2013/14. This involved targeted follow-up *of Arms length external organisations (ALEOs) – are you getting it right?* (June 2011) and *Major capital investments in councils* (March 2013).

152. We reported our findings from our review of ALEOs to the council in June 2014 concluding that the council met better practice in two (financial commitment and risk and financial performance monitoring) out of the four areas and basic practice in the remaining two areas (clarity about the reasons to use ALEOs and the role of members and officers). An action plan was attached to the report highlighting one key risk area and officers agreed actions to address this.

153. The aim of the follow up of the major capital investments in councils report is to consider to what extent the council has improved performance in managing its capital investment programmes, including:

- how the council considered and implemented the report's recommendations including the extent to which the good practice guide and checklist were used to help improve the management and delivery of major capital projects and to support effective scrutiny plans
- whether capital investment plans reflect strategic priorities
- whether elected members are provided with sufficient information to support effective scrutiny and decision-making.

154. The follow up will not cover how capital projects are funded as this formed part of a separate national study of borrowing and treasury management in local government. The findings from our follow up audit will be reported in November 2014.

National performance audit reports

155. Audit Scotland carries out a national performance audit programme on behalf of the Commission and the Auditor General for Scotland. A summary of national performance audit reports published in 2014 is included in Appendix II.

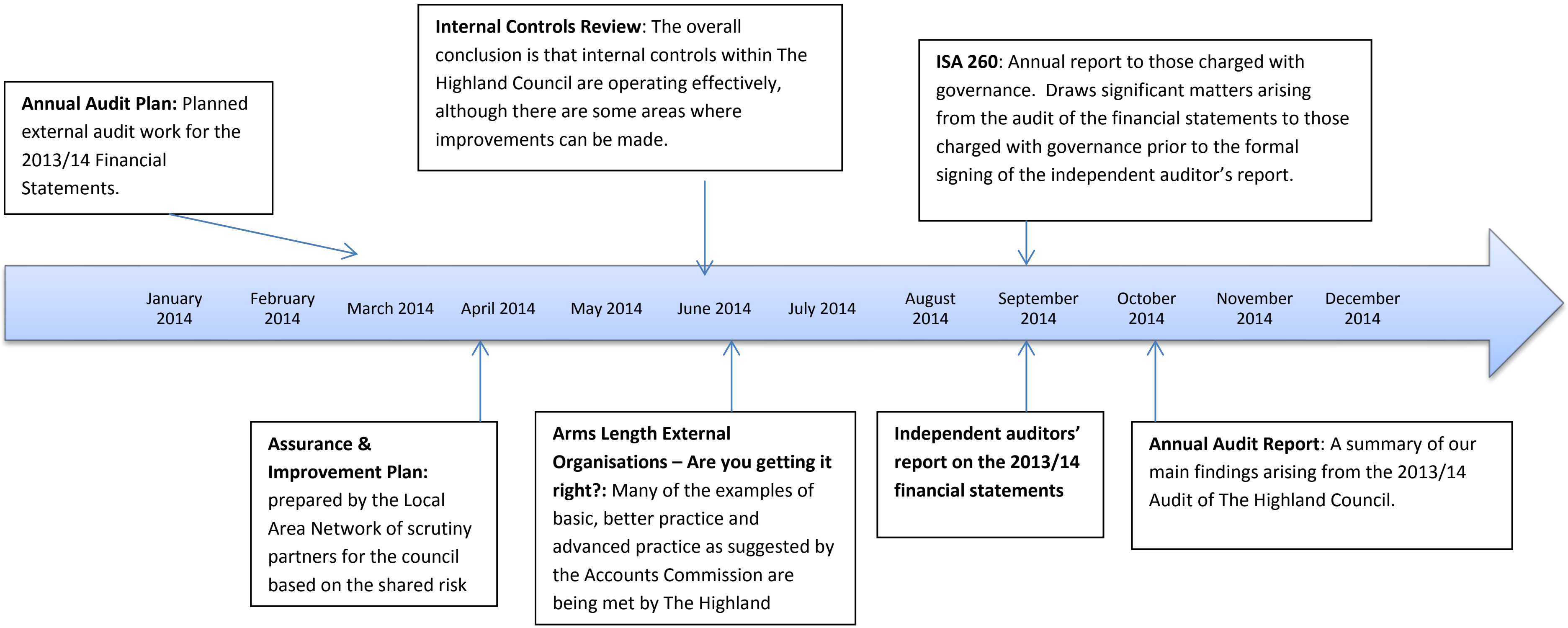
156. Audit Scotland encourages local authorities to review national reports, assess local performance against them and identify actions required to improve performance. The expectation is that these reports are presented to an audit or scrutiny committee for members to review and to question management on key issues.

157. Within The Highland Council, all national performance reports published by Audit Scotland are presented to the relevant Strategic Committee to enable members to consider and agree the action proposed in response to the report's recommendations. Each report is also submitted to the Audit and Scrutiny Committee as its remit includes ensuring that appropriate action was taken by individual Strategic Committees in response to national reports. This ensures that officers and members review the findings and recommendations included in each report in order to identify any that will assist the council in its drive for continuous improvement.

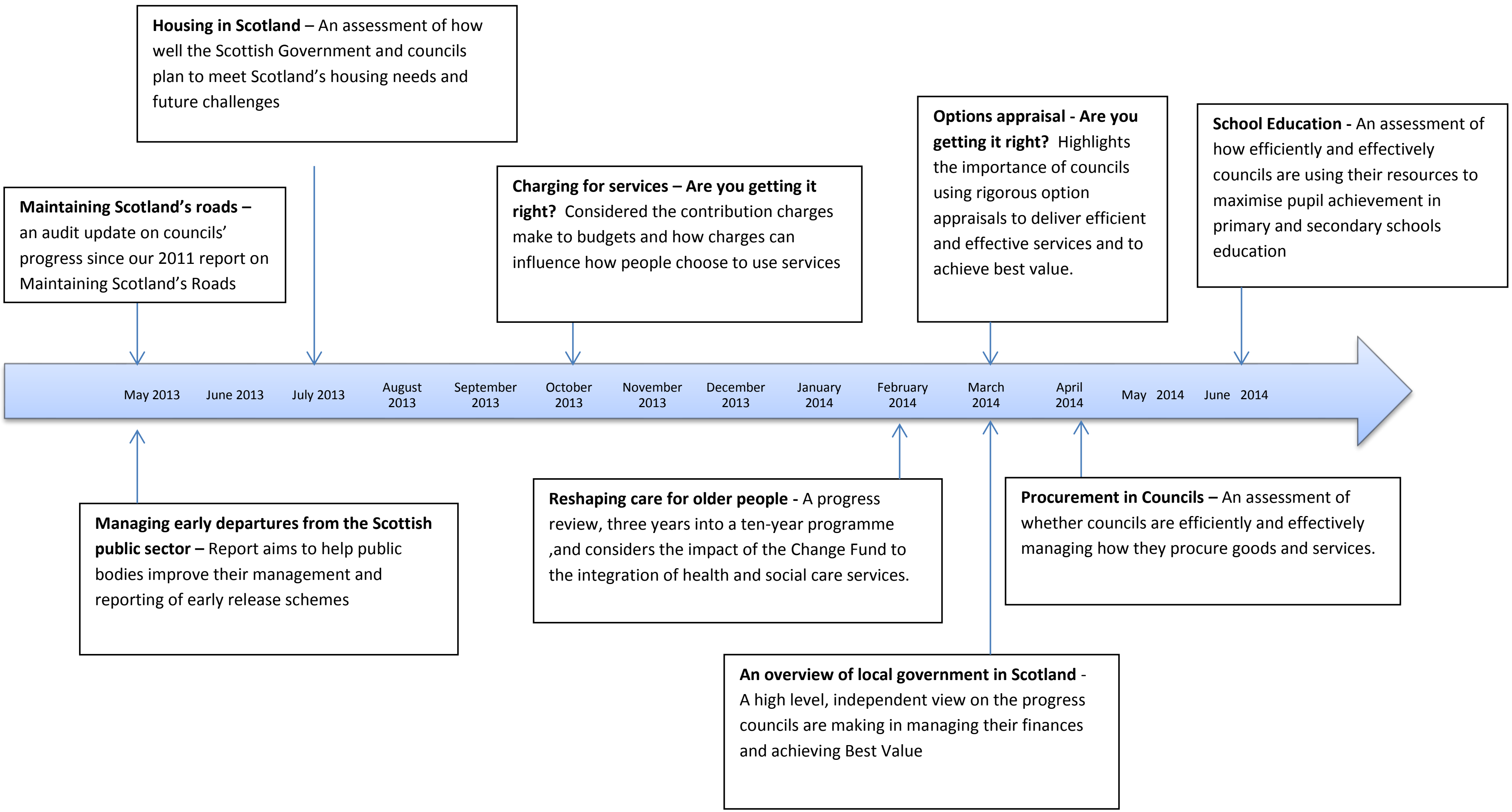
Outlook

158. In common with other councils, The Highland Council faces the key challenges of reducing budgets, an ageing population with higher levels of need and the public expectation of high quality services. Savings have been made in recent years largely by reductions in the workforce. However as choices on how to address funding gaps becomes increasing difficult, councils will have to focus on making the very best use of all available resources and to challenge existing ways of doing things. A strong and effective performance management framework will be critical to the success of the council achieving its key priorities.

Appendix I – Summary of The Highland Council local audit reports 2013/14



Appendix II – Summary of Audit Scotland national reports 2013/14



Appendix III – Significant audit risks

The table below sets out the key audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure
Financial management and sustainability In December 2013 the council set a balanced budget for the 2014/15 financial year. The Director of Finance highlighted the financial challenges facing the council in the period 2015/16 to 2018/19 with a forecast budget gap of £80 million overall or £20 million per annum. The council agreed a budget strategy for the period 2015/16 onward which will focus on strategic reviews, service redesign and transformational change. ***Risk: the council may be unable to continue to deliver key public services due to increasing financial pressures and reducing financial settlements.***	The council's financial position as at 31 March 2014 is set out in paragraph 67 above. Exhibit 1 shows that usable reserves increased by £3.891 million since the previous year. The latest budget monitoring report for 2014/15 projects that the general fund budget will be overspent by £1.322 million (0.23%) as at 31 March 2015 as a result of overspends within the Care and Learning Service. The Service is working to reduce its budget pressures and address the overspend position. The housing revenue account budget is forecast to breakeven at 31 March 2015. Current estimates are that the council now has a £63.7 million funding gap over the four years to 2018/19. Services have been asked to consider options for delivering 6% savings in the period 2015-19. Financial year 2015/16 will prove particularly challenging, and additional service reductions on top of the 6% already requested may be required.

Audit Risk	Assurance procedure
Accounting for charities The Charities Accounts (Scotland) Regulations 2006 require the preparation of financial statements and the provision of an auditor's opinion for each charity covered by section 106 of the regulations. Discussions are taking place with the Office of Scottish Charities regulator (OSCR) with a view to amalgamating and reorganising the council's charitable trusts into one overarching trust. ***Risk: the overarching trust may not be in place by the end of the financial year which will result in the council having to prepare separate accounts for a large number of trusts which will also incur additional costs.***	Discussions with finance staff identified that after amalgamating and reorganising its trusts, the council had two charitable trusts which required to be audited under section 106 of the regulations. We gave an unqualified opinion that the financial statements of each of the charitable trusts properly present the receipts and payments of the charity for the year ended 31 March 2014 and its statement of balances at that date.

Audit Risk	Assurance procedure
Capital accounting In our 2012/13 financial statements audit specific issues were identified in relation to the preparation of capital accounting entries. We found a lack of audit trail as to how key figures in the unaudited accounts tied back to the council's asset registers, and a lack of internal consistency in disclosures within the draft financial statements. In addition, considerable work was required to resolve issues identified with the operation of the revaluation reserve and capital adjustment account. ***Risk: the council's unaudited financial statements do not accurately reflect the capital accounting requirements.***	We worked closely with the capital accountant and overall the audit process was much smoother than in previous years. However, we again identified 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. This is an area that requires further improvement in future years.

Audit Risk	Assurance procedure
Central accountancy team The council plans to implement a new financial management system from 1 April 2015. Staff from the central accountancy team will be seconded to the project implementation team at the conclusion of the accounts preparation process. ***Risk: staff availability may impact on the 2013/14 final accounts audit process resulting in delays in getting responses to audit queries to enable the accounts to be signed off by the 30 September deadline.***	The timing set for the project implementation plan was set to, as far as possible, minimise the impact on the accounts closedown and audit procedures. The council consulted us on proposals that could have impacted on our ability to meet the deadline and amended their plans to mitigate our concerns. The accounts were certified by the 30 September deadline. We will continue to work with finance staff to manage the impact of the implementation of the new financial management system on the final accounts and audit processes in 2014/15 audit.
Information management The information environment of the council is complex and fast-changing and essential to support the delivery of services as well as savings plans. There is also a considerable amount of external interest. ***Risk: the achievement of service and efficiency objectives could be made harder by a fragmented approach to information management.***	We monitored the development of the council's information environment through review of committee papers and discussions with officers. The 5 year contract with Fujitsu, which commenced on 1 April 2010, has been extended for the majority of services for a further 18 months. A dedicated ICT procurement team has been set up to ensure continuous provision of ICT services when the current and extended contracts with Fujitsu come to an end. We will continue to monitor developments as part of our 2014/15 audit.

Audit Risk	Assurance procedure
Risk management Risk management is an essential part of the council's approach to corporate governance. As part of the Finance Service restructure the posts of Principal Auditor and Insurance and Risk Management were removed from the establishment and replaced by an Audit and Risk Manager post. The new manager has identified that further work is required to improve processes and train managers and staff to fully embed risk management throughout the council. ***Risk: the council's approach to risk management is not fully effective nor embedded throughout the organisation.***	We monitored the developments in risk management during 2013/14 through review of committee papers, and attendance at Audit and Scrutiny Committee meetings. We noted that risk management training was provided to members in February 2014 and that a new risk information template has been developed. A critical review of corporate risks has also been undertaken which resulted in the following changes: • risks are now categorised by type • responsible officers have been allocated to manage the actions put in place to mitigate the risks • the number of corporate risks have been reduced from 16 to 10 • there has been a significant increase in the number of actions put in place to manage the remaining risks. Work is ongoing to revise the council's risk management strategy by 31 December 2014 and to improve the robustness of the process for recording and monitoring service risks by March 2015. We will continue to monitor this area as part of our 2014/15 audit.
Welfare reform The changes resulting from Welfare Reform are considerable and will have significant implications for the council, its staff and benefit claimants. Inverness will be the first location in Scotland for the progressive rollout of universal credit. ***Risk: the council may fail to meet the challenges of supporting the delivery of the welfare reform agenda.***	We monitored the impact of the changes resulting from Welfare Reform through review of committee papers and discussion with officers. The council is responding well to the challenges of these reforms. Officers have participated in discussion and working groups with both the Scottish and UK Governments and Inverness is the only Jobcentre in Scotland to administer claims for Universal Credit. The Director of Finance reports quarterly to the Resources Committee on welfare reform and other welfare initiatives.

Appendix IV – Action plan

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/11	**Whole of government accounts** The WGA process requires the consolidation pack to be reviewed by management prior to submission to Audit Scotland. The council's original WGA submission failed the initial (gateway) checks undertaken by Audit Scotland although it had been signed off as reviewed by the Director of Finance. **Risk** The consolidation pack submitted for audit does not pass the gateway checks and has to be revised and resubmitted. **Recommendation** Procedures for completing the WGA consolidation pack and management review checklist should be reviewed to ensure that the pack submitted for audit is in line with the council's financial statements.	WGA consolidation pack and management review checklist will be reviewed at year end to ensure in line with the group accounts workings prior to submission to audit.	Finance Manager (Accounts and Central Services)	30 June 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/12	**Intercompany accounts** Our audit of the pension fund's accounts raised a number of queries about the intercompany balances included in the council's accounts which took significant time for officers to resolve. Officers are investigating why the council is not reimbursing the fund for all of the strain on the fund costs paid on its behalf and to identify the make up of the unexplained balance. **Risk** Transactions between the pension fund and the council are not correctly disclosed in their respective financial statements. **Recommendation** Officers should regularly review the transactions posted to the intercompany accounts to ensure that the correct amounts are disclosed in the respective accounts and transferred between the pension fund and council bank accounts.	There are compensating payments from and to the council accounted for through the intercompany account. A review will be undertaken to determine the monthly payments to be made to and from the pension fund to reimburse either the council or the pension fund for payments made one each others behalf.	Finance Manager (Corporate Budgeting, Taxation and Treasury)	31 December 2014

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
3/12	**Capital accounting** A number of adjustments were required to the non-current assets figures included in the unaudited balance sheet. Adjustments were also required between the revaluation reserve and capital adjustment account. A number of areas have been carried forward for further discussion in 2014/15 including how the council accounts for non-enhancing capital expenditure, the need to account for investment properties within the council's balance sheet, and the importance of internal consistency in disclosures within the financial statements. **Risk** Potential misstatement of the council's financial statements. If amounts are material, the accounts may be qualified or the audit may not be completed by 30 September. **Recommendation** The council should review and amend its capital accounting procedures to reflect our 2013/14 audit findings.	Capital accounting procedures will be reviewed and amended as necessary to reflect the findings from the 2013/14 audit.	Finance Manager (Accounts and Central Services)	31 March 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
4/13	**Housing revenue account** The reconciliations provided to audit contained small differences between the ledger position and that recorded in the housing information system for which satisfactory explanations could not be provided. **Risk** Potential misstatement of the council's financial statements. If amounts are material, the accounts may be qualified or the audit may not be completed by 30 September. **Recommendation** The council's procedures should be amended to ensure that differences on reconciliations are investigated and resolved throughout the year and as part of the year end procedures.	A review of the reconciliation between the housing information system and the financial ledger will be undertaken by internal audit and the finance team (Community Services).	Head of Internal Audit and Finance Manager (Community Services)	31 December 2014

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
5/13	**Final accounts procedures** During our audit we identified a number of instances where the council's balance sheet included both a debtor and a creditor for the same transaction. Investments were also misclassified in the unaudited balance sheet. **Risk** Potential misstatement of the council's financial statements. If amounts are material, the accounts may be qualified or the audit may not be completed by 30 September. **Recommendation** The council should amend its final accounts processes to ensure that only valid debtors and creditors are included in its financial statements and that investments are correctly classified.	Final accounts processes will be reviewed to include a review of debtors and creditors for possible overstatements and a check on the classification of investments.	Finance Manager (Accounts and Central Services)	30 June 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
6/13	**Capital fund** The council has established a capital fund into which it pays developers' contributions and council tax income from second homes. Schedule 3 of the Local Government (Scotland) Act 1975 specifies that a capital fund can only be used to finance capital expenditure or the repayment of loans principal. The council had not correctly accounted for capital expenditure funded from the capital fund in the unaudited accounts. **Risk** Potential misstatement of the council's financial statements. If amounts are material, the accounts may be qualified or the audit may not be completed by 30 September. **Recommendation** The council should amend its final accounts processes to ensure that it correctly accounts for capital expenditure funded from the capital fund in future years.	Final accounts processes will be reviewed and updated prior to next year end. A review of the classification of the Landbank Fund and the balance of developers' contributions will also be undertaken.	Finance Manager (Accounts and Central Services)	31 March 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
7/13	**Building dilapidations** The council leases a number of buildings which will require to be returned to their original leased condition at the end of the lease. The council currently does not recognise the costs associated with this future reinstatement work within its financial statements. **Risk** Potential misstatement of the council's financial statements. If amounts are material, the accounts may be qualified or the audit may not be completed by 30 September. **Recommendation** The council should investigate whether a reliable estimate can be established in order to make provision for these costs within the financial statements.	This will be reviewed as part of the council's asset management strategy. Such costs only materialise should the council decide to vacate the premises, so dilapidation is a material consideration in developing a business case for vacating premises. As such the council does not believe that it needs to make provision for such costs, but will review this position prior to completion of the 2014/15 accounts.	Director of Finance / Director of Development & Infrastructure	31 March 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
8/14	**Heritage assets** No heritage assets were included in the council's balance sheet in 2013/14 although heritage assets totalling £1.578 million were valued by Sothebys which did not belong to the common good funds. **Risk** Potential misstatement of the council's financial statements. If amounts are material, the accounts may be qualified or the audit may not be completed by 30 September. **Recommendation** The council should update its balance sheet disclosures in 2014/15 and create a new category of heritage assets. A wider review should also be undertaken to identify other heritage assets for inclusion in the council's balance sheet.	Assets will be reviewed prior to the year end to identify heritage assets. These will be brought on to the 2014/15 balance sheet.	Finance Manager (Accounts and Central Services)	30 June 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
9/15	**Local Authority Accounts (Scotland) Regulations** The revised regulations require that the audited accounts be considered and approved for signature by the Audit and Scrutiny Committee by 30 September. **Risk** The new requirements will not be met in 2014/15. **Recommendation** The council should review its final accounts timetable and processes to ensure that the new requirements set out in the revised regulations can be met. The timing of the Audit and Scrutiny meeting should also be reconsidered.	The Audit and Scrutiny Committee meeting on 24 September 2015 will consider the 2014/15 audited accounts. We will meet with Audit Scotland to review the final accounts and audit timetables to ensure that the new deadline is met.	Head of Corporate Finance	24 September 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
10/18	**Integration of adult health and social care** The first two years of the council's partnership with NHS Highland have been financially challenging for both parties. The council has agreed to provide additional funding over the next three years which it plans to partly fund from balances (£2 million) and its preventative spend budget (£2 million). The council will consider how it will fund the remainder of its additional contributions as part of the work required to deliver a balanced budget for 2015-19. **Risks** • The council is unable to provide the agreed additional funding without reducing the funding for other frontline services, or further reducing balances. • The expected benefits (more efficient use of resources and improved outcomes for service users) of integration are not realised. **Recommendation** The council should continue to monitor progress made by NHS Highland in redesigning adult health and social care services to ensure that the benefits expected from integration are realised.	The budget performance of Adult Social Care will be reviewed regularly and regular meetings between the Directors of Finance will review the position.	Director of Finance	Ongoing

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
11/21	**Charitable trusts** The council's two charitable trusts are governed by trustees. We noted that there had been no trustee meetings during the year, nor for a number of years prior to this. **Risk** Trustees are unable to demonstrate proper stewardship of the trusts' funds. **Recommendation** Regular trustee meetings should be held to enable trustees to consider and agree on how funds are to be managed and disbursed.	A review of the governance required for the two new Charitable Trusts will be undertaken. Responsibility for day to day administration is currently delegated to the Corporate Manager. The Corporate Manager can, in conjunction with local ward members, award grants up to £10,000. Larger grants or those involving more than one ward are submitted to the Resources Committee for consideration.	Director of Finance / Depute Chief Executive	31 December 2014

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
12/24	**West Link road** In last year's report on the audit we highlighted that, given the scale of investment required in the West Link road project, it was important that members continued to receive regular updates on cost so that they could effectively monitor developments. The last update members received on the project was more than a year ago, in September 2013. **Risk** The council's governance arrangements do not ensure adequate scrutiny of performance against the council's capital programme. **Recommendation** Capital project and programme information should be routinely provided to members including performance against estimated costs, and the timetable for project implementation. Explanations for cost, time and scope changes should be clearly set out together with lessons learned for future capital projects.	This is a significant project and costs are currently being reviewed as part of a wider review of the council's capital plan. The Resources Committee receives regular monitoring reports, but the council will investigate how these can be enhanced.	Director of Finance	31 December 2014