AGENDA ITEM 4a

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The Highland Council

External Audit Annual Report to Members and the Controller of Audit - DRAFT

2016/17 Financial Year

28 September 2017

Contents

Summary of our audit plan:

Our materiality has been updated based on unaudited financial statements to £7.588 million (1% of gross 2016/17 expenditure)

Performance materiality is set at £4.932 million and we have reported to management everything identified over £75,880 (1% of materiality)

Financial statement audit risks were: management override of controls; risk of fraud in revenue recognition; and valuation of property assets. Other risks were: completeness of operating expenditure and employee remuneration.

We identified four wider scope risks in relation to: future financial sustainability; use of resources; governance and workforce planning.

We can confirm we are independent of The Highland Council and our objectivity is not compromised in accordance with International standards on Auditing (UK & Ireland) and APB ethical standards for Auditors. No non-audit services have been provided to The Highland Council in 2016/17. Our audit fee was as set out in our audit plan dated March 2017 and was £403,150 (£234,580 related to auditor remuneration and £168,570 Audit Scotland contributions including performance studies).

Key Messages

We intend to issue an unqualified opinion on:

- True and fair view of the financial statements
- Other prescribed matters

This report is a summary of our findings from our external audit work for the financial year ended March 2017. Our work has been undertaken in accordance with International Standards on Auditing (UK & Ireland) and the Code of Audit Practice (2016).

Our report is addressed to the elected members (in their role as those charged with governance) and the Controller of Audit. This report will be published on the Audit Scotland website at: www.audit-scotland.gov.uk

This report has been discussed and agreed with Officers, and presented to the Audit and Scrutiny Committee on 28 September 2017. We would like to thank Officers for their co-operation and assistance throughout our audit work.

Our work included:

- An audit of the 2016/17financial statements
- A review of the Management Commentary, Annual Governance statement and Remuneration Report
- Sign off of a number of grant claims
- Completion of the 'EU funding' return and Role of Boards return submitted to Audit Scotland
- Completion of the National Fraud Initiative (NFI) return and review of data matching progress

The unaudited accounts were published online and made available by the statutory deadline of the end of June. The unaudited accounts were of a reasonable quality, with the "front end" of the accounts being particularly user friendly and reflective of the Council arrangements. However, a number of adjustments have been discussed and processed in the final accounts, some which we would consider material, albeit the overall out-turn of the Council remains unchanged from that reported at the end of June.

Overall we feel the Council finance team has worked with us pro-actively over the course of the audit, and been very responsive to our queries. We will continue to build on this good working relationship in future years reflecting on how we can continue to work together in 2017/18.

This report reflects our broader reporting obligations under the Code of Audit Practice. We have provided commentary against our specific wider scope risks as well as certain aspects of The Highland Council's arrangements as they relate to: financial management; financial sustainability; governance and transparency and value for money.

Reflecting on the Council's medium term financial strategy significant financial challenges are likely over the next 5 years with the Council looking to achieve substantial financial savings, which need to be on a recurring basis. The work of the redesign board during 2016/17 gives the Council a good platform to go forward.

The forward look of the Council is one of ambition, improving outcomes and working across Communities and a clear pathway and direction has been agreed.

For and behalf of Grant Thornton UK LLP

28 September 2017.

Financial Statements Audit

Our audit plan was presented to the Audit and Scrutiny Committee on 2 March 2017. We have not altered our planned audit approach. However, we have updated our final materiality figures based on the unaudited 2016/17 accounts to 1% of gross expenditure so £7.58 million (compared with £7.82 million in the plan).

Our audit is substantially complete, subject to the finalisation of:

- Signed letter of representation and receipt of final accounts for signing

Our year-end audit work commenced on 3 July and we had a complete set of the accounts with good supporting audit working papers. During the course of our audit we identified, as did Officers, a number of material amendments. Three of these adjustments changed the overall Net Cost of Services, but none of them affected the General Fund position. However these errors could have been previously identified and challenged when preparing the draft financial statements. See **Action Point 1**.

Overall the Finance team were pro-active and worked quickly with us to resolve audit queries which was appreciated and we will continue to build on this good working relationship in future years.

We have reported all potential audit adjustments identified above £75,880 to management (the level we consider to be trivial to the accounts); along with identified disclosure enhancements.

A summary of corrected adjustments and disclosure amendments are set out in Appendix 1.

Internal Control Environment

During the year we have sought to understand Highland Council's overall control environment as related to the annual report and accounts. In particular we have:

- Considered procedures and controls around related parties, journal entries and other key entity level controls
- Performed procedures around IT general controls
- Performed walkthrough procedures on the design of key controls around; operating expenditure, Employee Remuneration, Non grant revenue, Property, plant and equipment and the processing of journals

No material weaknesses in the accounting and internal control systems were identified during the audit which could have an adverse impact on Highland Council's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. However, we did identified some control deficiencies which are set out in this report.

Under ISA's we are required to report to those charged with governance the main issues arising from our audit of the Annual Accounts and Report.

This report discharges our obligations under the relevant ISA's.

We identified a defective control around the identification and elimination of internal recharges. Our work on payroll prompted the finance team to identify a material reconciling item which was an internal recharge relating to labour costs charged to former significant trading operations, which were brought in house during 2013/14. This balance had not been eliminated when preparing the Council annual report and accounts resulting in a double count of income and expenditure. See **Action Point 2**.

Our review of exit package disclosures noted that a number of teachers had been incorrectly excluded from the unaudited accounts. See **Action Point 3.**

We noted a control issue around the lease register. The draft figures were reviewed and discrepancies were noted when tracing a sample to supporting documentation. See **Action Point 4**

Internal Audit

As set out in our plan we have not placed formal reliance on the work of the in-house Internal Audit function during 2016/17.

The Internal Audit function confirmed compliance with the Public Sector Internal Audit Standards as part of their Annual Report. An external assessment of the Internal Audit function was completed in the year through the Scottish Local Authorities Chief Internal Auditor Group (SLACAIG) which was reported to Audit and Scrutiny Committee at the 2 March 2017 meeting.

This report highlighted that overall the function generally conforms with standards, with 7 areas of full conformance noted and 6 areas of general conformance. There were no areas of partial or non-conformance noted.

We have reviewed the internal audit plan, and the internal reports considered relevant to our external audit, in particular reviews of; IT security, debtors and rental income.

Based on the work throughout the year, Internal Audit have concluded that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. They have provided an opinion that reasonable assurance can be placed on the adequacy and effectiveness of the Council's framework of governance, risk management and control.

Overall internal audit are sufficiently resourced to undertake the internal audit programme.

Highland Charities Trust and Highland Council's Charitable Trusts

We are registered as appointed auditors to provide an audit opinion on charitable trusts registered with the Office of Scottish Charities Regulator (OSCR) where the council, or some members of the council, act as sole Trustee.

Regulation 7 of The Charities Accounts (Scotland) Regulations permits charities that have a common purpose of shared management are a single set of 'connected charities' accounts. In line with this guidance, and with the approval of OSCR, Officers have prepared sets of connected charities accounts. We have undertaken audit procedures for the Council's two such charities: Highland Charities Trust and the Highland Council's Charitable Trusts and provided the Council with separate audit opinions for these. No issues arose that we wish to draw Members attention to.

Statutory Trading operations (STO's)

The Highland Council has one significant trading operation; Fishery, Piers and Harbours. We have summarised financial performance over the rolling three year period in the table below:

STO	2014/15 (Surplus) /Deficit £000	2015/16 (Surplus) /Deficit £000	2016/17 (Surplus) /Deficit £000	3 Year Cumulative (Surplus)/ Deficit £000
Fishery, piers and harbours	(96)	(1,113)	(652)	(1,861)

We note that this STO has complied with the breakeven requirement over a rolling three year period. Officers have confirmed that they have reviewed this STO and are satisfied that it still meets the requirements to be classified as a significant trading operation.

Audit risks set our in our external audit plan

Our audit plan set out a number of identified audit risks, including the two presumed risks under International Standards of Auditing (management override of controls and the risk of fraud in revenue recognition). Set out in an appendix to this report is a detailed explanation of the work we have undertaken in relation to each risk and our conclusions. This can be summarised as:

Audit Risks in our plan	Conclusion
Risk of fraud in revenue recognition	Satisfactory
Management override of controls	Satisfactory
Valuation of property assets	Satisfactory
Risk of fraud in expenditure (practice note 10)	Satisfactory
Employee remuneration	Satisfactory

The narrative elements of your annual report and accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding of The Highland Council and the financial information set out in the accounts, alongside the guidance in the local Government Code of Practice and additional supporting guidance. We have set out our observations below.

Management Commentary

- The report outlines performance analysis and highlights the key issues and risks facing the Council, aligned to the Council's refreshed risk register.
- All required disclosures included in line with the relevant guidance
- We have confirmed financial performance analysis included is in line with our understanding and work performed.
- We are satisfied that management commentary is consistent with our knowledge of the council and no key information has been omitted
- The management commentary is very clear and makes good use of diagrams which is particularly helpful for users of the accounts who are less familiar with financial accounting. This commentary is one of the best examples we have seen.

Annual Governance Statement

- All key elements are included within the annual governance statement and is in line with the recommended disclosures
- Each Director has signed off to the Chief Executive to provide assurances to allow him to provide overall assurance in the governance statement. In addition, the Standing Committees have also provided an assurance statement. No matters of note raised in any of the statements
- This approach is in line with best practice and provides a clear paper trail behind the annual governance process.

Remuneration report

- The remuneration report has been completed in line with the Local Authority Accounts (Scotland) Regulations 2014 and the CIPFA Local Government Code
- We have audited the financial information included in the remuneration report (marked audited information). We have no matters we wish to bring to your attention.

Judgements and estimates

We consider other aspects of your annual report and accounts, in particular key areas of judgement. We have summarised below our observations in these key areas:

Accounting Policies

- Accounting policies are in accordance with the CIPFA Local Government Code of Practice and we consider these to be appropriate to The Highland Council.

Accounting estimates and judgements

- We have identified and gained comfort over the following key estimates and judgements:
- Property valuation arrangements including assessment of impairment risks
- Pension fund liabilities of £520.1 million calculated using information from the Actuary
- Bad debt and other provisions. (£37.7 million bad debt provision (including Council tax debt), and £2.0 million other provisions)

Going Concern

- The Highland Council has an agreed budget for 2017/18 of £566.3 million, including forecast savings of £14.3 million and continues to identify further savings.
- Given the nature of The Highland Council's activities delivering services to a community within a fixed geographical location, as set out in various legislation, we do not have reason to consider that The Highland Council will not continuing to operate over the next 12 months from the account signing date. See additional commentary around future financial sustainability risks beyond this period.

Timing of transactions and period in which they are recorded (Cut off assertion)

- We identified one cut off issue related to the recognition of capital grants which is corrected and no further issues were identified from our additional testing.
- Through our substantive audit testing we did not identify any other concerns over timing of transaction or the period in which they were recorded.

Impact on the financial statements of any uncertainties

- No uncertainties have been identified which have an impact on the final annual report and accounts.

Accounts Commission Strategic Priorities

The overarching Council plan has been reviewed and is built on solid, clear objectives which articulate the Council vision

The Council invests in Elected Member training to support members in enhancing scrutiny and decision making

The Council continues to evolve and is very clear on its priorities and ambitions. The Council is open and transparent in its decision making and presents a balanced picture of performance and the challenges ahead.

Performance information is accessible and makes good use of comparative data which is visually presented presenting a balanced picture of performance

The Council is open and transparent in its decision making – all meetings are available on-line and the website is easy to navigate

The Redesign Board has made good progress and a clear way forward was approved in September 2017. This is ambitious but founded on solid principles that have worked well to date

The revised leadership structures introduced for 2017/18 are streamlined, aligned to Council priorities and reflect the Council's desire to be efficient and focus on improving outcomes

Council Plan

Highland Council has developed seven core values: listening, open, valuing, improving, supporting, partnering, and delivering. These values underpin the respective Council strategies and the culture the Council is continuing to develop.

The Council's corporate plan "Highland First" has been in place since 2015 and sets out the strategic commitments of the Council. A performance framework is in place to support the Highland First corporate plan. From September 2017 Highland First has been replaced with the new programme following the changes in administration – "Local Voices Highland Choices".

The strategic commitments are supported by a series of commitments, a responsible Lead Officer and a suitable series of performance measures. The priorities are:

- Community led Highland
- Well served Highland
- A fairer Highland
- Inverness City – The capital of the Highlands

Openness and transparency

The Council publishes all information on the Council website. Council meetings are recorded and easily available alongside the respective minutes and reports. Based on our review of the website we noted that it is easy to navigate, makes good use of diagrams to display information and performance information is readily available.

For the 2017/18 budget setting process the Council like other Local Authorities made available a budget simulator as part of the consultation process. This enabled citizens to consider how they would set the budget for the year ahead, what they would prioritise over other areas. This was a good tool which received good feedback, and showed to members of the public in a easy to understand, transparent way that the Council cannot afford to spend on services the way it currently does. During the period the tool was available 1,026 budgets were submitted, and as budgets could not be submitted until they balanced, all showed ways of achieving the anticipated savings for 2017/18. Services prioritised by the public as part of this exercise included: Children, young people and Education, services for vulnerable adults and roads and bridge maintenance.

Elected Member Training

The Council established an Officer group who met from October to June 2017 to identify respective training needs from pre-election, induction and then ongoing development. The Council's Learning and Development team worked with the Improvement Service and specialist training providers to develop materials, addressing Member needs and supporting the Council priorities.

In addition, each Member was supported during their first few days in office by an Officer and received additional orientation support from administration, ICT. In line with the Council's digital approach Members have access to resources hosted on the Members' intranet and online learning resources. Members feedback on the induction process has been positive.

A programme is in place throughout 2017/18 related to ongoing members development focused on key topics and wider skills and behaviours,

Public Performance Reporting

The Council readily makes performance information available to members of the public and from our review this information is balanced, and represents a fair picture of the Council. The Council regularly produce a Council magazine which is available on-line. The Spring 2017 edition set out a comprehensive overview of performance of the Council. The section was well laid out, made good use of graphics and case studies linked to the Council priorities.

On an annual basis the Council undertakes a performance and attitudes survey which is used to gauge levels of satisfaction with Council Services. This was last undertaken for 2015/16 and showed an overall satisfaction rate of 73% compared to 83% in prior year. A common theme for improvement is around the Council's roads network and maintenance of roads.

Also included in the magazine was an analysis of the latest performance data available via the statutory performance indicators and Local Government Benchmarking framework data. Being graphical in nature it was easy to identify good as well as poorer performance compared to others.

During 2015/16 the Council ranked in the top quartile in a number of places for example: residential accommodation for looked after children (by spend), how much does the council spend on fostering/family placements for looked after children, level of sickness absence, people needing social work support getting to chose how their support needs will be met.

The Council ranked in the bottom quartile for: spend on secondary schools per pupil, how many council buildings are suitable for current use, how many women are in the top 5% earners, spend per person on residential care for older people and how many local unclassified roads are in need of repair.

Future Council management structure

One of the recommendations of the redesign Board was a leaner management structure and the Chief Executive set out in a paper to the full Council on 7 September 2017 the proposals for a structure of 4 Directorates, merging Finance and Corporate Development. The 4 Directorates are: Corporate Resources, Community Services, Development and Infrastructure and Care and Learning. The proposals further reduce the number of senior managers at the Council which is in addition to the 83 senior manager posts removed over the last 9 years, saving the Council circa £6million. Some of the drivers behind the restructure include the shift to localism, creating affordable proposals within existing resources and recognising that aspects of some functions will need arrangements at different geographies. When considering future management structures the Council did a benchmarking exercise comparing the Council's arrangements with 13 Councils, largely rural in nature. The report outlines that the Council has 0.34 Chief Officer/Director/Head of Service posts per elected member, which is smaller than other Local Authorities.

Underpinning the streamlined structure are a number of other changes including:

- Slimmer Care and Learning service focused only on care and learning functions
- All property functions except housing maintenance within Development and Infrastructure services to support improved performance and decision making in one place
- Housing maintenance within Community services will be simplified to improve performance and reduce costs. Also all operational transport functions will fall under the remit of Community services
- Create a new commercial team within Corporate Resource Services to support the Commercial Board
- All ward manager roles will fall under the strengthened Chief Executive office with the Council's Head of Corporate Governance and the Monitoring Officer role also falling within this remit.

These changes will further streamline Council structures, making decision making simpler but also by re-aligning what falls under certain Directorates support the Council in the drive to enhance efficiency and deliver improved performance outcomes.

Redesign Board and forward look work plan – 2017/18 and beyond

Following Local Government elections in May and the refreshed vision for the Council the remit of the redesign board has been reviewed and a forward looking work plan proposed in September 2017. The paper and options presented to Council reflect on the work of the previous redesign board and from discussions and ideas generated from the newly formed redesign board over the summer. Central to the work of the design board is the redesign statements approved by the Council in June 2017. The agreed vision for redesign is that the Council needs to be:

1. More open minded to new ways of delivering services with 10 options identified
2. More commercially minded, raising income to sustain services and jobs across the region
3. More community minded by listening locally, widening participation in decision making, supporting community bodies to do more and to target support to those particular people and places in most need.

Based on previous experience it was emphasised that Council staff were central to identifying and making the changes needed and new ways of engaging staff should be built into the redesign process through developing a programme of organisational change and support. Lastly, it was identified that a new way of working between Members and Officers was needed to support a constructive working relationships across Member groups with staff, and earlier involvement by members in policy development.

The redesign board will link with the new policy development groups and the Commercial Board to ensure no duplication.

Peer reviews are built into the redesign process and the paper agreed a core number of areas to be subject to peer review during 2017/18.

Reflecting that the previous redesign process was very internal to the Council there is a desire to make the forward looking programme focused on identified Council behaviours and those that are required in the future, exploring these with the Council's partners.

Overall the redesign board has a clear remit, supported by a work plan which is timetabled across the year. The vision underpinning the board reflects the ethos and ambitions of the Council and are well articulated.

Although very much linked to affordability, they also set out the future culture of the Council that Officers and Members want to create, and that is one of ambition, doing the right thing for communities and embracing change.

City Region Deal

The Inverness and Highland City-Regional deal amounts to £315million and was signed in March 2016. It is anticipated that the deal will help secure long term productivity and economic growth for the region, including unlocking additional investment by the private sector. Specific funding will be used to enhance digital connectivity, digital healthcare, skills, innovation and infrastructure. This deal represents a great opportunity for the Highlands to continue to grow and support economic development, attracting investors into the area and continuing to support the tourist economy.

A key anticipated benefit from the city deal funding is attracting and supporting younger people to live, work and study in the region, which will hopefully shift the trend of the outward migration from the Highland area, which is referenced in the Council workforce plans also.

Financial Management and Sustainability

For 2017/18 the Council needs to achieve savings of £20 million to achieve a balanced budget. Recognising the financial challenges these savings need to be recurring which will be difficult

Financial papers are sufficiently detailed and during the year Finance were accurate in forecasting budget to actual with no significant variations.

The Council continues to have one of the lowest general fund reserves which means unexpected pressures may not be able to be fully funded and will limit future investment

The financial challenges facing the Council over the medium term are substantial. The revenue consequences of borrowing should be carefully considered and the Council does need to consider its future reserves position.

During 2016/17 the Council spent £105.4million on capital projects of which £74.9million was funded from borrowing

The longer term financial strategy is clear and built on work undertaken to date. The assumptions set out are reasonable and focus on income as well as cost reduction

Council borrowing remains in the upper quartile for all Scottish Council's and the revenue costs of borrowing need to be effectively built into decision making

Financial performance 2016/17

The Council achieved a small surplus as at 31 March 2017 of £1.8 million. This was due to net spend on services being £0.8million less than planned, and an additional £1million of income received in-year than forecast. The £1.8million has been credited to the general fund reserve to spend in future years.

During the year the Council spent £293.1 million on employee costs, with borrowing costs of £55.8 million and other costs of £388.2million which were slightly higher than anticipated.

Council funding for 2016/17 consisted of £313 million in Revenue Support Grant, £128million Non-Domestic Rates and £105.6 million from Council tax.

The Housing Revenue Account (HRA) reflects the rent charged for the 13,957 council houses owned by the Council and associated costs with income and expenditure in-year of £50.599 million to achieve a break-even financial HRA position.

During the year the Council contributed the year-end surplus to the useable reserves. However, £2.3million of useable reserves were used to fund one off costs arising in year, mostly to facilitate the staffing reductions. Given the level of Council reserves this is not sustainable in the longer-term.

Financial performance in-year

The Council's financial position is reported to the Council's resources committee throughout the year. Budget to actual tends to track accurately during the year. As at quarter 3 a small overspend was anticipated of £1.517 million, but the outturn at year end was an underspend against budget of just under £1million through continuing to manage spend.

The budget set at the start of the year included £34.896 million of savings. In year the Council achieved £28.440 million of planned savings in full, alongside £3.870 million which were partially achieved. £2.586 million were not achieved related to savings which had not been allocated to individual services, and certain savings planned in Care and Learning.

Given the size of the savings this was a good achievement and demonstrates that savings identified can be delivered in-year.

Capital Planning

During 2016/17 the Council spent £105.4 million on capital, excluding HRA Capital spend. Of this, there was an overspend of £7.9million on in-year capital projects in particular River Ness flood prevention scheme, Portree Hostel, Cromarty Primary School, Caol Joint Campus, modular accommodation at special schools and the Kingussie Council Offices. In addition, £28.3 million of capital expenditure was initially planned for 2016/17 but delayed into future years.

The capital programme seeks to match the money available to capital spend by planning to spend more than initially set out as affordable in the expectation, based on historic trends, that some planned expenditure will not be delivered in-year. Money is only borrowed to fund capital expenditure as it occurs and not in advance.

Out of the total £105.4 million spend in year, £74.9 million was funded by borrowing. The largest area of capital spend for the Council continues to be on school buildings and investment in roads and bridges.

The Council acknowledge a key risk going forward is the need for the Council to review its capital spending priorities and that the capital programme is affordable. This is recognised as being challenge given the level of investment needed to maintain and develop the school estate and the roads infrastructure.

Group Accounts

The Council has interests in other organisations and these are consolidated into the Council's group accounts. The Council group is made up of: Highlife Highland; Highland and Western Isles Valuation Joint Board, Inverness Common Good Fund, Nairn Common Good Fund and HITRANS. Total comprehensive income and expenditure for the group was £177.4million, with net assets and total reserves of £1,078.6 million and a pension liability of £531.0million.

Budget for 2017/18

The Council approved the budget for 2017/18 in February 2017. The Budget included an increase in Council Tax of 3% as well as the approval of a number of savings programmes to ensure a balanced financial position could be achieved.

The papers presented were very detailed but in a logical structure and it was clear for Elected Members the processes that had been followed and the thought process for what was proposed.

The identified budget gap was circa £20 million and this represents the savings the Council need to identify and achieve to achieve a balanced budget.

£1.4 million in savings for 2016/17 were not achieved so this was carried forward into the setting of the 2017/18 budget. Recognising the size of the Council and the extent of savings that need delivered year on year this was a good position in terms of savings not realised carried forward, and demonstrates a good track record on delivering against plans.

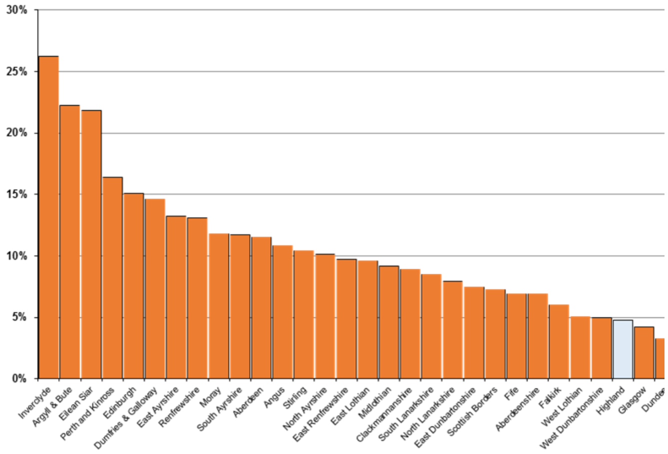
Expenditure for 2017/18 is budgeted at £581.255 million, with core Scottish Government income budgeted at £437.493 million and Council tax income of £123.418 million (including the 3% Council tax increase and the impact in the change of the Council tax multiplier).

The paper included a breakdown of savings per individual Directorate. Recognising a number of services are in effect considered "protected" Corporate Services, Development and Infrastructure and Finance are earmarked as delivering the highest proportion of savings. This is consistent with prior years but looking forward, identifying savings in these areas will become increasingly difficult and this option alone will not ensure future financial sustainability.

The Council continues to run an Employee Early Release Scheme (EERS). In January 2017 326 applications were received. Recommended applications following review were for 26 individuals, 22.9 FTE posts with an associated cost of £0.327 million. These applications were funded from the un-earmarked general fund balance. The EERS scheme to date has allowed the Council to reshape its workforce and reduce staff costs. However, long term it is not a financially viable solution as although savings are generated it is a costly option and this is referred to in the Council's workforce plan.

Unearmarked general fund reserves

Unearmarked general fund reserves represents the Council's main source of funding for delivering transformational change and allowing the Council the capacity to absorb any unforeseen budget pressures during the year. At the start of 2017/18 this balance is £11.363 million (representing 2.02% of the Revenue budget for 2017/18). This is low compared to other Councils and at the bottom end of the recommended range of 2% to 4% of total revenue. The graph below highlights Highland Council's reserves as a percentage of total revenue in comparison.to other Councils



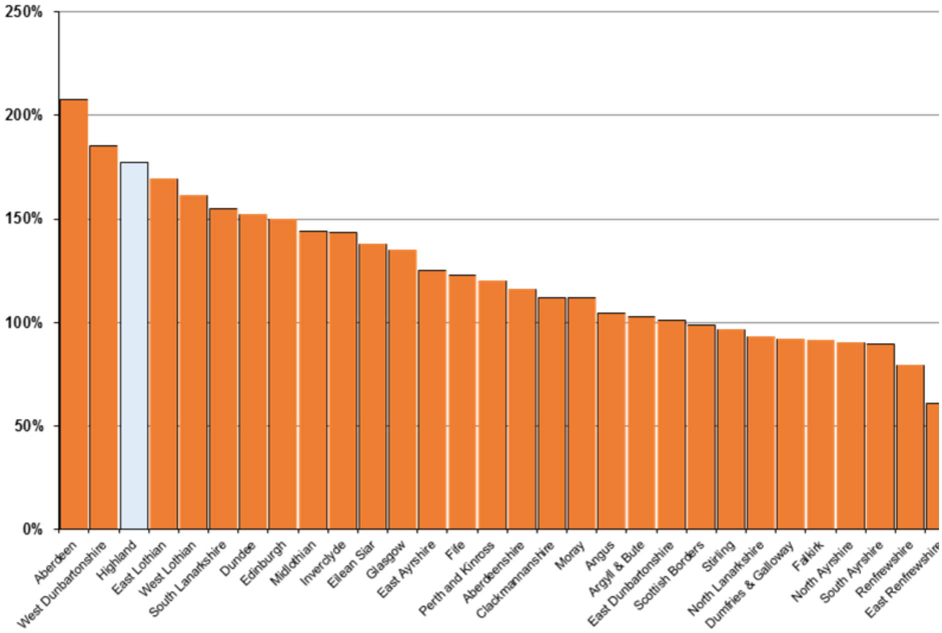
Council Officers recognise this is a risk to the Council and propose the re-building of reserves as part of the Council's longer term financial strategy in order to mitigate the risks but without holding in effect "too much" in reserves. Any additional savings achieved during 2017/18 will be allocated into this reserve for future investment.

Treasury Management Strategy

The Council has adopted the CIPFA Code of Practice on Treasury management in Local Authorities and this is reviewed and approved on an annual basis. The strategy is developed using the Council's treasury management expertise supplemented by forecasts from the Council's treasury advisors, Capita. The strategy emphasises the importance of ensuring that capital expenditure increases are limited to a level whereby corresponding increases in revenue charges are affordable and within the projected future income of the Council. To date the Council has benefited from lower borrowing costs due to low interest rates, and common to all Local Authorities has looked to make best use of the low rates available on temporary borrowing.

However, looking at percentage level of debts (borrowing) compare to other Scottish Local Authorities we would highlight that the Council is in the upper quartile when comparing debt to net revenue budget:

Comparing debt to net revenue budget



The Council should continue to review borrowing costs linked to the capital programme and consider the revenue implications and longer term financial affordability, linked to the draft financial strategy. **Action Plan 7**

Five year financial planning

Officers have prepared a financial strategy for the period 2018 to 2023 which was presented to the Council meeting in September 2017 for initial discussions. The paper sets out a funding gap over this period of between £129million and £186million. The gap is wide, as the paper sets out a number of assumptions particularly related to grant income from the Scottish Government. A mid point of £158.5million is calculated taking into account the following assumptions:

- Annual pay inflation of 1.5% with non-pay costs with inflation of 1%
- Annual 0.5% increase in pension rates
- Inclusion of general budget pressures of £7.5million per annum
- Annual increase of loans fund charges of £2.5million to fund the capital programme
- Annual reduction of grant funding by 3.5% per annum

The Council has forecasted the savings to be delivered as being consistent per annum, where as others have looked at savings patterns in prior year, with greater savings geared to 2018/19 and 2019/20 financial years. Even at this level a change in the assumption could have a big impact on the Council's achievement of breakeven.

Detailed budget planning work will be undertaken over the next couple of months to align the financial strategy and budget to the new political priorities of the Council. The paper proposes five work streams: prioritisation, efficiency, redesign, commercial and income. This demonstrates that the Council are considering options to increase income as well as reduce the Council's cost base.

The paper reflects that given the reducing resources there is a need to prioritise and low priority areas or those areas not directly related to the strategic priorities of the Council will see a reduction in services or a possible removal of a service. Within the constraints of what is considered a protected or non-protected budget for example PPP costs, loan charges and Education are all currently protected.

In addition the Council has planned for a degree of efficiency being achieved year on year across all non-protected budgets, in addition to the savings plans. It is anticipated savings will come from corporate initiatives including the shared procurement service with Aberdeen and Aberdeenshire Councils. In addition, the investment of LEAN will be used to support managers in identify savings.

Redesign is planning on building on the existing redesign programme which initially focused on individual services. The aim is to fundamentally change the way the Council provide services through for example digital, how the Council can partner with and enable community organisations to provide services and increased localism and what that could mean for service provision.

Increased income from commercial activities is considered to be an option for delivering savings towards the end of the five year period. However, as set out the Council will need to consider its attitude to risk, and the opportunity risks within the current Local Government operating structures. In addition, some of the savings will need additional investment to achieve the planned transformation, and this needs considered in terms of balancing risk and reward. **See Action point 9.**

There are currently a number of services the Council provide for free but charges could apply, and this will be further explored.

A Senior Council Officer is proposed as the lead for each of the five work streams and a working group is established with appropriate service, partner and administration group member represented on each of the five. Given the potential for duplication across themes the paper recommends the establishment of an overall financial planning board. The paper reflects that the method of working of each group may vary depending on the theme being considered but the outcome from each group will be captured on consistent templates.

All Council's are going through similar processes so Council Officers should continue to speak to other Council's to consider differing approaches and lessons learnt. **See Action point 10**

Governance structures planned include an Executive Leadership Team (ELT) oversight group, responsible for monitoring progress, and the continuation of the administration budget group.

Governance and transparency

The Audit and Scrutiny Committee meets four times a year and although large at 25 members a good degree of challenge and scrutiny takes place

Fraud and Whistleblowing Policies are in place, and comprehensive guidance in available on the Council Intranet

Governance arrangements have evolved following the election and are aligned to the strategic priorities through a streamlined committee structure. This structure will need time to bed in and develop

The Corporate Governance Code is up to date and reviewed annually by the Audit and Scrutiny Committee

All Committee meetings are available to the public and are webcast on-line to ensure transparency of decision making

The refresh of the corporate risk register better reflects the core risks impacting on the Council and how the Council intends to mitigate the risks where possible

Committee papers clearly set out the options for Elected Members to consider and summarise the respective data in the main papers

Audit and Scrutiny Committee

The Council continues to have an established Audit and Scrutiny Committee and the remit of this committee remains unchanged following the local government elections in May 2017.

All meetings are recorded and the agendas typically cover: internal audit; external audit; risk management on a six monthly basis; compliance with corporate governance code; and updates on Accounts Commission and other Audit Scotland publications. Scrutiny of service performance and service outcomes takes place at the individual service committees.

Recognising the number of elected members the Council has, and the aim of balancing political representation the Committee is large, at 25 members.

Based on our attendance during the year we noted that on the whole there was a good debate and a number of questions asked. We also note that training has been provided to members of the Audit and Scrutiny Committee to support them in their role going forward and in particular the need to be balanced, and leave political viewpoints to one side.

Looking forward the Council should continue to review the effectiveness of the Audit and Scrutiny Committee and in particular consider whether the size of the committee still supports effective scrutiny. **Action point 10**

Corporate Governance code

The Council has in place a Code of Corporate Governance. This was last reviewed and discussed at the Audit and Scrutiny Committee in September 2016. The code is reviewed annually with the next update being presented to the Council in October and then to the Audit and Scrutiny Committee in November.

Fraud and standards of conduct

The Council has an established fraud policy which is easily accessible on the Council's intranet. In addition to the policy regular fraud updates and fraud alerts are shared to promote awareness. Internal audit routinely investigate potential frauds and/or irregularities producing a report which ensures lessons learnt from the incident is also widely shared across the Council.

In addition, the Council's arrangements in relation to standards of conduct are adequate. Arrangements include:

- A whistleblowing policy
- A confidential helpline for reporting fraud which is open to the public
- The financial procedures provide clear instruction on the investigation of suspected or actual fraud including reporting lines and escalation
- A code of conduct is in place for employees and for Elected Members which sets out the overarching principles and expected behaviours when undertaking Council business.

Openness and transparency

All of the Council's agenda; minutes and associated papers, unless exempt under the Local Government Act are available to the public on-line. In additional each Committee meeting is recorded as a webcast and available to view for twelve months from the date of the meeting.

Council committee structures

In June 2017 the Council approved a new strategic committee structure. The changes originated from the work of the Redesign Board and are based on three strategic committees (previously were five). The committees are: People, Environment, Development and Infrastructure and Corporate Resources. Each committee will be supported by a Policy Development Group consisting of Members, Officers and Trade Union Representatives working together to develop policy proposals for Committee consideration and approval. It is anticipated that this new structure will also support the Council in getting closer to communities and community decision making.

We will look at how this structure develops over 2017/18 as part of our wider scope considerations.

Risk management arrangements

Over the last six months the Council has reviewed and significantly refreshed its approach to risk management in particular the Corporate Council Wide risk register. The Executive Leadership Team has considered how the corporate risks reflect the future challenges the Council is facing and are linked to the strategic objectives/priorities of the Council.

On a six monthly basis the corporate risk register is scrutinised by the Audit and Scrutiny Committee and this is expected to continue. The Council has sought support and guidance from Zurich Municipal on the Council's risk management strategy, and the identification and mitigation of risk and a session is planned for the November Audit and Scrutiny Committee meeting on this topic. When refining the current risk register the Executive Leadership Team considered the risks and challenges outlined in the Accounts Commission report "Performance and Challenges 2017".

The revised register includes 9 corporate risks:

- Financial sustainability
- Security and resilience
- Legislative changes (which could significantly change the Council's role)
- Brexit
- Effective governance and local decision making
- Workforce planning
- Climate change
- Demographic change
- Safe and effective buildings

These nine risks will be supported by mitigating controls and associated action plans which will be monitored.

Supporting the risk management framework and Officer group will be established. This group will pull in risk management service and specialist expertise from across the Council and will: identify common risks; escalate risks where appropriate, monitor compliance with the Corporate Risk Strategy and share best practices.

This is a positive development in risk management for the Council with the new risk register very clear in its articulation of the risks and the potential impact on the Council. The session planned in November 2017 to engage with members of the Audit and Scrutiny Committee will be helpful in sharing the Council's understanding and consideration of risks and supporting members to contribute to the discussion and effectively scrutinise the arrangements in place.

Redesign – looking back over progress during 2016/17

At the Council meeting on 9 March 2017 the work of the redesign board was summarised, reflecting the work that had taken place during the year.

The redesign board was established in April 2016 comprising 16 Elected Members and 2 Trade Union representatives. Throughout 2016/17 the Board held 23 workshops, and updated full Council at each meeting during the year.

The work of the design board is clearly set out in full via the Council website and reflects a wide range of engagement and differing approaches as well as seeking to learn from other Local Authorities across the UK.

Six phases of work were completed, including:

Reprioritising statutory and non-statutory duties

All statutory and discretionary functions carried out by the Council were assessed and captured in one place. Those classed as essential or desirable were prioritised for review and this was approved by the Council in September 2016.

Appraising the options for change

In prioritising the Council's functions the Board identified around 120 out of 270 for review. To make this manageable they were organised into bundles of similar functions so a larger review can be carried out, mini reviews where the focus was on commercial and income generation opportunities, functions where a service review had already started. Within these reviews a peer approach was piloted involving other staff and Board members.

A key part of the service reviews were to consider a range of future options for example:

in-house and lean – This option was chosen for catering, cleaning and facilities management

to be brought back in-house – This was a strong theme in waste services and a business case is being developed,

a shared service – for example a review of depots, stores and fleet and options are identified for internally sharing more between administration for schools and business support within the Council

partnership or integrated service – Thinking around a review of children's services around residential care and mental health services

Other options explored included out-sourced, commercially run, run through a council owned company, community run, reducing demand for the service, and reducing service levels or stopping the service.

Localism and public participation objectives

All reviews were asked to consider how they could support localism. Findings reflected on decision making, service delivery options, management arrangements, and engagement of community groups. Key findings included:

Local committees should have greater budget responsibility and accountability and that the Council needed to engage more with community bodies to find new local solutions and for them to have a greater say in resource allocations (Transport)

The new local community partnerships have potential to develop and share ideas and information on service delivery needs and options

Introduction of more decentralised management approaches for example in transport, and residential places for looked after children.

Reflecting on all the information on redesign publically available a significant amount of work and progress was made during 2016/17 across a number of projects, all within consistent themes which are being taken forward into future years.

Elected Members were all engaged in the redesign process, and showed commitment to considering and taking proposals forward.

Value for money

"Local voices Highland Choices" is the new Council framework building on Highland First and sets out the vision for the Council

The workforce strategy approved in August 2017 sets out a good framework for workforce planning and addressing the aging workforce challenges

The Council continues to engage with a wide range of citizens and groups to develop the strategic priorities for the Council

At the foundation of all the Council's plans is engagement. 2016/17 was a year of consolidation giving a good foundation for all the respective future challenges the Council is facing, and the Council remains ambitious with a drive to succeed.

The Lead agency model is starting to demonstrate improved outcomes for service users and the Council will continue to work with the NHS to ensure the delivery of shared objectives

Performance reporting is clear and consistent reported at service level and full Council. Actions are in place to improve performance aligned to the strategic priorities of the Council

Of the 68 indicators benchmarked nationally the Council are in the top quartile for 7 and bottom quartile for 14

Citizens panel December 2016 – changing how the Council provides public services

As in previous years the Council undertook a survey of the members of the citizens panel in December 2016 to help shape and inform the budget setting process and the key priorities for the Council for 2017/18.

The survey was distributed to 2,346 members of the panel, and 877 responses were received. The survey was designed to support the Council re-design process and although not all saving proposals were consulted on in this manner, services impacting on the public were included.

Themes included and analysed were: street lighting, waste (including collection), street cleaning, and public transport.

Although responses were slightly lower than previous years, good coverage across the Highland area was obtained. Looking ahead the Council plan to continue to use this approach to gauge views on the service transformations proposed, linked to the budget setting process.

ICT Transformation programme

The Council has an established ICT transformation programme which consists of six core projects: Active Directory, data centre, end user computing (corporate and office 365), End user computing (Schools), review of business applications and Application portal for self service. Part of the transformation plans is the introduction of Chromebooks which is linked to the Council's strategy of improving education attainment.

These projects will run until end the 2019/20 financial year, completing at different stages.

The focus of the ICT programme board is to ensure that the new systems and solutions are fully tested and quality meets the expectations rather than potentially impact on service delivery just to meet the deadlines set at the start of the project. The project board is overseeing the delivery and regular updates are presented to the Corporate Resources committee for consideration including progress per timetable and costs per budget.

There is a clear link between the ICT investment planned and the Council's redesign plans including improving ways of working, supporting efficiency and therefore supporting Council staff continue to focus on customer service and improved outcomes.

Lead Agency Model

Highland Council and NHS Highland have in place a Lead Agency model for the delivery of Health and Social Care. Under this model a number of Highland Council Social Care staff transferred across to NHS Highland and on an annual basis the Council provides funding to NHS Highland, who determine how this money is spent in the delivery of health and social care across the Highland area.

To date there have been a number of achievements through working in partnership, in this way, for local communities.

The differing financial and governance models between NHS Highland and Highland Council have at times been difficult to navigate and culturally both organisations have different styles of working, in part due to different funding and governance models.

However, continued financial pressures within Local Government and the NHS will mean that the Council needs to continue to work with NHS Highland to review how the Council continues to ensure the arrangements in place deliver on the shared objectives between the Council and the NHS.

We will continue to review the Council's relationship with NHS Highland and the progression of the Agency Model in 2017/18.

Performance Reporting

The Council routinely assesses performance against the Corporate Plan which is the performance framework for the Council's programme "Highland First". The annual report for 2016/17 was reported to Full Council in September 2017 and set out good progress with 89% of the commitments (64 or of 72) being either complete, on track or performance maintained. For 8 commitments (11%) the paper outlined mixed performance.

Those areas which were reported as being behind target included:

- Against a target of 77% of invoices paid within 10 calendar days of receipt the Council achieved 63.3% (compared with 56.5% in prior year)
- The time taken between a looked after child being accommodated and a permanency decision has increased
- The average working day lost per employee for sickness absence for both teachers and non-teachers has increased.

There is a clear and transparent link between the overarching commitment, the individual commitments and the measurement. The performance paper given its nature is detailed but it is clear what is on track and where performance is behind what is expected. The paper could be further enhanced by setting out the actions that will be taken for those commitments that are behind expectation, this is within the supporting narrative but could be made clearer. **Action point 11**.

Local and National Statutory performance indicators

A report on 2015/16 performance was reported to the Council in March 2017, which reflects a time lag on certain national information being collated and available. Overall the report shows performance has improved by 5% or more in 2015/16 on 32 indicators. In the case of 31 indicators a decline of 5% or more was experienced. Of the 68 indicators which are benchmarked nationally the Council was in the top quartile for 7, and in the bottom quartile for 14.

LGBF	2014/15	2015/16
No. of indicators in top quartile	14	7
No. of indicators in 2nd quartile	9	17
No. of indicators in 3rd quartile	15	26
No. of indicators in bottom quartile	13	14
Rank/data not available	5	4
Total	56	68

The paper sets out the detail behind the performance and this data is also cut at a service level so that the strategic committees see in greater detail the performance against indicators relevant to its area and associated improvement actions.

Workforce planning

A number of actions were agreed in February 2016 to support effective workforce planning and Members scrutinised the first cycle of Service Workforce Plans and Service Learning plans at the relevant strategic committees during 2016/17.

The next stage is the implementation of a Council wide Corporate workforce planning strategy for the period 2017 to 2023. A draft of this strategy was discussed at the Corporate Resources Committee in August 2017.

The workforce strategy has been drafted taking into account the findings from the Audit Scotland publication "Scotland's Public Sector Workforce" published in November 2013.

Members agreed that: a consistent approach to workforce planning should be implemented across all Council services; Workforce plans should forecast expected staff numbers, skills needs and cost on a consistent basis aligned to the budget planning process; should be linked to longer term financial planning; and the Head of People and Transformation should develop guidance, toolkits and templates to facilitate workforce planning.

The draft strategy emphasises cultural change through upskilling and leadership development, and that this will be key to supporting the Council in delivering the transformational changes necessary.

The Council has an aging workforce, with a high proportion of staff aged between 41 and 60 years of age, with 41% of employees over the age of 50. Highland Council is one of the largest employers in Highland, with circa 10,000 employees across a wide geographical area.

The strategy is built around core workforce principles which include continuing to build on the Council's position as employer of choice in the Highlands, support the change agenda of localism; re-design; digital; commercialisation and efficiency, recruit to meet service outcomes and attract skilled workers, and develop transition and retraining as opportunities and alternatives to redundancy.

Overall the draft strategy sets out a clear framework and overarching principles for the way forward with a workforce planning route map, linked to the medium term Council financial plan. Work will take place during 2017/18 to further develop the necessary tools and techniques to support the strategy and put the strategy into practice.

Modern apprenticeship programme

Corporate Resources Committee at the end of August 2017 approved the Council's modern apprenticeship programme. The paper presented set out a number of options for consideration, reflecting on the introduction of the Modern Apprenticeships Levy (April 2017) and the Local Authority Social responsibility for youth development, employability and local economy.

A council wide approach was approved, adopting a corporate methodology which included the establishment of a new programme and resources to support it through the creation of a Modern Apprenticeships Team.

This programme links to the Council's desire to have a workforce with a differing age profile and that currently Highland as an area experiences mass out-migration of younger people. The paper includes a three year timetable including in year 1 engagement with schools and colleges, developing the support structures, through to year 3 and enhanced partnership working.

Staff Engagement

The Council has an active staff partnership forum and good partnership working relationships with the Trade Unions as evidenced for example in the Council's Early Release scheme and continue discussions on workforce planning. Staff are engaged throughout the redesign work as evidenced in all the redesign papers and the future work plan for redesign.

New methods of staff engagement were introduced through redesign and are now being mainstreamed. In 2016/17 the Council introduced:

- Face to face briefings across the region between staff and the Executive Leadership Team (50 were held in council offices, depots and village halls reaching over 620 staff in the summer and over 400 staff in the winter). These are now being run twice a year to follow the management briefings and involving local Members on the Redesign Board.
- The creation of a staff panel, with around 900 staff agreeing to take part in surveys.
- Developing an on-line tool for sharing ideas for improvement. The Council bought a license for one product last year and are now working on developing our own in-house tool. Last year it generated 157 efficiency ideas and 61 commercial ideas.
- Created a staff Facebook page for sharing news.
- Training over 25 staff as Lean facilitators as a way to involve staff in identifying where to make changes and streamline processes. Further staff will be trained in 2017/18.
- Involved over 40 staff in peer review teams, with the numbers growing through the next round of reviews for 2017/18.

Highland Outcome Improvement Plan

The Community Empowerment Act (2015) placed a new duty on Community Planning Partnerships (CPP) to produce and publish a Local Outcome Improvement Plan.

In September 2017 the Council prepared a paper setting out that the Highland Outcome Improvement Plan (HOIP) will provide the long term vision for the CPP. It is agreed that the HOIP will be strategic in its outlook and targeted on activity that requires partnership action. The plan includes 10 year outcomes but also year 1 and year 3 milestones/actions to deliver against these outcomes.

Based on engagement with communities and organisations across Highland the draft HOIP has been prepared and in September 2017 Members were asked their views as part of this consultation process. A substantial amount of work has gone into drafting the HOIP, including 11 engagement workshops drawing a wide range of diverse groups together.

Specifically Members were asked to consider whether the plan identified all the main risks and challenges for tackling inequality over the next 10 years?; are the 5 key outcomes proposed the right ones? And are the cross cutting themes the right ones to support the delivery of outcomes?

The 5 key outcomes are:

- Poverty reduction
- Community participation and dialogue
- Infrastructure
- Community safety and resilience
- Mental health and wellbeing

To achieve these 5 outcomes, there are 4 cross cutting themes which will be critical to ensuring the outcomes are delivered: Employability, community investment and development, digital connectivity and equality.

Appendices

Audit adjustments

There were no uncorrected misstatements noted in the year. Set out below is a summary of corrected misstatements.

Corrected misstatements

	CIES £000	BS £000	MIRS £000
Evergreen grant incorrectly recognised Dr Capital grants and contributions Cr Capital grants received in advance This was due to incorrect information provided by services.	 9,000 -	 - (9,000)	 - -
VDLF opening creditor not reversed Dr Capital grants and contributions Cr Creditors This was due to a misposting	 418 -	 - (418)	 - -
Other grant income incorrectly recognised Dr Capital grants and contributions Cr Capital grants received in advance This was identified during a follow-up review after the Evergreen adjustment was noted	 297 -	 - (297)	 - -
Cash / investments mapping issue Dr Cash Cr Short term investments This was due to a miscoding	 - -	 23,503 (23,503)	 - -
Borrowing ageing adjustment Dr Long term borrowing Cr Short term borrowing This was due to an ageing adjustment	 - -	 858 (858)	 - -
Payroll mapping adjustment Dr Service income Cr Service expenditure This was due to internal recharges not being correctly offset	 26,282 (26,282)	 - -	 - -
Payroll correction Dr Creditors Cr Debtors This was due to a miscoding	 - -	 1,684 (1,684)	 - -
Credit note adjustment Dr Creditors Cr Debtors This was due to an incorrect journal posting	 - -	 751 (751)	 - -
Community service correction Dr Service expenditure Cr Service income This was due to a mapping error	 16,645 (16,645)	 - -	 - -
Landbanking loan repayment Dr PPE Cr Long term debtors This was due to new information arising in relation to the timing of a transfer of land to settle a portion of a landbanking loan	 - -	 960 (960)	 - -
Total	**9,715**	**(9,715)**	**-**

Disclosure misstatements

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow audit committees to evaluate the impact of these matters on the financial statements. During the course of our audit process we identified some disclosure enhancements throughout the annual report and accounts. The key disclosure changes are set out below and all have been amended in the final version of the accounts.

Account balance	Impact on financial statements
Financial instruments – maturity, ageing and fair value	A number of adjustments were noted in these disclosures due to calculation errors. These were corrected in the revised financial statements.
Financial instruments – assets and liabilities	The draft figures included assets and liabilities such as prepayments which are not financial assets. These were correctly excluded in the revised version.
Financial instruments – fair value hierarchy	Per paragraph 2.10.2.29 of the CIPFA Code of Practice, local authorities are required to follow the fair value hierarchy prescribed by paragraphs 76-90 of IFRS 13 to increase consistency and comparability in fair value measurements and related disclosures. The hierarchy categorises into 3 levels. The Council did not initially disclose their fair value measurements in terms of the hierarchical levels.
Remuneration report	Additional 26 individuals / £0.7m of packages identified during the audit process and amended through revised accounts. See **Action Point 4.**

Our identified audit risks

Our audit plan identified a number of significant and other audit risks. We have set out below a summary of the work undertaken over these risks and our conclusions.

Audit plan identified risk and work completed	Our conclusion
Management override of controls Under ISA (UK&I) 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities (fraud risk). **Work undertaken:** Completed a walkthrough of the controls and procedures in place around journal entries Reviewed the key accounting estimates, judgements and decisions made by Officers in particular property valuation, bad debt provision and PPE depreciation policies Tested journal entries with a focus on large and/or unusual values; posting sources; timing as identified using our IDEA data analysis software Reviewed unusual and/or significant transactions.	**Key accounting estimates**: We did not identify any significant areas of bias in key judgements by Officers and judgements were consistent with prior years. Fixed asset deprecation: We have reviewed the council's depreciation policies and used analytical procedures to recalculate depreciation estimates. We found the councils depreciation policies are in line with the Local Government SORP. To assess the bad debt provision we reviewed the inputs used by the council and the calculation performed. We found that the percentages used by the council are based on experience, and that a significant portion of the outstanding balance has been recovered post year end through a key focus on pursuing aged debts. **Journals:** We made inquires of Officers who can post and authorise journals related to inappropriate or unusual activity with no concerns noted. We confirmed completeness of journals, and targeted large and/or unusual journals. We consider large journals to be those above our performance materiality and unusual to be those not expected in the usual course of Council activities. We noted no issues from our journals selected for testing. Through our substantive audit testing we did not identify any significant transactions out with the normal course of business for The Highland Council.
The revenue cycle includes fraudulent transactions Under ISA 240 (UK&I) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. **Work undertaken:** Completed a walkthrough of the controls and procedures in place around sales invoicing and sales ledger Agreed other revenue to cash receipts in the year / post period end to gain comfort over validity of these transactions Performed cut off testing to gain comfort around the completeness and accuracy of recognised income Considered the recoverability of any outstanding balances at year end.	We have performed our year-end cut-off procedures and assessed recoverability of outstanding amounts at year-end by performing analytical reviews of debtors and reviewing accounting treatment for post year end receipts Specifically in relation to Council tax, NDR, HRA, capital grants and contributions, revenue grant and Other Income we completed detailed procedures on all material income streams. This included substantive sample testing where income was agreed to supporting information and bank statements. Beyond the elimination of the internal recharge income identified in Action point 1, no issues were noted from our review of the treatment of service income in the year, which has been accounted for in line with the Local Government Code of Practice. Our work on capital grants and contributions identified a number of cases where revenue was recognised ahead of the conditions of the grant being met. This was due to incorrect information provided by services which noted this grant was spent in full in year despite not being received until March 2017 See **Action Point 6** We rebutted the risk of fraud related to the income steam from the Scottish Government, Council tax, HRA and NDR. given the nature of the funding received. While the fraud risk was rebutted, we still performed procedures around these material balances. - For Scottish Government income we agreed this to the final allocation letter and income receipted to bank. - For Council Tax we performed analytical procedures and agreed to council tax system. - Non Domestic Rates income was agreed to Scottish Government allocation letter, and pooling amount agreed to amount collected.

Audit plan identified risk and work completed	Our conclusion
Valuation of property assets The council hold £1,991 million of property assets with property, plant and equipment. The valuation of these properties is inherently judgemental and are by nature a significant estimate based on both management assumptions and key inputs provided by valuation specialists. There is a risk that the balance in the financial statements is thus materially misstated. **Work undertaken:** Completed a walkthrough of the controls and procedures in place around the valuation process. Reviewed the revaluation performed in year, including an assessment of the credentials of the valuer. Considered any indicators of material movements in those assets which have not been revalued in the year. Tested a sample of revalued assets to ensure adjustments have been correctly processed.	In 2016/17, in line with the 5 year rolling revaluation programme £101.129 million assets were revalued in year. We have performed substantive procedures over these assets, and concluded that the revaluations have been undertaken in accordance with the Local Government code and applicable guidance issued. The Highland Council's valuer is in-House and we confirmed their suitability and qualifications through independent third party confirmation. The valuer is independent of the finance function working as part of the estates team which fall under separate directorates. We inquired of the valuer of their methodology and assumptions. The primary assumption being the building costs rates which are provided by BCIS, and produced for national use. We are satisfied that both methodology used and assumptions are in line with guidance. We have also assessed the arrangements in place to consider the risk of impairment of assets that have not been revalued in year. This is performed through recording of any events which may impact the value of a property and where necessary, considering if a revaluation should be undertaken earlier than planned. We are satisfied that procedures in place are appropriate. Through the sample inspection of title deeds we have confirmed ownership of assets.
Completeness of operating expenditure Operating expenses are understated or not recorded in the right period. This risk also relates to Practice Note 10 (revised) in respect of public sector entities which outlines that auditors should also consider the risk that misstatement may occur by the manipulation of expenditure recognition (Fraud risk). **Work undertaken:** Completed walkthrough of the controls and procedures in place around purchase ordering, procurement and general payment and recording of expenditure. Reconciled creditors ledger to the general ledger and financial statements Performed cut-off testing on pre-year end and post year end transactions to gain comfort around the completeness and accuracy of recognised expenditure	We have concluded through the performance of our year end procedures that the expenditure and receipts were incurred or applied in accordance with the applicable enactments and guidance issued and the expenditure is valid and correctly classified between revenue and capital. Where grants had specific conditions for testing we have confirmed that monies have been spent in line with these conditions. Through our pre and post year end cut of testing we did not identify any expenditure that was incorrectly accounted for. Larger areas of expenditure were substantively tested. No issues have been identified through the procedures we have performed.

Audit plan identified risk and work completed	Our conclusion
Completeness of employee remuneration expenditure Completeness of employee remuneration accruals. Staff costs account for 43% of the total Council spend, a notable proportion of the Council budget. The nature of employee remuneration includes a large number of transactions and numerous control activities to ensure accuracy. **Work undertaken:** Perform an analytical review against expectations and investigate significant movements in employee remuneration expenditure. Perform substantive testing of employee remunerations accruals at year end. Perform substantive testing to agree staff members to the e-payroll system and re-calculate employer costs.	We have concluded through the performance of our year end procedures that the expenditure of employee remuneration was incurred or applied in accordance with the applicable enactments and guidance issued and the expenditure is valid and correctly classified. The payroll reconciliation process identified £26.2 million of internal recharges which were not eliminated in error when preparing the draft annual report and accounts. Please see **Action Point 2** Through our substantive payroll testing which covered the 9 council payrolls (including teachers, elected members, general payroll) we did not identify any expenditure that was incorrectly accounted for. Larger areas of employee expenditure were substantively tested. In particular we considered the holiday pay accrual of £9.56 million, agreeing this to payroll system data and recalculating and agreeing the accrual. We have also tested the number of people who left the council under the Early Retirement/Voluntary severance Scheme. In 2016/17 89 people left the council at a cost of £3.547 million.

Action Plan for 2016/17

During the course of our 2016/17 audit work we have identified the following actions for Officers:

	Area	Issue and Risk	Priority	Recommendation
1	Adjustments and mispostings	During our audit, we identified and Officers identified 4 material adjustments to the unaudited accounts. These were not identified when producing the unaudited accounts, albeit the accounts did go through a challenge process. There is therefore a risk that the challenge process is not as effective as it could be, or that the Council control environment is not sufficiently robust in certain areas to identify mis-coding errors.	High	As Officers continue to review how the annual accounts are produced and reviewed, a review should also take place around the control environment to ensure correct posting and that the individual review and challenge in place when producing the accounts is sufficiently robust. **Officer responsible for implementation:** Finance Manager **Timescale:** 31 March 2018
2	Payroll reconciliation	There was not a consolidated payroll reconciliation completed and the Council do have a number of payrolls across the Council. When this was subsequently completed a significant internal employee balance that should have been eliminated was noted. There is a risk that the reported payroll figure does not agree to underlying ledgers without such a reconciliation being performed.	High	On an ongoing basis or at least annually a full payroll reconciliation will be completed, and any internal employee re-charges will be confirmed as eliminated. **Officer responsible for implementation:** Principal Accountant **Timescale:** 30 June 2018
3	Exit packages	An additional 26 individuals / £0.7 million of packages were identified during the audit process and amended through the revised accounts. There is a risk that incomplete information is passed to management and that disclosure in the accounts is incomplete.	Medium	We recommend that processes around exit packages are reviewed to ensure that accurate and complete information is provided to the finance team on a timely basis. **Officer responsible for implementation:** Principal Accountant **Timescale:** 30 June 2018
4	Lease disclosure	Our review of a sample of leases back to supporting documentation identified a number of discrepancies around lease terms and rental amounts between the working papers and the source documents. There is a risk that the disclosure of lease commitments and obligations is incomplete or inaccurate	Medium	We recommend that management undertake a process to review the existing breakdown of lease obligations. **Officer responsible for implementation:** Capital Accountant **Timescale:** 30 June 2018

	Area	Issue and Risk	Priority	Recommendation
5	Grant income recognition	Finance when preparing the accounts are reliant on other departments notifying them on when grant funding has been spent. One department incorrectly recorded income and spend in 2016/17 when the grant was received in March 2017 and had not yet been spent. There is therefore a risk that income and associated expenditure are incorrectly treated in the year and/or between years.	High	Departments should be reminded of the importance of reviewing grant income, particular close to year end, and confirming to finance the associated spend and therefore treatment in the accounts. Finance when preparing the accounts should specifically review and challenge the accounting of grants in the correct period. **Officer responsible for implementation:** Capital Accountant/ Service Accountants **Timescale:** 31 March 2018
6	Reserves	The Council continues to have a low level of un-earmarked general fund reserves, compared to other Local Authorities. This results in a risk should an unforeseen event happen which cannot be paid for, from in-year income. A low level of reserves also constraints the Council in ability to future invest to develop new services	High	Linked to the longer term financial strategy the Council should determine the optimum level of reserves needed to protect the Council from future unforeseen financial events and/or contribute to new projects. The strategy should then be clear on how reserves are going to be accumulated over time. **Officer responsible for implementation:** Elected Members and Director of Corporate Services **Timescale:** During 2017/18
7	Borrowing	The Council's borrowing costs at circa 9% of net expenditure are high when compared with other local authorities. The Council may be borrowing with long term revenue consequences which may not be affordable.	High	As set out in the financial strategy it is important the Council agrees a capital programme that meets the Council's strategic priorities but is affordable for the Council over the longer term. **Officer responsible for implementation:** Elected Members and the Director of Corporate Services **Timescale:** As part of the budget setting process for 2018/19
8	Opportunity risk	During the year the Council has further refined its risk management approach and identification of corporate risks. The financial strategy is ambitious, particularly in relation to increasing income. Without agreeing and taking measured risks in this area the Council may limit its achievement of the financial savings and/or income needed to achieve long term financial sustainability.	Medium	The Council should clearly articulate its appetite to risk, particularly related to income generation and how and where they may wish to capitalise on opportunity risk. **Officer responsible for implementation:** Elected Members and the Executive Leadership Team **Timescale:** By the end of the 2017/18 financial year

	Area	Issue and Risk	Priority	Recommendation
9	Approach to savings	Over the long term the Council need to achieve substantial savings. A redesign board has been established and a plan is in place to form groups to look at the 5 key savings areas. There is a risk that the Council do this in isolation without continuing to learn from others and what worked well and what worked less well.	Medium	The Council should continue to look to learn lessons from others on savings delivery and how they can further refine their approach to ensure it is disciplined, consistent and systematic. **Officer responsible for implementation:** Elected Members and the Executive Leadership Team **Timescale:** During 2017/18
10	Audit and Scrutiny	The Audit and Scrutiny Committee is a large committee with 25 elected members, and one of the largest across the 32 Scottish Local Authorities. There is a risk that due to the size not all elected members will have an opportunity to contribute to discussions and/or scrutiny could become less effective.	Medium	At the end of the 2017/18 financial year Council Officers and Members of the Audit and Scrutiny Committee should undertake a formal assessment of the Committees effectiveness and identify any future learnings and or training needs. **Officer responsible for implementation:** Corporate Audit and Performance Manager **Timescale:** June 2018
11	Performance reporting – Future actions	The Committee papers on performance are easy to read and detailed. From review they could be further enhanced with a clearer link to the necessary future actions to bring performance back to expected levels, where performance dips below the levels expected. There is a risk that the necessary future actions are not as visible or clear to members as they could be.	Low	Where performance is below expected the future action to bring performance back on track should be clearly reported and set out. **Officer responsible for implementation:** Chief Executive **Timescale:** March 2018

Follow up on prior year recommendations

We have undertaken a follow up of outstanding recommendations from prior years raised by the previous external auditors (Audit Scotland). The results of our work are outlined below:

Prior year finding	Action in 2016/17	Status
Financial accounting and reporting The number and nature of the misstatements identified through the audit process suggests that the council needs to do more to improve its arrangements for financial accounting and reporting. Recommendation The council should review its accounts preparation and management review processes to ensure that the accounts submitted for audit comply with the Code of Practice on Local Authority Accounting in the United Kingdom.	We have identified a number of similar issues in 2016/17 and this remains an area for ongoing focus. See Action Point 1.	Amber
Documentation of key judgements There is scope for the council to improve the documentation of the key judgements made in the preparation of the financial statements. In particular, accounting for complex areas would benefit from more research and documentation prior to the submission of the accounts for audit. Recommendation Key judgements should be thoroughly researched and documented prior to submission of the accounts for audit.	The finance team were proactive in engaging early in key changes being made to the presentation of the accounts in current year, and provided suitable supporting documentation.	Green
Valuation of Inverness Town House The District Valuer valued the Inverness Town House at nil value as at 31 March 2016 (£2.3 million as at 31 March 2015). The Inverness Town House is used by the council in provision of its services and so, in our opinion, this asset should be categorised as an operational building within the group accounts. We discussed with officers whether market value was the most appropriate basis for its valuation, as it could be argued that it is a specialist building and so should be valued at depreciated replacement cost. Recommendation The council should review the categorisation and valuation basis of the Inverness Town House prior to the preparation of the 2016/17 accounts.	The Council have assessed that as the asset generates rental income for ICGF it should be classed as an investment asset and accordingly valued at market value. ICGF is a subsidiary in the Council's Group Accounts and as such the assets of ICGF are consolidated on a line by line basis. The investment assets of ICGF are part of the Property Plant and Equipment heading on the Group Balance Sheet. Having considered the above position the Finance Manager responsible for the production of the accounts is satisfied that the current reporting decisions regarding the Inverness Town House are suitable and should continue.	Green

Fully implemented (green) Partially implemented (amber) Not implemented (red)

Prior year finding	Action in 2016/17	Status
Good received not invoiced The unaudited accounts included £1.290 million of creditors for goods received but not invoiced at the year end. Audit testing of a sample of transactions making up this balance identified that around 65% of the value tested was not a valid creditor at the year end. These results demonstrate that council staff need more guidance and training on the proper operation of this module within the council's new financial management system. Recommendation Checks should be introduced as part of the final accounts preparation process to provide assurance to the Director of Finance that the goods received not invoiced balance in the unaudited accounts is not overstated.	No concerns or issues noted during our 2016/17 testing.	Green
Communication with the valuer In 2014/15 we reported that there were issues around communication between the valuer and the finance department and this continued to be the case in 2015/16. Recommendation Reasonableness checks should be undertaken on all information provided by the valuer. Significant amendments to valuations should be challenged prior to inclusion in the unaudited accounts.	This year the Council had early meetings with the Valuer, to ensure he was clear on our requirements and to afford him an opportunity to ask for any clarification. Following the prompt presentation of his valuations there was adequate opportunity for the Council to seek clarification on any valuation issues arising.	Green
New financial management system The council implemented a new financial management system for 2015/16. There were a number of areas where standard reports that we would expect to be available had not been provided as part of the working papers package. Recommendation The working papers package should include reports of all sales and purchase ledger invoices	We were comfortable with the quality of working papers provided. The only key working paper that was not easily available was the payroll reconciliation – see Action Point 2.	Green
Highways assets The Accounting Code requires the inclusion of highway assets in the council balance sheets from 1 April 2016. In order to arrive at the value to be included in the accounts, the council needs to have arrangements in place to measure the relevant assets. The council has made good progress on measuring carriageways but has more to do with regard to other assets such as gullies and traffic calming. Recommendation The council continues to address the relevant work to ensure that matters are addressed and keeps in touch with the national picture.	At its meeting on March 8th , the CIPFA/LASAAC Code Board decided not to proceed with the introduction of the Highways Network Asset Code into the financial reporting requirements for local authorities. The Board decided that, currently and in particular in the absence of central support for key elements of the valuation, the benefits are outweighed by the costs of implementation for local authorities. The Board determined that it will give further consideration to this issue only if provided with clear evidence that benefits outweigh costs for local authorities.	No longer relevant

Prior year finding	Action in 2016/17	Status
Cyber attacks The council is aware of the risks associated with cyber attacks and is taking action to mitigate these. Our review identified a number of areas for improvement including advising senior officers on how to stay safe and secure in their private use of ICT to prevent that information being used to focus cyber attacks. Recommendation The council should review its arrangements for the identification and prevention of cyber attacks.	Quarterly vulnerability assessments and as part of our PSN accreditation an annual IT Health Check. Lessons Learnt and reactive remedial action as part of security incident management Quarterly security penetration testing as part of new system introduction and major system upgrades Quarterly Security Incident Management Plan testing with continuous improvement. Security Intelligence Centre (SIC) services for the SIEM and Log management functionality. This service is responsible for the 24x7 security event monitoring of the Highland Council ICT infrastructure Outsourced supplier implementation of ITRO (Information Technology Risk Office) framework such that the ICT Risk Officer will ensure the continued integrity of ICT systems by ensuring that the in place ICT architecture, security architecture, procedural controls and people are following the laid down guidelines for the integrity protection of the Authority's ICT systems. This framework supports external third party audits including the Authority audits for continued PSN, EU DPA, FOISA, ISO 27001/2 compliance/guidelines.	Green
Related party transactions 13 of the council's 80 members did not respond to officers' requests for information on related party transactions with the council in 2015/16. This is a significant improvement from the previous year when 33 members did not respond but still represents 16% of the council's members. Recommendation The council should review its procedures for identifying related parties within the annual accounts. Members should be reminded of their responsibilities as set out in the Councillors' Code of Conduct.	Despite numerous reminders and follow up from Officers only 42 returns were received out of 80 members for the 2016/17 financial year. This in part was not helped by the May Local Government elections and a number of Councillors not standing for re-election. However this is a declining position and we strongly encourage all elected members to submit returns and that this message can be re-enforced through the ongoing programme of elected member training.	Not implemented
Workforce planning Workforce plans need to be revisited to reflect the impact of the council's voluntary redundancy scheme. Recommendation Service workforce plans should be revisited to reflect the impact of the council's voluntary redundancy scheme, and to help inform its council redesign project.	During 2016/17 workforce plans have been revisited and a council wide workforce strategy approved (August 2017). Our report provides updated commentary on workforce.	Green

Summary of audit deliverables

Audit deliverables for 2016/17	Outcomes/Summary of progress
Audit opinion on the annual report and accounts and our report to those charged with Governance and the Controller of Audit	Complete: Our opinion is unqualified and will be signed and included in the final annual report and accounts published by the Council. This report discharges our responsibilities under ISA standards and the Code of Audit Practice.
Charitable Trusts	Complete. We have completed the audit of the Highland Charities Trust and the Highland Council Charitable Trusts and provided signed opinions for the inclusion of these accounts which are then submitted to OSCR.
Whole of Government Accounts (WGA)	Ongoing. As the Council is over the reporting threshold for WGA we need do certain checks and issue an assurance report to the NAO. The deadline for this is the end of September and we are on track to meet this deadline.
Criminal Justice Authority (CJA) Grant Claim	Completed. We have audited the CJA Grant claim and submitted that by the deadline of end of September 2017. No issues were identified
Education Maintenance Allowance (EMA) Grant Claim	Completed. Grant Claim submitted by the deadline of the end of July 2017. Whilst we did not identify any errors we could not locate a number of signed EMA agreements as these as retained by the schools and one school did not return the information requested due to school holidays.
Non-Domestic Rates Grant Claim	Completed. Our work on the NDR Grant claim is complete and submitted ahead of the deadline of the start of October 2017. There were no issues to report.
Housing Benefit subsidy claim	Ongoing. Our work over the housing benefit subsidy claim is ongoing and will be completed during October 2017 and November 2017 to ensure we can return the required information and certificate to the DWP by the end of November 2017
Audit Scotland returns and information	During the year we submitted certain information to Audit Scotland. These were submitted by the deadlines and included: - Updates on Highland Council risks/challenges/opportunities to help Audit Scotland in their reporting to their FAAC committee - EU Grants return - Role of "Boards" return to inform a future performance study - LG return, linked to our final report, to support LG overview reporting and an indicative Best Value 5 year plan to inform the arrangements for Best Value Assurance Reporting.

Reminder of Responsibilities

The Code of Audit Practice sets out responsibilities of the audited body (pages 10, 11 and 12) across: Corporate governance; financial statements and related reports; standards of conduct for prevention and detection of fraud and error; financial position; and value for money (as described in the Scottish Public Finance Manual). As appointed auditors our responsibilities are set out on page 13 and are summarised below.

An audit of the financial statements is not designed identify all matters that may be relevant to those charged with governance. Weaknesses or risks are only those that have come to our attention during our normal audit work in accordance with ISA's and the Code and may not be all that exist

Communication of the matters arising from our audit work does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control. We have requested a letter of representation from the Council, with specific representations around grant revenue recognition, equal pay and exit packages.

The Council has not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our work. We have not been made aware of any incidences of fraud or corruption in the year.