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30 June 2014

David Robertson  
Head of Corporate Finance  
The Highland Council  
Council Headquarters  
Glenurquhart Road  
INVERNESS  
IV3 5NX

Dear David

### Highland Council 2013/14 - Review of main financial systems

Audit Scotland's Code of Audit Practice requires us to assess the systems of internal control put in place by management. In accordance with ISA 330, paragraphs 14 and 15, our audit judgements are based on current year testing of controls and, where appropriate, prior year results. In carrying out this work, we seek to gain assurance that the Council:

- has systems for recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests
- has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
- complies with established policies, procedures, laws and regulations

Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible. As part of our 2013/14 audit we undertook a review of internal audit and concluded that it generally operates in accordance with the Public Sector Internal Audit Standards. A programme of internal and external quality reviews is being put in place. There is also a perceived threat to Internal Audit's independence with the Head of Internal Audit & Risk Management acting as a bank signatory.

The following table summarises the key systems that were tested during 2013/14 including those where we planned to place formal reliance on internal audit's work:

Key System	External audit coverage	Proposed reliance on Internal Audit work
General ledger	✓	
Payroll	✓	
Trade payables	✓	✓
Trade receivables	✓	
Cash and cash equivalents	✓	✓
Non domestic rates	✓	
Council tax	✓	
Housing rents	✓	
Housing benefits	✓	✓
Treasury management	✓	

In our 2012/13 Annual Report we highlighted concerns regarding the robustness of controls covering the capital accounting system. The Council plan to introduce a new financial management system in April 2015 which will include a capital accounting module to replace the existing spreadsheet asset registers. We are therefore as yet unable to rely on the controls system for capital accounting in 2013/14. We will therefore undertake targeted testing on capital accounting entries in the financial statements at the year end. Our findings from this review will be incorporated in our annual report on the audit.

Our 2013/14 Annual Audit Plan detailed three areas of internal audit work as highlighted above where we planned to place reliance for our financial systems assurances. These audits are currently being completed by internal audit. Internal audit has also undertaken work to support the Head of Internal Audit & Risk Management's opinion on the adequacy and effectiveness of the Council's key financial systems and governance arrangements. We will review internal audit's work in these areas and report our findings in our annual report on the audit.

### **Overall Audit Findings**

Our overall assessment is that the key controls within the Council's main financial systems are operating satisfactorily. Where controls have not been tested or where the evidence of a control's effective operation does not exist, we adjust our planned coverage of the financial statements to obtain sufficient evidence that they are free of material misstatement.

A summary of those areas where identified risk exposure requires management consideration is included in Appendix A to this management letter. The issues identified in preparing this management letter are only those which have come to our attention during the course of our normal audit work and are not necessarily all of the weaknesses which may exist. Although we have reported a number of areas for improvement, we should highlight that it is the members and officers of the Council who are responsible for the management and governance of the organisation. We would stress, however, that an effective system of internal control is an essential part of the efficient management of any organisation.

### **Acknowledgements**

The factual content of the enclosed action plan has been agreed in discussion with the appropriate officers. The co-operation and assistance of council staff during the review is gratefully acknowledged.

Please do not hesitate to contact me if you have any queries.

Yours sincerely

**Neil O'Connor**  
**Acting Senior Audit Manager**

No.	Audit Finding	Control Risk	Proposed Management Response & Action	Responsible Officer	Date
<b>Payroll</b>					
1.	Overtime claims are verified and authorised by authorised signatories prior to submission to Payroll. Overtime claims processed by the Payroll Section are not reconciled to the information provided by services by an independent officer.	Individuals are paid for hours not worked.	Will consider as part of the upgrade to Resourcelink.	Payroll and Pension Manager	March 2015
<b>Trade Payables</b>					
2.	Any changes to bank account details require be authorised by completion of a standard form prior to processing. However changes to supplier's bank details can be processed without this written authorisation. There is no independent review of changes to supplier bank account details to ensure only authorised changes are processed.	Payments are made erroneously. Errors/manipulation to supplier's bank account is not detected.	Introduce safeguards to the new Financial system.	Payroll and Pension Manager	March 2015
3.	Controls that prevent the Council processing a duplicate payment can be overridden. To address this weakness potential duplicate payments are investigated. Six months of potential duplicate payments had still to be investigated.	Error/manipulation is not detected timeously.	The backlog of duplicates has been cleared and the checking process is now done in advance of payment being made.	Payroll and Pension Manager	Complete
<b>Cash &amp; Cash Equivalents</b>					
4.	The general income bank account should be reconciled monthly. The September 2013 reconciliation was the latest reconciliation to be evidenced as independently reviewed.	Error/manipulation is not detected timeously.	The reconciliation had been completed and discussed timeously but not actually signed off. In future the person responsible for undertaking the reconciliation will insist on the review being signed off. The Finance Manager will add a monthly task in Outlook calendar as a reminder to review the reconciliation control sign off sheet.	Finance Manager (Accounts and Central Services)	Complete

No.	Audit Finding	Control Risk	Proposed Management Response & Action	Responsible Officer	Date
<b>Housing Benefits</b>					
5.	The benefits system is updated on an annual basis to ensure the calculation of benefits for individuals is accurate. In 2013/14 the War Widows Pension income was not updated.	Incorrect benefit is awarded to individuals. There is a further risk that the Council lose benefit subsidy as the payments will be classified as local authority error.	The 2013/14 War Widows Pension was updated by 1.64% in error. The correct uprating amount was 2.2%. This error affected 2 Housing Benefit claims with income over the applicable amount. War Widows Pension is fully disregarded for the purposes of administering Housing Benefit. This uprating error therefore has had no financial impact for the 2 claimants. The impact on subsidy was negligible. The Assistant Policy and Development Manager will continue to check and sign off this extensive report.	Assistant Policy and Development Manager	Complete
<b>Council Tax</b>					
6.	The Council review those individuals awarded a single person discount on an on-going basis. Other long standing exemptions/discount awards are not subject to a rolling programme of review.	Exemption/discounts may continue to be awarded when they are no longer valid.	Monthly review reports are run to identify disabled band reductions, discounts, disregards and exemptions. Action is to be taken during 2014/15 to undertake reviews including making better use of existing technology to automate the review process which is currently very labour intensive, and a targeted review of some discounts similar to that undertaken in 2011.	Operations Manager	March 2015

No.	Audit Finding	Control Risk	Proposed Management Response & Action	Responsible Officer	Date
<b>Internal audit</b>					
7.	<p>Our 2013/14 Annual Audit Plan detailed the areas of internal audit work we planned to place reliance on for the financial systems assurances including:</p> <ul style="list-style-type: none"> <li>• trade payables</li> <li>• cash and cash equivalents</li> <li>• housing benefits</li> </ul> <p>All of these internal audit reviews were in the process of being completed at the time of our review. We will review internal audit's work in these areas and report our findings from these reviews in our annual report on the audit.</p>	<p>Internal audit is not in a position to provide the planned assurances to external audit.</p>	<p>The audits are substantially complete and the status is as follows:</p> <ul style="list-style-type: none"> <li>• trade payables (creditors) – the draft report is in progress and is expected to be issued within the next 7 – 10 days.</li> <li>• this planned central audit did not take place due to staff vacancies. The key controls were examined as part of the Statement on Internal Control work for 2013/14. In addition, some specific audits of income systems have taken place: <ul style="list-style-type: none"> <li>○ High Life Highland – income systems. Fieldwork nearing completion for this audit. Draft report expected to be issued by the end of this month.</li> <li>○ School Meals Income Collection and Monitoring System (follow-up) – final report has been issued and will be considered by next week's Audit &amp; Scrutiny Committee.</li> </ul> </li> <li>• housing benefits - testing of the 2013/14 cases is substantially complete, a number of queries have been put to the Assistant Operations Manager and a response is expected in the next couple of days. Once this has been obtained then the information on HBCOUNT can be reviewed.</li> </ul>	<p>Head of Internal Audit &amp; Risk Management</p>	<p>30 June 2014</p>