

The Highland Council

Annual report on the 2012/13



Prepared for members of the Highland Council and the Controller of Audit
October 2013

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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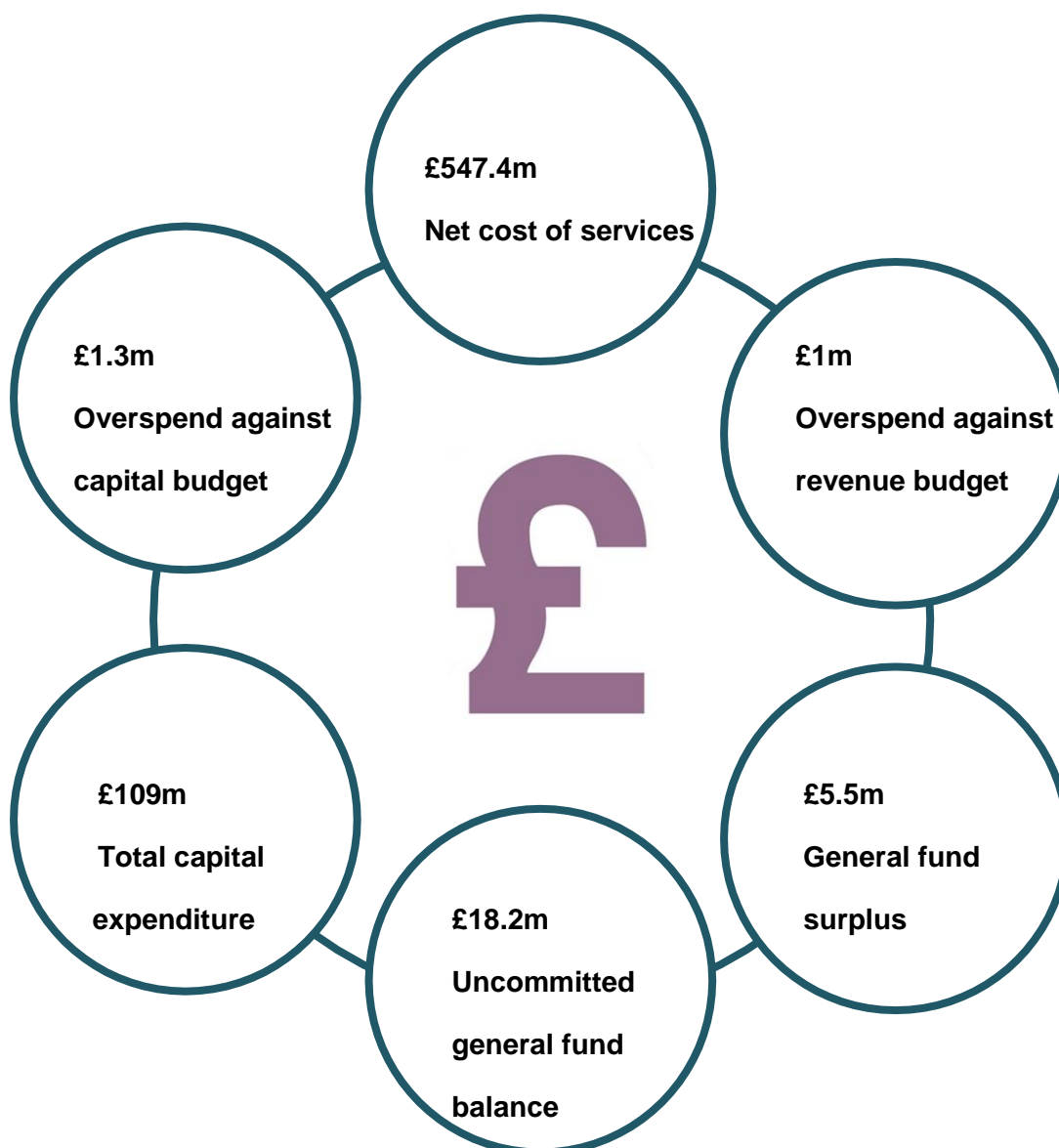
Key Messages

2012/13 audit findings

Financial Statements

We have given an unqualified opinion that the financial statements of The Highland Council for 2012/13 and give a true and fair view of the state of the affairs of the Council and its group as at 31 March 2013 and of the income and expenditure for the year then ended. The Council's six statutory trading organisations made aggregate surpluses in the three years to 31 March 2013 and thus met the statutory requirement to break even over the three year rolling period.

Financial position



Our audit of the financial statements identified a number of specific issues in relation to the preparation of capital accounting entries. We will work with the Director of Finance to identify improvements to the final accounts preparation and audit process in advance of the 2013/14 closedown. This will help ensure that both the Council and ourselves are prepared for any changes that emerge in 2013/14 from the Scottish Government's recent consultation for the introduction of revised Local Authority Accounts Regulations.

Governance and accountability

The Council has effective governance arrangements in place. Each year it assesses its own corporate governance arrangements against the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government' and reports the results in the Corporate Governance Assurance Statement included within its financial statements. Although the 2012/13 assessment identified a number of areas for improvement, the overall results suggest that the Council has a sound governance framework in place.

Performance and best value

The Council's performance management framework is robust and integrated with service planning and delivery. During 2012/13, the Council continued to make good progress in delivering the commitments set out in its 2012-2017 Corporate Plan and Single Outcome Agreement. The Council's 2013 performance survey results were also positive with 88% of respondents satisfied with Council services.

Outlook

Looking ahead, the financial outlook for public spending for the period 2013/14 to 2018/19 remains challenging. The Council has been proactive in preparing a 5 year financial plan and identifying the savings requiring to be achieved to reflect reduced local government settlements. Budget forecasts have been developed which show a funding gap of £3.6 million for 2014/15 and total funding gap of £82.2 million over the five year period equating to 14.6% of the current base budget for 2014/15. The Council's plan outlines the significant financial risks that it faces but anticipates that through forward financial planning, it has time to consider its options to address this situation.

On 1 April 2012, new arrangements for the delivery of integrated care in the Highlands came into effect. Under these new arrangements, the Council has lead agency responsibility for the delivery of children's services and NHS Highland has lead agency responsibility for adult community care services. Integration of child health and social care has been achieved with single management, budgets and governance for these services. The establishment of integrated front line teams and support services over the next year aims to achieve the full benefits for service users and communities. A joint scrutiny review of the new arrangements

for delivery of social care services will also be undertaken by the Care Inspectorate and Audit Scotland in 2014/15.

Introduction

1. This report summarises the findings from the 2012/13 audit of The Highland Council. The nature and scope of the audit were outlined in the Audit Plan presented to the Audit and Scrutiny Committee on 28 March 2013, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011. The purpose of the annual audit report is to summarise the auditor's opinions (i.e. on the financial statements) and conclusions, and to report any significant issues arising. The report is divided into sections which reflect the public sector audit model.
2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of The Highland Council.
3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed 'planned management action'. We do not expect all risks to be eliminated or even minimised. What we expect is that the Council understands its risks and has arrangements in place to manage these risks. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to monitor progress.
4. This report is addressed to members and the Controller of Audit and should form a key part of discussions with elected members, either prior to, or as soon as possible after, the formal completion of the audit of the financial statements. Reports should be made available to other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
5. This report will be published on our website after consideration by the Council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.
6. The management of The Highland Council is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. The auditor is responsible for auditing and expressing an opinion on the financial statements. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

7. The co-operation and assistance given to us by The Highland Council's members, officers and staff is gratefully acknowledged.

Financial statements

8. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
9. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.
10. Auditors review and report on, as appropriate, other information published with the financial statements, including the Explanatory Foreword, Corporate Governance Assurance Statement, and the Remuneration Report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

11. We have given an unqualified opinion that the financial statements of The Highland Council for 2012/13 and give a true and fair view of the state of the affairs of the Council and its group as at 31 March 2013 and of the income and expenditure for the year then ended. The Council's six statutory trading organisations made aggregate surpluses in the three years to 31 March 2013 and thus met the statutory requirement to break even over the three year rolling period.

Legality

12. Through our planned audit work we consider the legality of the Council's financial transactions. In addition, the Director of Finance has confirmed that, to the best of his knowledge and belief, and having made appropriate enquires of the Council's management team, the financial transactions of the Council were in accordance with relevant legislation and regulations. There are no legality issues which require to be brought to members' attention.

Corporate governance assurance statement

13. As part of our annual audit we review the disclosures made in the Corporate Governance Assurance Statement and the process for obtaining sufficient assurances to inform that content of the statement.
14. The 2011/12 statement included reference to a number of areas for development identified in relation to the Local Code of Corporate Governance. Progress has been made across these

areas; however, several of them have been included in the 2012/13 statement as not all planned improvements have yet been implemented. Key actions identified in the 2012/13 statement to enhance existing arrangements include:

- delivery of all efficiency savings from the corporate improvement programme
 - complete the review of governance arrangements within arm's length organisations (ALOs) established by the council
 - complete the communications strategy
 - review and development of a new local code of governance for 2013/14
 - working with NHS Highland to further develop collaboration in respect of central and support services.
15. In his 2012/13 annual report the head of internal audit and risk management provided his opinion that, based on the internal audit work undertaken during the year, reasonable assurance can be given on the adequacy and effectiveness of the Council's control environment during the year to 31 March 2013. This view is reflected in the corporate governance assurance statement.
16. We are satisfied with the disclosures made in the corporate governance assurance Statement and the adequacy of the process put in place by the Council to obtain the necessary assurances. The statement complies with the requirements of Delivering Good Governance in Local Government, published jointly by CIPFA and SOLACE.

Remuneration report

17. We are satisfied that the remuneration report has been prepared in accordance with the relevant legislation. The disclosures within the 2012/13 financial statements include all eligible remuneration for the relevant council officers and elected members under a number of categories including pension benefits.

Accounting issues

18. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 (the 2012 Code). Overall, we are satisfied that the Council prepared its 2012/13 financial statements in accordance with the 2012 Code.

Accounts submission

19. The Council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. In 2012/13 specific issues were again identified in relation to the preparation of capital accounting entries. We found a lack of audit trail as to how key figures in the accounts tied back to the council's asset registers, and a lack of internal consistency in disclosures within the financial statements. In addition, considerable work was required to

resolve issues identified with the operation of the revaluation reserve and capital adjustment account.

20. As a result of our audit £10.129 million of capital expenditure on council housing required to be de-recognised in respect of kitchens, bathrooms and windows that had been replaced. We also identified capital grants to third parties of £4.764 million which should not have been capitalised. Capital expenditure incurred by third parties is not an asset of the council and should not appear on the council's balance sheet. The finance department acknowledges that further improvement is required and has agreed to work with us to ensure that this is achieved.

Refer Action Plan No. 1

Presentational and monetary adjustments to the unaudited accounts

21. The Council adjusted the financial statements to reflect the majority of our audit findings. These adjustments primarily relate to reclassifications within the balance sheet and comprehensive income and expenditure statement. The cumulative effect of these adjustments was to decrease net expenditure on the provision of services by £3.239 million and increase taxation and non-specific grant income by £0.674 million in the Comprehensive Income and Expenditure Statement. Net assets (and reserves) as recorded in the Balance Sheet have increased by £3.913 million.
22. In addition to those changes noted, a number of immaterial errors were set out in our ISA260 'Communication of Audit Matters to Those Charged with Governance' report which was submitted to the Audit and Scrutiny Committee on 26 September 2013. The Director of Finance decided not to amend the financial statements for these errors. Had adjustment been made, the Surplus on the Provision of Services in the Comprehensive Income & Expenditure Statement (£30.890 million) would have increased by £0.165 million and total assets less liabilities and net worth in the Balance Sheet would have increased by the same amount. These amounts are not material to the financial statements and we agree with the Director of Finance's decision not to amend for them.

Pension costs

23. The Highland Council is a member of The Highland Council Pension Fund which is a multi-employer defined benefit scheme. In accordance with pensions accounting standard IAS19 'Retirement Benefits', the Council has recognised its share of the net liabilities of the pension fund in its balance sheet. The valuation at 31 March 2013 provided by the scheme's actuaries increased the Council's share of the deficit from £289.5 million last year to £329.5 million this year. The increase is mostly due to changes in actuarial assumptions such as mortality levels and the discount rate used to calculate scheme liabilities. The actuary has recommended that the Council's contributions should be maintained at 18% of pensionable pay for 2013/14.

Landfill sites

24. The restoration and aftercare of landfill sites is a matter that may require a provision to be recognised under IAS 37 Provisions, contingent liabilities and contingent assets. A recent survey by the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) identified that although a number of Scottish local authorities currently operate landfill sites, they did not recognise a provision in their 2011/12 financial statements for their obligations relating to the restoration and aftercare of these sites.
25. The council operates landfill sites and therefore has an obligation to undertake restoration and aftercare. A provision of £2.25 million was recognised in the council's 2012/13 financial statements in respect of these costs. These costs are included in the Council's capital programme.

Whole of Government Accounts

26. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. The council submitted the consolidation pack to support its 2012/13 WGA return to the Scottish Government prior to the deadline of 7 August 2013. This has now been audited and the audited return submitted.

Group accounts

27. The diversity of service delivery vehicles used by local authorities' means that consolidated group financial statements are required to give a true and fair view of the activities of the Council. To enable the preparation of group financial statements councils are required to consider their interests in all entities including subsidiary companies, joint ventures and statutory bodies, such as police, fire and valuation boards.
28. The Council consolidated the results of High Life Highland, Inverness and Nairn Common Good Funds as subsidiaries, and Northern Joint Police Board, Highland and Islands Fire Board, Highland and Western Isles Valuation Joint Board and Highlands and Islands Transport Partnership as associates into its group accounts in accordance with the 2012 Code. The overall effect of the inclusion of these group entities was to reduce net assets by £257.6 million, mainly due to the inclusion of Joint Board pension liabilities.
29. Police and Fire functions transferred to the Scottish Police Authority and the Scottish Fire and Rescue Service on 1 April 2013. The group balance sheet position will improve, in future years, as the council will no longer be required to accrue the pension liabilities of Police and Fire into its group accounts.

Registered Charities

30. The Charities Accounts (Scotland) Regulations 2006 as amended (the 2006 Regulations) set out the accounting and auditing rules for Scottish registered charities. These apply to all local

authority registered charities and require an audit of a registered charity's financial statements where the local authority is sole trustee and where certain thresholds apply (i.e. income of £500,000 or above or gross assets of £3,260,000). An independent examination is required for the financial statements of charities below these threshold values. The interaction of section 106 of the Local Government (Scotland) Act 1973 with the Charities Regulations results in all registered charities, where the local authority is the sole trustee, requiring to be audited from 2013/14.

31. The Assistant Auditor General (AAG) advised Local Government Section 95 officers by letter in June 2013 of these new arrangements and the Accounts Commission's decision to appoint the auditor of each council as the auditor of its relevant charities. This is likely to result in an increase in audit costs and will form part of the fee discussions as part of the 2013/14 audit planning process.
32. The AAG has also indicated that councils that have not made any progress in reducing the number of registered charities using the reorganisation provisions of the charities legislation might want to consider doing so in order to reduce the number of separate audits required. Councils may also want to consider whether they can use the connected charities provisions in the regulations to reduce the number of separate reports and accounts required to be submitted to OSCR.
33. At the Audit and Scrutiny Committee meeting on 26 September 2013, the Director of Finance set out the current position with regard to financial position of the Council's 80 charities and officers are presently looking at options for mitigating the implications. These include winding up charities with no or minimal balances and merging charities which share a common trust purpose. So far the council has formally de-registered 25 charities which have a nil balance. Depending on the success in merging charities in 2013/14 we will may have to audit and report on up to 55 charities.

Common good funds

34. In December 2007, Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued a guidance note for practitioners, 'Accounting for the Common Good Fund'. The Council complies with this guidance as it includes a separate statement within the financial statements and a separate common good asset register is maintained.
35. The Nairn Common Good Fund has been in debt to the Council for several years in respect of the costs of bringing land at Sandown to a saleable condition. As at 31 March 2013, the common good balance sheet contains a long term liability of £0.734 million in respect of these costs. On the 27 June 2013 the council considered a report by the Director of Finance on options to resolve this issue.
36. The Council agreed to write off all of the debt that related to a fee of £0.390m paid to acquire vacant possession of the land and transfer a pro rata share of the land equivalent to the value

of the remaining debt, with the conditions that any gain in land value was returned to the Nairn Common Good Fund and Highland Council did not gain financially from any future sale of the land. This will cancel out the long term liability of £0.734 million in the Nairn Common Good Fund, add £0.390 million to its revenue reserve and reduce the value of the fund's investment properties by £0.344 million to £9.657 million. These entries will be made in the 2013/14 financial statements and resolve our concerns about debts owing by the Common Good Fund to the Council.

Financial position

37. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
38. Auditors consider whether audited bodies have established adequate arrangements and examine:
- financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
39. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

40. In 2012/13, the Council spent £846.2 million on the provision of public services, including £109 million on its capital programme. In delivering these services, the Council generated an accounting surplus of £30.9 million. Adjustments are, however, required to this accounting surplus to reflect the statutory funding arrangements in place and, once these are taken into account, the financial statements show that the Council increased its usable (cash backed) reserves by £6.8 million (see Exhibit 1 for details).

Exhibit 1: Usable reserves and funds

Description	31 March 2013 £ Million	31 March 2012 £ Million	Movement £ Million
General Fund	37,890	32,402	5,488
Housing Revenue Account Balance	6,804	6,804	0
Repair and Renewal Fund	1,667	1,665	2
Insurance Fund	2,394	2,226	168
Capital Fund	31,171	30,238	933
Capital Receipts Reserve	1,517	1,318	199
Total	81,443	74,653	6,790

Source: The Highland Council 2012/13 financial statements

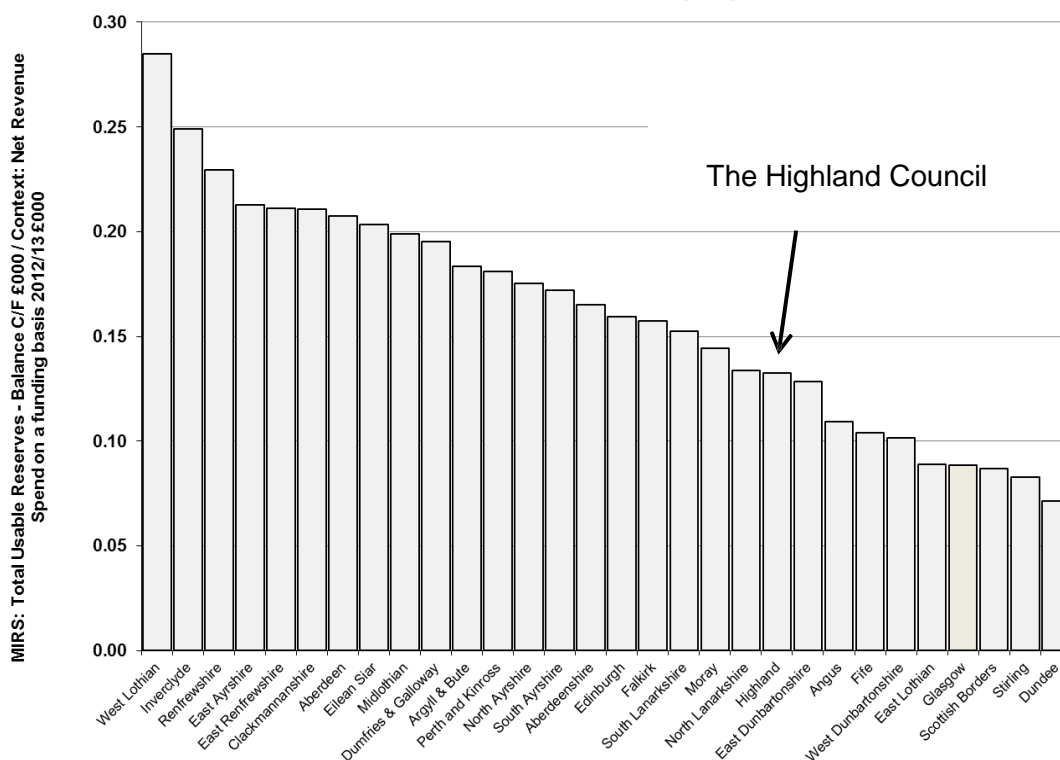
Budgetary control

41. Net service expenditure across the Council (general fund and HRA) was £547.436 million; an underspend of £5.488 million against budget. Within this overall underspend, there were some services which overspent against budget. The most significant of these was a £4.1 million overspend by transport, community and environmental services, the majority of which resulted from overspends on winter and cyclical maintenance and coastal protection following the storm surge in December. The most significant underspend (£3.4 million) related to loan charges and resulted from underspends on the capital programme and lower than expected interest rates. Council tax and non-domestic rate income was also £2.3 million greater than budget. During the year the provision of £2.803 million for the potential repayment of grant in respect of the Caithness Heat and Power project was written back as it is no longer required.
42. The budget for 2012/13 was based on a Band D Council tax level of £1,163 and assumed net contributions from earmarked general fund reserves of £2.55 million. As a result of the underspends delivered by services, this contribution was not required and an additional £1.6 million was added to the general fund balance as at 31 March 2013.

Financial position

43. The general fund balances totalled £37.9 million as at 31 March 2013. The Council aims to maintain a general fund working balance of up to 3% of its revenue budget (£17 million) as a contingency. At 31 March 2013, earmarked amounts totalled £19.7 million, leaving an unallocated general fund balance of £18.2 million, which is £1.2 million in excess of its £17 million target. This additional flexibility is likely to be needed in the short to medium term to address the significant financial pressures facing the Council in the years ahead. These are discussed in the outlook section below.

Exhibit 3: Total usable reserves carried forward as a proportion of net revenue spend

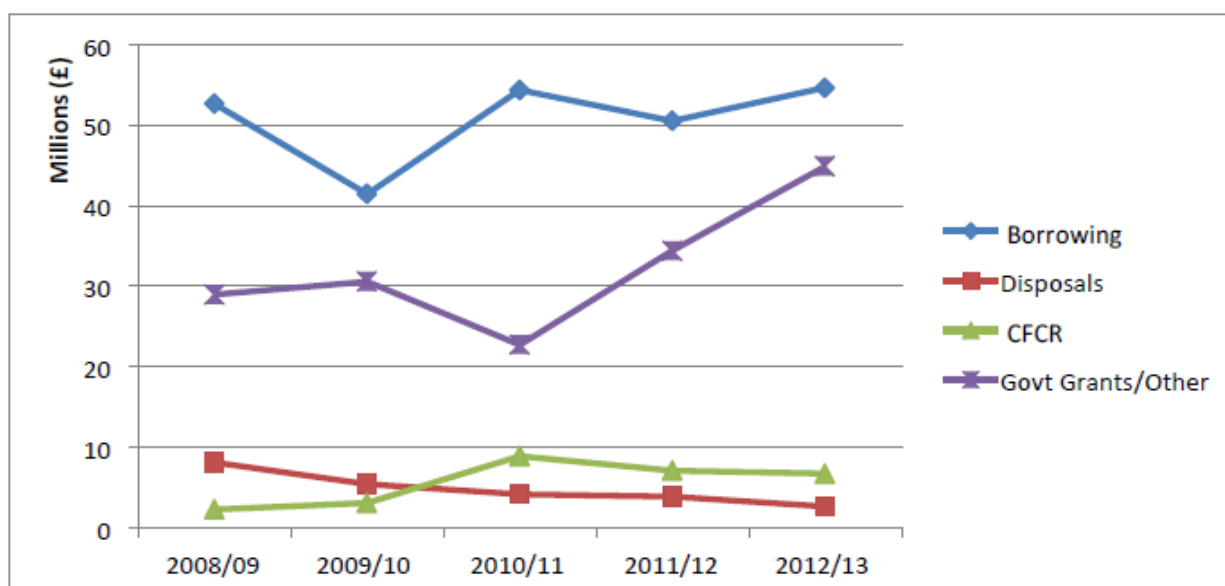


Source: Audit Scotland - Local Government in Scotland Analytical Review 2013 (excl. Shetland and Orkney)

Capital investment and performance 2012/13

47. The Council's general service capital spend for 2012/13 was £76.1 million against a budget of £80.2 million, resulting in an underspend of £4.1 million (5%). The most significant slippage occurred in Education, Culture and Sports (£4.9 million) and the Chief Executives Service (£3 million). This was offset by overspends of £7.1 million in Transport, Environmental and Community Services.
48. The housing capital programme includes expenditure on the provision of new council housing and improvements to existing stock to meet the Scottish housing quality standard. Actual spend in 2012/13 was £32.9 million against a budget of £27.5 million, resulting in an overspend of £5.4 million (19.6%) due to acceleration of the programme to achieve the Scottish Housing Quality Standard and the new build programme.
49. The trend in sources of funds for capital investment over the last five years is set out in Exhibit 4. This shows a decline in the funds received through the sale of assets. Government grants and other contributions increased significantly in 2012/13 (this was also the case in 2011/12) whilst advances made to services from the Council's loans fund borrowing remains the most significant source of funds for the Council's capital programme.

Exhibit 4: Sources of finance

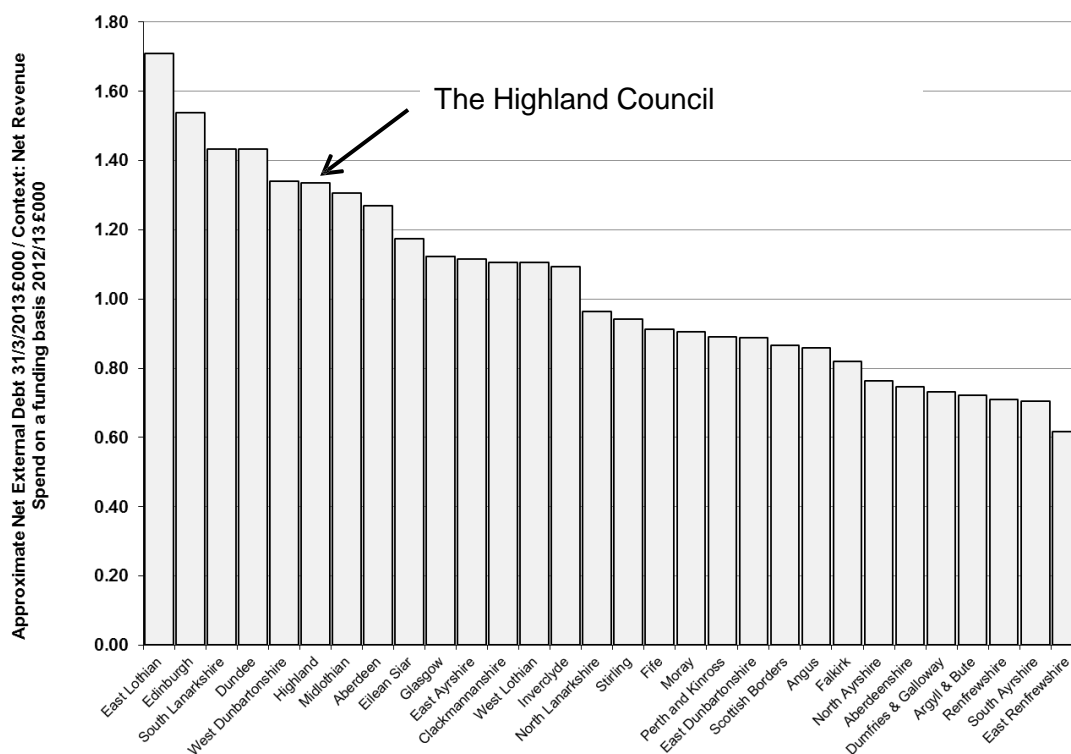


Source: *The Highland Council 2012/13 financial statements*

Treasury management

50. As at 31 March 2013, the Council held cash and cash equivalents of £63.8 million, an increase of over £6 million on the previous year. Borrowing increased from £693.7 million at 31 March 2012 to £708 million at 31 March 2013.
51. The Council raised £43.9 million of new loans from the Public Works Loans Board in 2012/13 to fund capital expenditure and its capital financing requirement.
52. Analysis of net external debt as a proportion of net revenue spend gives an indication of the relative indebtedness of the Council. Exhibit 5 shows the net external debt as at 31 March 2013 as a proportion of the net revenue spend for the year for all councils in Scotland, with the Highland Council highlighted as being at the higher end of the range.

Exhibit 5: Net external debt as a proportion of net revenue spend



Source: Audit Scotland - Local Government in Scotland Analytical Review 2013 (excl. Shetland and Orkney)

Financial planning to support priority setting and cost reductions

Change management and efficiency

53. Over a number of years the Council has reviewed how it delivers its services and where it can make changes to its back office functions and management costs to improve efficiency and deliver savings to support front line services. The Corporate Improvement Programme (CIP) has brought about many positive changes to how the Council conducts its business and continues to be the major focus of the Council's efficiency strategy. Developments in a number of the major projects and financial savings achieved by the programme are highlighted below.

Workforce reduction

54. Reduced local government settlements have implications for the Council's workforce with reduced spending on staff a key component of the way in which the Council is responding to the challenges it faces. The Council earmarked £3 million of its general fund balance at 31 March 2011 to meet the costs associated with reducing staff numbers over the next two years. During 2012/13 the remaining earmarked balance was utilised to meet the cost of redundancy payments and strain on the fund costs due to early release of pension benefits for 26 staff.

55. Savings associated with reductions in staff numbers are reported annually to the Audit and Scrutiny Committee. The saving from the reduction in these 26 posts was calculated at £4.6 million giving a net saving of £3.2 million once the capitalised costs to the Council's revenue account and the pension fund were taken into consideration

Partnership working

56. The Scottish Government and CoSLA reviewed community planning and Single Outcome Agreements in 2012 following which they published their 'Statement of Ambition'. It makes clear that significant changes to improve community planning are needed to respond the challenges of reducing public finances while demand for services increases.
57. The Audit Scotland report Improving community planning in Scotland (March 2013) concluded that partnerships have not been able to show that they have had a significant impact on delivering improved outcomes across Scotland.
58. The last best value audit of the council and community planning noted that community planning structures were well developed at strategic, thematic and local levels with appropriate political, official and community representation on each. The single outcome agreement (SOA) is regarded as the improvement plan for public services in Highland and has the support of all partners within the Highland Public Services Partnership. The partnership has 181 performance indicators in place across the Scottish Government's 15 national outcomes.
59. However, these processes require periodic review and challenge to ensure they remain fit for purpose. With a new SOA to deliver from June 2013 community planning partners are presently reviewing partnership working and governance arrangements to minimise the risks to effective community planning in the Highlands.

Integrated Care in the Highlands

60. A key Scottish Government Policy remains the drive towards health and social care integration across Scotland. Partnership working is actively being promoted by the Scottish Government as a means of making service delivery more efficient and cost effective.
61. Highland has been a pioneer in this respect. In May 2011, the Highland Council and NHS Highland formally agreed to commit to planning for integration of health and social care services by putting into place single lead agency arrangements for Adult Community Care Services (NHS Highland) and for Children's Services (the Highland Council). Both bodies have joint responsibility for specifying the outcomes to be achieved and the total resources allocated to these two service areas.
62. The Partnership agreement was signed by representatives of both authorities on 21 March 2012 ahead of the new arrangements commencing on the 1st of April 2012. The Partnership

agreement details the governance arrangements put in place as well as the model for financial disbursements, resource allocation and reporting arrangements.

63. Planning for integration had been on-going for 15 months before the April target date and it was recognised from the outset that this was the first stage of a period of redesign which would see services evolving in an integrated way. The on-going process will involve all stakeholders and focus on developing new ways of service delivery that reflects a commissioning approach and focusses on the agreed outcomes. This is being managed through the Integrating Care in the Highlands programme.
64. Governance arrangements to scrutinise the delivery of services by both lead agencies have been put in place. A Strategic Commissioning Group was also established, involving senior members of the Council and NHS Highland, as well as the chief executives, senior officers, third sector partners and staff side representatives. This Group reports to both the Council and the Board of NHS Highland on the agreed performance indicators for commissioned services and makes refinements to these as required.
65. As with any significant change in service delivery, there are higher risks until new working practices and processes are embedded. Front-line operational services were the key focus during the year, but support services were not given the same emphasis. Advice and support from the Scottish Government on how to deal with differing approaches to support services is being sought.
66. The adult social care budgets transferred from the Council to NHS Highland are large and complex with the final figure of £86.9 million not fully agreed until March 2013. The partnership agreement tasks both directors of finance with agreeing the treatment of any budget variances. As this agency agreement evolves and budgets are more clearly understood there may be a need for more formal arrangements to be agreed to address differences that arise.
67. For 2013/14, it has been agreed that uplifts received from the Scottish Government for adult and children's services will be passed on in full. The Council received a zero uplift in respect of adult services and NHS Highland received an uplift of 2.8% for children's services. The Scottish Government expects all public sector bodies to deliver an efficiency saving of at least 3% and both the Council and NHS Highland will be mutually accountable for complying with this requirement in respect of the delegated services.
68. Highland Council care homes were used by the NHS Highland under a license to occupy agreement in 2012/13 and work is currently underway to determine a longer term arrangement for the use of these facilities.
69. Approximately 1,400 staff transferred from the Council to NHS Highland and, under the partnership agreement, this group of staff stayed within the Local Government pension scheme. As a result NHS Highland became an admitted member of the Highland Council

Pension Fund. The Highland Council retains net liabilities of £20.217 million on an IAS 19 basis in respect of pensions accrued by staff prior to the date of transfer.

70. A joint scrutiny review of the new arrangements for delivery of social care services will also be undertaken by the Care Inspectorate and Audit Scotland in 2014/15.

Refer Action Plan no. 2

Outlook

2013/14 budget

71. The Council has been proactive in preparing financial plans and identifying savings to reflect reduced local government settlements. In 2009 the Council commenced a three year budgeting process and in August 2012 launched its second formal budget consultation process to identify savings for 2013/14 and 2014/15. Savings totalling £12.1million were agreed for 2013/14 enabling the council to balance the 2013/14 budget. In February 2013, the Council approved a general fund budget of £548.436 million for 2013/14. The Council reported its progress in respect of its plans for an Inverness West Link Road to members on 3 September 2013. Given the scale of investment required in the project, it is important that members continue to receive regular updates on cost so that they are able to effectively monitor developments.
72. The Council's latest revenue monitoring report, based on the position as at 31 August 2013, projects that the estimated outturn will be £0.324 million (0.06%) more than budget at 31 March 2014. Within this overall projected overspend, there are two main variances. The Education, Culture and Sport budget is projected to overspend by £0.856 million due to an increase in pupils requiring additional support needs. This is offset by a projected underspend of £0.6 million on loan charges due to continuing favourable interest rates and a lower than anticipated opening loan debt position. Managers within the Education, Culture and Sport have identified a number of actions to partially mitigate these pressures including a freeze on non-essential expenditure, delaying the filling of vacant posts and only undertaking repairs and maintenance of a health and safety nature.

Financial forecasts beyond 2013/14

73. When the council set its revenue budget for 2013/14 proposals were agreed to take forward longer term financial planning covering the five years 2014/15 to 2018/19. It is expected that the current period of austerity and public sector spending restraint will continue and that "flat cash" settlements experienced presently will continue to 2018/19. Budget forecasts have been developed which show a funding gap of £3.6 million for 2014/15 and total funding gap of £82.2 million over the five year period equating to 14.6% of the current base budget for 2014/15.
74. There are a number of national reforms which are likely to have an impact on the Council's future financial planning including Welfare Reform (see paragraphs 99 to 102), pensions

reform, and the integration of health and social care (see paragraphs 60 to 70 above). The impact of these reforms remains uncertain, and future budgets may have to be amended as the implications become clearer.

Refer Action Plan no. 3

Governance and accountability

75. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
76. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
77. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
- corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption
78. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

79. The Council has effective governance arrangements in place. Each year it assesses its own corporate governance arrangements against the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government' and reports the results in the Corporate Governance Assurance Statement included within its financial statements. The 2012/13 assessment identified a number of areas for improvement in 2012/13, but overall, the results suggest that the Council has a sound governance framework in place. The Assurance and Improvement Plan Update 2013-16 assessed the Council as having no significant risks in this area.
80. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account on service delivery and support the modernisation agenda. The Audit and Scrutiny Committee meets regularly to receive reports from internal and external audit and scrutinise performance. The Committee is well attended and overall, complies with the expectations set out in CIPFA's guidance note 'Audit Committee Principles in Local Authorities in Scotland'.

81. The Director of Finance is a member of the Council's senior management team. CIPFA have recently issued a Statement on the Role of the Chief Financial Officer in Public Service Organisations and the 2011 Code introduced a requirement to report the Council's compliance with this statement in its Corporate Governance Assurance Statement. A review undertaken by the Assistant Chief Executive confirmed that the Council complies with most of this Statement. To further improve the Council's governance arrangements financial regulations will be revised to clarify that the Director of Finance has direct access to the Audit and Scrutiny Committee.

Internal control

82. Internal audit plays a key role in the Council's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. Our overview of the Council's internal audit service confirmed that the section operates in accordance with the CIPFA Code of Practice for Internal Audit in Local Government.
83. As part of the 2012/13 audit, we relied on the work undertaken by internal audit on the following systems: housing rents, accounts receivable, council tax and non domestic rates valuation, housing and council tax benefits.
84. The results of our review of the controls in operation within the Council's remaining financial systems will be reported to the Audit and Scrutiny Committee shortly. We made eight recommendations to further enhance the Council's system of internal financial control in 2011/12 report and found seven of the agreed recommendations implemented in full and one partially.
85. Last year we reported that, following the setting up of separate bank accounts for the Pension Fund, the council's processes had not been amended to ensure that all of the Pension Fund's transactions were banked / paid through the Pension Fund's bank accounts. As at September last year, work was still ongoing to match the £208,000 of the creditors balance due to the Highland Council to individual pension fund transactions. This work was completed during 2012/13 and work continued to ensure that current year transactions were correctly accounted for and that cash was held in the correct bank account as far as practicable

Information technology/data handling and security

86. The Council's information systems are provided by Fujitsu Services as part of a five year contract which commenced on 1 April 2010. The Council wrote to Fujitsu in June 2011, identifying areas of concern relating to their compliance with their contractual obligations and formally requesting an overarching plan to address the issues raised. In October 2011, the Council and Fujitsu jointly resourced a team to address the Council's concerns. Regular reports on progress to address the items of non-compliance were presented to the joint Partnership Board and the Council's Finance, Housing and Resources Committee. We have

been advised that settlement of key commercial issues has been reached with Fujitsu and the correction plan completed. This has enabled the introduction of utility charging, resolution of outstanding payments and the Unified Communications Project, a replacement for the Telephony Project to progress. The council is now pursuing options for implementing a Unified Communications Project independently of Fujitsu Services.

87. In order to express an opinion on the financial statements, we are required to obtain sufficient appropriate evidence on the nature of the services provided by Fujitsu and their significance to the Council including their effect on the Council's internal control system, and the risk of material misstatement within the financial statements. We have placed reliance on the ISO27001 accreditation held by Fujitsu for the purposes of our 2012/13 audit. ISO27001 is the most influential and globally recognised standard for information security management, and we are content that the accreditation covers the period of our audit and all of the sites where Council data is held.
88. The contract with Fujitsu allows the Council to conduct audit reviews, for various purposes, each year at the Council's discretion. A visit was made to the Stevenage Data Centre by the council's Computer Audit staff in May 2013 and no areas of concern were identified.

Public Services Network

89. The council exchanges data with many other public bodies and in so doing makes use of Cabinet Office sponsored arrangements to share electronic data with other public sector bodies. For example, the council shares benefit information with the Department of Works and Pensions while social work and education departments exchange information with the police, Criminal Justice Partnership and Children's Hearings.
90. The Government Secure Intranet (GSI) is the mechanism that allows the council to share data and services. The council must re-apply annually to the Cabinet Office to be allowed to connect to the government secure network. This year the government is replacing GSI with the Public Services Network (PSN).
91. The council's ICT Services are currently working towards this annual accreditation. This year a zero tolerance approach has been adopted by PSN which means before submission the council must address security issues which previously allowed as acceptable risks. All other local authorities in Scotland are in a similar position and are finding it challenging to meet the required security standards within the timescales.
92. ICT Services are working at pace with Fujitsu, to resolve the security issues and have developed a bespoke communications plan to support members and users through the change process.

Caithness Heat and Power

93. Caithness Heat and Power (CHaP) was a company established by the Council to progress a district heating system project. In May 2011, the Council announced it was terminating the procurement exercise to find a private sector operator to take over the district heating system in Wick. The Council further decided, on 27 October 2011, to take over CHaP's trade and assets for £1 and to wind up the company.
94. CHaP ceased trading on 23 December 2011. An operator purchased, at auction, some of the assets formerly owned by the company and commenced energy supply operations to the company's former customers in early 2012/13. The Council retains the obligation to reinstate traditional heating systems within its housing stock where alternatives are no longer available. A provision of £2.803 million made in prior years for possible repayments of grants to the Energy Savings Trust was considered as no longer required and written back during 2012/13.

Prevention and detection of fraud and irregularities

95. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.
96. The Highland Council has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. These arrangements include: an anti-fraud and corruption policy and response plan; a whistle blowing policy; codes of conduct for elected members and staff; and defined remits for committees.

NFI in Scotland

97. The National Fraud Initiative in Scotland (NFI) uses data matching to compare a range of information held on bodies' systems to identify potential inconsistencies or circumstances that could indicate fraud or error which are called 'matches'. Where matches are identified these are made available to bodies to investigate via a secure web application. Bodies investigate these and record appropriate outcomes based on their investigations.
98. The latest round of NFI started in June 2012, and expands the range of data sets and bodies.

The Highland Council submitted all of the required data sets, except those used for checking duplicate payments. The Council's accounts payable software is able to identify potential duplicate invoice payments so there is no need to do this checking under the NFI. We will report on the progress made by the Council in reviewing its data matches in next year's annual report on the audit.

Standards of conduct and arrangements for the prevention/detection of bribery and corruption

99. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. We have concluded that the arrangements in The Highland Council are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Welfare Reform

100. The Welfare Reform Act 2012, as reported last year represents the biggest reform of the UK welfare system for 60 years. The council receives regular reports on the potential impact of welfare reform on its communities and services. Some changes have already taken place since April 2013 particularly for those of working age.
101. Rent arrears have been increasing in Highland. At the end of the 2012/13 financial year current tenant rent arrears were £1.295 million compared with £1.179 million the previous year (an increase of 10%). Housing officials estimate that welfare reform will result in a further net increase in arrears of £0.199m during 2013/14. Finance, Housing and Social Work Services are actively exploring ways of tackling the problem through prevention, intervention (support) and sanctions.
102. The council as part of a communications strategy has published a number of quick guides to help people understand the changes.

Outlook

103. Welfare reform will continue for several years to come and from October 2013 the Universal Credit has started to be rolled-out nationally. This will replace a range of existing means-tested benefits and tax credits for people of working age. Inverness Job Centre is to be the first in Scotland where the Department for Work and Pensions (DWP) will introduce Universal Credit from November 2013. The council has estimated that the potential number of Universal Credit claimants to migrate across from existing benefits by 2017 to be approximately 26,000.

Best Value, use of resources and performance

- 104.** Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value.
- 105.** The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.
- 106.** As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
- a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
- 107.** Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.
- 108.** This section includes a commentary on the Best Value/ performance management arrangements within the Council. We also note any headline performance outcomes and measures used by the Council, and comment on any relevant national reports and the Council's response to these.

Management arrangements

Best Value

- 109.** In 2009/10 The Highland Council was one of five 'pathfinder' sites for the Best Value 2 audits. The audit concluded that the Council demonstrates that it is improving well and is well placed to deliver future improvements. Effective partnership working and community engagement were highlighted as areas of strength. An improvement plan was agreed by the Council in June 2010 to address the areas for improvement raised by the audit.

110. The improvement plan is substantially complete. The remaining actions have been incorporated into some elements of the Corporate Improvement Programme and the Workforce Development Plan, which continue to be monitored through the relevant Programme Board, or Service Plan.

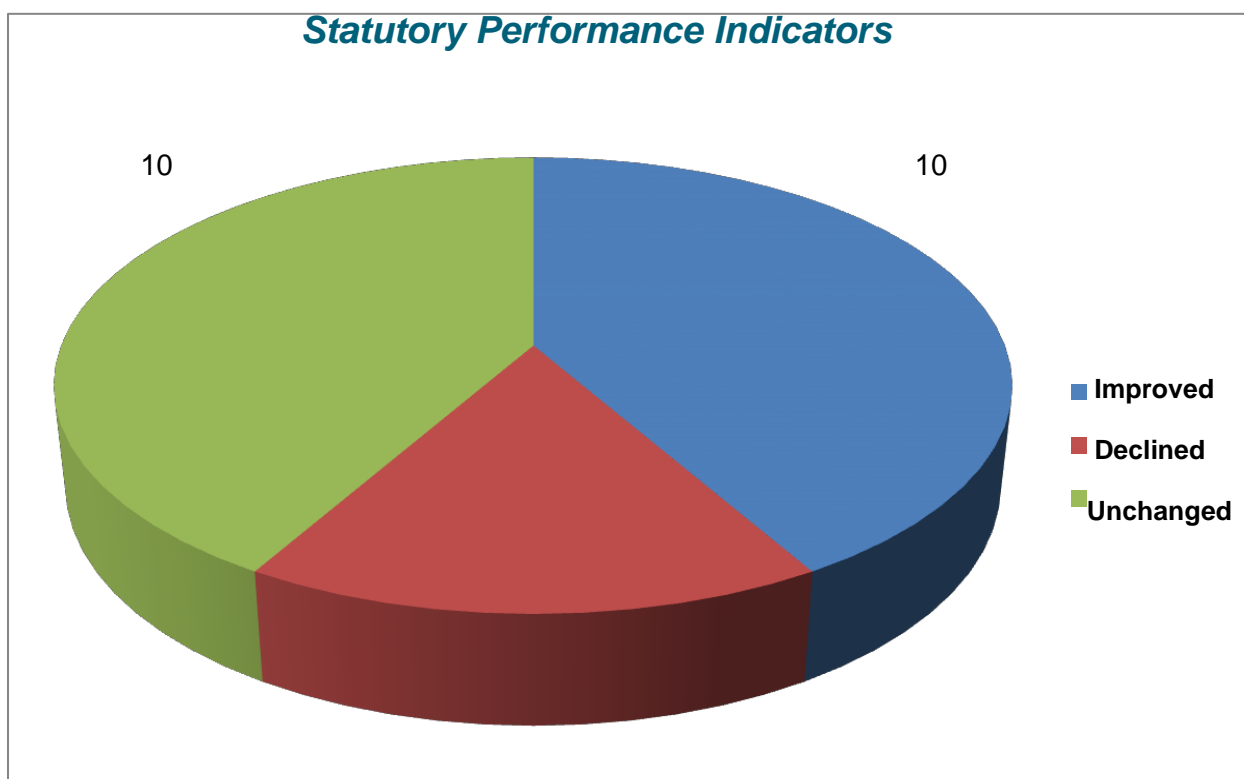
Performance management

111. The Council's performance management framework is robust and integrated with service planning and delivery. Performance information is recorded and reported on an electronic Performance and Risk Management system, with service performance reviewed through Quarterly Performance Reviews (QPR) where service directors and senior managers are held to account. Overall, the Council is making good progress on delivering its commitments.
112. An annual report of corporate performance is prepared based on performance against the council's commitments and corporate performance indicators set out in the performance framework for the council programme "Working Together for the Highlands 2012-17" and the council's corporate plan 2012 -17. Performance against the 129 commitments set out in the council's corporate plan continued to be monitored through the Performance and Risk Management system during 2012/13. As at 31 March 2013, 124 (96%) of these commitments were either complete, progressing well, on target or performance was being maintained. For the remaining 5 (4%) of commitments there was mixed performance. Key commitments delivered or progressing well in 2012/13 include:
- meeting the government's annual efficiency targets
 - introduced a living wage of least £7.45 per hour for all staff from 1 April 2013
 - making good progress towards achieving the Scottish Housing Quality Standard. The proportion meeting the standard is now 70.2% an increase from 41.6% the previous year
 - launched a £1million community challenge fund scheme.
113. As part of the Single Outcome Agreement, the Council and its community planning partners agreed joint commitments to deliver better outcomes for the people of the Highlands. These commitments were grouped under 15 local outcomes, supported by 178 performance indicators.

Statutory performance indicators

114. The Council was required to report a total of 25 SPIs for 2012/13. Exhibit 6 shows the changes in the SPIs compared to the previous year. The measurement basis for one indicator, processing time of planning applications, changed for 2012/13 so no comparison can be made with the prior year.

Exhibit 6: Changes in SPIs compared to previous year



Source: *The Highland Council SPI data return*

- 115.** Indicators showing improvement include the time taken by the Council to re-let houses, the gross administration cost for housing and council tax benefit, the cost of collecting council tax per dwelling and the use of libraries. Homelessness levels have also improved with the Council housing 20% more families that are assessed as homeless or potentially homeless than in the previous 12 months. SPIs where performance has declined include visits to museums, rent arrears and the highest paid 5% of earners among council employees that are women. The Council has investigated those SPIs where performance has declined and is taking action to improve performance in future years.
- 116.** One of the ways the Council listens to its communities is through the annual survey of Council performance and attitudes. This survey is completed by the Citizens' Panel which was set up in 2010, and consists of 2,300 adults. Overall, the 2013 performance survey results were generally positive with 88% of respondents satisfied with Council services and 90% agreeing that they found it easy to contact the Council. Of the 45 service areas surveyed, there were more positive than negative views for 44 services. Only for road repairs and potholes were respondents more dissatisfied than satisfied with the service provided. This is the first year where only one service is viewed negatively on balance. An additional £2 million is earmarked

within the council's general fund balance for roads maintenance in 2013/14 which may improve scores in future years.

National performance reporting

117. Audit Scotland carries out a national performance audit programme on behalf of the Commission and the Auditor General for Scotland. Reports in the last year of direct interest are detailed in Exhibit 7.

Exhibit 7: A selection of National performance reports 2012/13

- | | |
|--|---|
| <ul style="list-style-type: none"> • Responding to challenge and change - An overview of local government in Scotland 2013 • Improving community planning in Scotland • Major capital investment in councils. | <ul style="list-style-type: none"> • Protecting consumers • Using cost information to improve performance - are you getting it right? • Health inequalities in Scotland • Reducing reoffending in Scotland. |
|--|---|

Source: www.audit-scotland.gov.uk

118. Audit Scotland encourages local authorities to review national reports, assess local performance against them and identify actions required to improve performance. The expectation is that these reports are presented to an audit or scrutiny committee for members to review and to question management on key issues.
119. Within The Highland Council, all national performance reports published by Audit Scotland are presented to the relevant Strategic Committee to enable members to consider and agree the action proposed in response to the report's recommendations. Each report is also submitted to the Audit and Scrutiny Committee as its remit includes ensuring that appropriate action was taken by individual Strategic Committees in response to national reports. This ensures that officers and members review the findings and recommendations included in each report in order to identify any that will assist the Council in its drive for continuous improvement.
120. The Audit and Scrutiny Committee recently completed a scrutiny exercise using the checklists contained within two of Audit Scotland's national reports: Using cost information to improve performance: are you getting it right ? and Managing performance: are you getting it right ? Internal Audit will shortly be preparing a report for the Audit and Scrutiny Committee on the outcomes from the exercise.

Local performance reporting

121. In 2010, Audit Scotland agreed to undertake targeted follow up of a small number of performance audit reports each year to promote local impact and assess how far individual

public bodies have improved performance as a result of selected, relevant national performance audits.

122. Scotland's Public Finances: addressing the challenges was selected for targeted follow-up in 2013 to assess how all 32 Scottish Councils were responding to the challenges of public sector budget constraints and their efforts to achieve financial sustainability.
123. Our follow up review found that the Council has a multi-year budgeting process, and has benefitted from the improved forward planning, certainty and stability the process provided. In order to identify the scope to reduce costs the council has a three year programme of service reviews using the Public Sector Improvement Framework model. The council also has its Corporate Improvement Programme which seeks to identify where changes can be made to its back office functions and management costs to improve efficiency and deliver savings to support front line services.
124. Following the balancing of its 2013/14 revenue budget the council has developed a longer term 5 year financial plan covering the period 2014/15-2018/19 and outlined an initial strategy for addressing the funding gap through to 2018/19 of £82.2million. The plan outlines the significant financial risks the council faces and anticipates that through forward financial planning, the Council has time to consider its options to address this situation.

Progress against scrutiny risks identified in the Shared Risk Assessment (SRA)

125. The first Assurance and Improvement Plan (AIP) for The Highland Council was published in July 2010. That document set out the planned scrutiny activity for the Council for the period April 2010 to March 2013 based on a shared risk assessment undertaken by a local area network (LAN) made up of representatives of all of the main local government audit and inspection agencies.
126. The 2013 refresh concluded that there were no significant scrutiny risks for the Council. While the housing service overall is assessed as having no scrutiny required, the Scottish Housing Regulator has asked the council to complete a homelessness enquiry submission and may perform on site work to understand changes in the performance indicators for homelessness.
127. The LAN also reviewed areas where there was uncertainty last year and concluded that further information is still required to reach a judgement in the following areas. Uncertain scrutiny risks remained in relation to community learning and development services now provided by High Life Highland, self evaluation in schools and nurseries and shifting the balance of care for older people from residential to home care. The effectiveness of the Council's new approach to self-evaluation in delivering improved outcomes for service users was also identified as an area of uncertainty for the LAN.

128. In addition, social work services remained an area of uncertain scrutiny risk as it was too early to assess what impact plans to integrate health and social care services would have on outcomes for service users. A joint scrutiny review of the new arrangements for delivery of social care services will be undertaken in 2014/15 by the Care Inspectorate and Audit Scotland. The LAN will meet again towards the end of 2013 to update the SRA and determine whether any further scrutiny work is required for the Council.

Equality Act 2010

129. In April 2011, the Equality Act 2010 introduced a new public sector 'General Duty' which encourages equality to be mainstreamed into public bodies' core work so that it is not a marginal activity but part and parcel of how public bodies operate. One of the key requirements of the legislation is for public bodies to publish a set of equality outcomes (and reporting requirements) no later than 30 April 2013.

130. The Highland Council's equality priorities during 2012 – 2017 are presented in "A Fairer Highland". This Equality Plan is designed to build and improve on the achievements of previous equality schemes, as well as to meet the new and extended public sector duties introduced by the Equality Act 2010.

131. In April 2013, the council published a set of Equality Outcomes for the council and education authority. Each of the equality outcomes aim to meet the needs of the public sector equality duty to eliminate unlawful discrimination, harassment and victimisation; advance equality of opportunity; and promote good relations. The council also published a Mainstreaming Equality report on how its build equality into all its work, an Equal Pay Statement and a Gender Pay Gap report.

Outlook

132. In response to a request from the Cabinet Secretary for Finance, Employment and Sustainable Growth, the Accounts Commission has led development work, with scrutiny partners, on how audit and inspection can support the delivery of better outcomes by Community Planning Partnerships. Following on from the initial pilot work, CPP audits will be carried out at Falkirk, Moray, West Lothian, Orkney and Glasgow City during 2013/14. The findings from these areas will inform our future work programme.

Appendix A: audit report

External audit reports and audit opinions issued for 2012/13

Title of report or opinion	Month of issue	Date presented to Audit Committee
Annual Audit Plan	March 2013	28 March 2013
Shared Risk Assessment/Assurance and Improvement Plan	April 2013	28 June 2013
Report on financial statements to those charged with governance	September 2013	26 September 2013
Audit opinion on the 2012/13 financial statements	September 2013	20 November 2013
Audit opinion on the 2012/13 Whole of Government accounts consolidation pack	October 2013	N/A
Report to Members on the 2012/13 audit	October 2013	20 November 2013

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1		<p>Financial Statements</p> <p>Our audit identified further improvements are needed relating to the arrangements for capital accounting, in the Council's accounting systems. Additional work was undertaken by external audit and Finance staff to identify the amendments required, and the unaudited accounts were adjusted for these and other financial misstatements identified as part of the audit process.</p> <p><i>Risk: potential misstatement of the Council's income, expenditure and year-end financial position. If material amounts are involved, the accounts may be qualified or may not be signed off by the target date.</i></p>	<p>The Finance Service will continue to adopt audit recommendations in an effort to improve its approach to capital accounting and a meeting will be arranged with Audit Scotland to review concerns. The current system for holding information relies heavily on spreadsheets and is therefore less robust than we would like. A new capital accounting module will form part of the project to replace the Financial Information System scheduled for April 2015</p>	Head of Accounting and Budgeting	December 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
2		<p>Integrated Care in the Highlands</p> <p>The integration of child health and social care has been achieved with single management, budgets and governance for these services. Work to establish integrated front line teams and support services in the 2013/14 financial year is ongoing to achieve the full benefits of local service integration for service users and communities.</p> <p><i>Risk: the new arrangements may do not deliver the agreed outcomes for service users.</i></p>	Work will continue to ensure the full benefits of integration are achieved for service users	Director of Health & Social Care	March 2014
3		<p>Welfare Reform</p> <p>Rent arrears are continuing to rise and this is exacerbated by welfare reform.</p> <p><i>Risk: the council may not be able to prevent arrears from increasing further leading to a significant loss of income.</i></p>	Welfare reform , and in particular the “Social Sector Size Criteria” has had a negative impact on arrears. We have increased our staffing resources on rent arrears work and money advice services delivered by the Council, and our financial support to advice agencies.	Director of Housing and Property and Director of Finance	March 2014

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
			We are also targeting additional Discretionary Housing Benefit and Scottish Welfare Fund budgets to mitigate the impacts of welfare reform		