AUDIT SCOTLAND

The Highland Council

Annual audit report to Members and the Controller of Audit

September 2015

The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies. (www.audit-scotland.gov.uk/about/ac)

Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. (www.audit-scotland.gov.uk)

The Accounts Commission has appointed Stephen Boyle as the external auditor of The Highland Council for the period 2012/13 to 2015/16.

This report has been prepared for the use of The Highland Council and no responsibility to any member or officer in their individual capacity or any third party is accepted.

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

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Key messages

Audit of financial statements	• Our independent auditor's report on the council's 2014/15 annual accounts is unqualified. • Our independent auditor's reports on the financial statements of the two charitable trusts administered by the council are unqualified. • The annual accounts submitted for audit did not fully meet the requirements of the new accounting regulations. A more robust and challenging review process is required to improve the quality of the annual accounts submitted for audit.
Financial management and sustainability	• The council's financial management arrangements require improvement in some areas. The failure of an ICT project led to a significant financial loss for the council. Failure to properly administer the Common Good Funds meant that the council had to reimburse the Funds for income lost. • The council has an adequate level of reserves, and is containing its expenditure within annual budgets. In its medium term plan it has identified that it needs to make £46.3 million of savings over the next three years. £14.4 million of savings have been identified but difficult decisions involving the reduction and cessation of services and the downsizing of the workforce will be required in order for the council to deliver the remaining savings.
Governance and transparency	• Overall, the council's governance arrangements operated effectively during 2014/15. However, the administration of the Common Good Funds requires improvement. Monitoring and reporting of compliance with the Councillors Code of Conduct was not completed in full during 2014/15. • Appropriate systems of internal control are in place except for those relating to the operation of the intercompany accounts with the pension fund and reconciliation processes. • The council has an effective internal audit function and sound anti-fraud arrangements are in place.

Best Value	• The council has a well developed framework in place for monitoring and reporting performance against strategic priorities. • Its annual performance report highlighted that 96% of the council's commitments were either complete, progressing well or performance was being maintained. • The council's approach to public performance reporting was assessed as fully meeting the requirements in 11 (42%) of the 26 criteria. Key areas for improvement include increased use of graphics, comparators, trend information and benchmarking.
Outlook	• In common with other councils, The Highland Council faces the key challenges of reducing budgets, an aging population with higher levels of need and public expectation of high quality services. Its remote location and rural geography brings further challenges in service delivery and future redesign of services. Continuing effective partnership working and the successful implementation of its transformational savings programme will be essential to make the best use of available resources supported by strong governance and leadership.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of The Highland Council. The report is divided into sections which reflect our public sector audit model.

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

3. Our responsibility, as the external auditor of The Highland Council, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements. This does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.

5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, summarised at **appendices II and III**, include recommendations for improvements.

6. **Appendix IV** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that The Highland Council understands its risks and has arrangements in place to manage these. Members and the Executive Leadership Team should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

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

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

Audit of the 2014/15 financial statements

Audit opinion	• We have completed our audit and our independent auditor's report is unqualified.
Going concern	• The financial statements of the council, its group and the associated charitable trusts have been prepared on a going concern basis. We are unaware of any events or conditions that may cast significant doubt on the council, its group and associated charitable trusts ability to continue as a going concern.
Other information	• We review and report on other information published with the financial statements, including the management commentary, annual governance statement and the remuneration report. We had nothing to report in respect of these statements in our independent auditor's report.
Charitable trusts	• We have completed our audit of the 2014/15 financial statements of the charitable trusts administered by The Highland Council and issued an unqualified independent auditor's report for both of the Trusts.
Group accounts	• The Highland Council has accounted for the financial results of three subsidiaries and two associates in its group accounts for 2014/15. The overall effect of consolidating these balances on the group balance sheet is to increase total reserves and net assets by £32.923 million.

Submission of financial statements for audit

9. We received the unaudited financial statements on 22 June 2015, in advance of the agreed timetable. The working papers were of an acceptable standard although there were issues with some not being fully updated from the previous year.

10. The unaudited accounts did not fully meet the requirements of the new Local Authority Accounts (Scotland) Regulations 2014. A more robust review process needs to be put in place in future years to improve the quality of the financial statements submitted for audit (see paragraph 24, issue 1 for details).

Action plan no. 1

Overview of the scope of the audit of the financial statements

11. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit and Scrutiny Committee on 26 March 2015.

12. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan, and as we did not carry out any additional work to our planned audit activity, the fee remains unchanged.

13. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).

16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

17. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of The Highland Council we set our planning materiality for 2014/15 at £8.2 million (1% of gross expenditure). We report all misstatements greater than £100,000. Performance materiality was calculated at £4.1 million to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our planning materiality level.

18. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original calculation remained appropriate.

Evaluation of misstatements

Council

19. A number of presentational and monetary adjustments were identified during the course of our audit. These were discussed with officers who agreed to amend the unaudited accounts. The effect of these adjustments is to increase the surplus on the provision of services by £4.098 million and increase the surplus on the revaluation of non-current assets by £1.183 million. Net assets (and reserves) have increased by £5.281 million.

20. A number of monetary errors were identified which were not processed through the annual accounts by management. If adjusted these would have a net effect of decreasing the surplus on the provision of services by £1.434 million, and the net assets (and reserves) on the Balance Sheet by £1.434 million. Management explained that these adjustments were not material to the financial statements.

Charitable Trusts

21. A number of adjustments were identified within the financial statements of the Highland Charities Trusts during the course of our audit. These were discussed with officers who agreed to amend the unaudited financial statements. The effect of these adjustments is to increase the surplus for the period by £24,516 and increase the statement of balances by £27,857 due to the omission of proceeds from the sale of investments and the the market value of one of the Trusts' investments.

22. A number of adjustments were identified within the financial statements of the Highland Council Charitable Trusts. These were discussed with officers who reviewed the basis for preparation of the unaudited accounts and concluded that the audited accounts should be prepared on a receipts and payments basis. The effect of this change in presentation is to decrease incoming resources for the period by £740,900, and increase the market value of investments by £1,435,218.

Significant findings from the audit

23. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:

- the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures
- significant difficulties encountered during the audit
- significant matters arising from the audit that were discussed, or subject to correspondence with management
- written representations requested by the auditor
- other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

24. During the course of the audit we identified the following significant issues that, in our view, require to be communicated to you.

Significant findings from the audit

Issue	Resolution
1. Local Authority Accounts (Scotland) Regulations 2014: the financial statements submitted for audit did not comply with the requirements of the new accounting regulations: • a management commentary had been prepared but the content did not fully comply with the guidance issued by Scottish Ministers • an annual governance statement had been prepared but the content did not comply with the CIPFA guidance 'Delivering good governance in local government'. • the statement of responsibilities had not been amended to reflect the new responsibilities set out in the new regulations. Also, the advertisement of the unaudited accounts for public inspection did not refer to the new regulations, instead giving notice under the previous (1985) regulations. In our opinion, there was an absence of a robust and comprehensive review of the accounts prior to their submission for audit.	The management commentary, statement of responsibilities and annual governance statement included in the audited accounts have been revised to comply with the 2014 regulations and guidance issued by CIPFA and Scottish Ministers. The annual accounts have been updated to include the names of the key officers and members who are required to sign them.

Issue	Resolution
2. Loan to Inverness Airport Business Park Ltd - – the council incurred costs of £1.175 million in support of Inverness Airport Business Park Ltd in 2005 and 2006 which the company was due to repay under a loan stock instrument. The company was due to repay half of the balance in 2010 and the remainder in May 2015 but on both occasions the company exercised its right to defer these payments. The terms and conditions of the loan agreement between council and the company does not enable the council to pursue the debt in the normal way. For example, the council does not hold security over any of the assets of the company. The loan agreement includes clear conditions that enable the company to defer repayment unless, in its opinion, certain conditions regarding its development plan have been met. In their view, these conditions have not been met and as such they did not repay either tranche of the loan. The Director of Finance and Director of Development & Infrastructure met with the directors of the company to discuss the situation and requested a business plan and timescale for repayment to be provided. This has yet to be received and, in our opinion, there is insufficient evidence to support the continued inclusion of the loan within the council's annual accounts as we think there is uncertainty about it ever being repaid. The surplus on the provision of services and net assets (and reserves) are, therefore, overstated by £1.118 million (the balance included in the 2014/15 annual accounts).	The Director of Finance has chosen not to amend the audited annual accounts for this amount as he does not agree with our assessment of the collectability of the debt. He has agreed to include a post balance sheet event in the audited annual accounts to explain the council's position. The amount is not material to our opinion on the annual accounts. **Action plan no. 2**

Issue	Resolution
3. Gross Income and Gross Expenditure disclosures- as part of the year end procedures journals are processed to reallocate income and expenditure so that the disclosures in the Comprehensive Income and Expenditure Statement (CIES) are in line with the Service Reporting Code of Practice (SeRCOP). Journals are also processed to eliminate internal income and expenditure. Errors in the processing of some of these journals resulted in significant misstatements between Services in the CIES. As a result: Central Services gross expenditure was understated by £21.7m Central Services gross income was understated by £8.5m Education gross expenditure was overstated by £7.4m Social Work gross expenditure was overstated by £2.2m Planning & Development gross expenditure was overstated by £1.8m Roads & Transport gross expenditure was overstated by £1.4m Other Housing gross expenditure was overstated by £0.2m, and Cultural & Related Services gross expenditure was overstated by £0.2m.	The audited accounts have been amended to correct these misstatements.
4. Split of borrowing between long term and short term – the working paper used to calculate the split of borrowing between long and short term had not been correctly updated. As a result, short term borrowing was understated and long term borrowing was overstated by £21.7 million in the unaudited accounts.	The audited accounts have been amended to correct these misstatements.

Issue	Resolution
5. Capital accounting - the audit of this area ran much more smoothly this year. There were, however, issues with the information provided by the valuer including lack of communication of changes made between different versions of the valuation reports and a lack of clarity over the terminology used in the valuation report. A number of adjustments were required to the unaudited accounts which have the net impact of increasing Property, Plant & Equipment by £5.3 million, the Revaluation Reserve by £1.6 million and the Capital Adjustment Account by £3.7 million.	The audited accounts have been amended to correct these misstatements.
6. Vacant and Derelict Land Fund (VDLF) – the council treated unspent VDLF grant at the year end as a creditor instead of as a Capital Grant Receipts in Advance as it had done in previous years. As a result, creditors were overstated and Capital Grant Receipts in Advance were understated by £2.334 million in the unaudited accounts.	The audited accounts have been amended to correct this misstatement.
7. VDLF and Finance income – the council did not properly clear its accrual reversals and was left with a credit balance on a suspense account at the year end. This was treated a windfall income for the Finance Service when it should have been offset against receipt of VDLF grant income which had been properly accrued for in previous years. As a result, Finance Services gross income was overstated and Capital Grant Receipts in Advance were understated by £0.230 million in the unaudited accounts.	The audited accounts have been amended to correct this misstatement.

Issue	Resolution
8. **Housing Benefit Subsidy Claim Income –** following submission of the subsidy claim, the council identified additional subsidy that it was due to claim back and so revised the subsidy claim. As a result, Housing Services gross income and debtors were understated by £0.239 million.	The audited accounts have been amended to correct these misstatements.
9. Capital expenditure funded from the Capital Fund - capital expenditure funded from the Capital Fund was incorrectly accounted for in the unaudited accounts. As a result, Other Housing gross expenditure, HRA gross expenditure and Capital Grants & Contributions were overstated by £0.391 million, £2.050 million and £2.441 million respectively.	The audited accounts have been amended to correct these misstatements.
10. HRA – rent arrears from former council house tenants are being written off the housing rents system and raised as a debtor through the council's sundry debtors system. As a result, HRA income and expenditure are overstated by £0.333 million, and Houisng Servcies income and expenditure are overstated by £0.314 million. In addition, former tenants' arrears disclosures are understated within the unaudited accounts.	The audited accounts have been amended to correct these misstatements.

Issue	Resolution
11. Common Good Funds – the council is not accounting for investment properties correctly within its Common Good Fund accounts. Properties should be valued at the Balance Sheet date but they are currently valued at the start of the year. Realised gains totalling £1.214 million have not been recognised in the Common Good Funds' CIES. These should be included as 'other income' in the CIES to ensure that the surplus/deficit on the sale of available for sale assets agrees to the movement on the reserve.	The valuer has provided a valuation of these investment properites as at 31 March 2015. This provides us with assurance that the valuation in the audited accounts is not misstated. The Director of Finance has confirmed that investment properties will be valued at the Balance Sheet date in future years. The audited accounts have been amended to correct the misstatement of realised gains.
12. IAS 19 (Retirement Benefits) - the council provides the Highland Council Pension Fund's actuary with information to calculate the IAS 19 costs in January each year. The costs associated with two early retirements granted by the council in the last quarter of the year are not reflected in the actuary's figures or the unaudited accounts. As a result, non distributed costs and the pensions liability (and pensions reserve) are understated by £0.102 million.	The Director of Finance has chosen not to amend the audited annual accounts for this misstatement. The amount is not material to our opinion on the annual accounts.
13. Capital grants and contributions – audit testing identified that a refund of capital expenditure had been treated as capital grants and contributions in the unaudited accounts. As a result, capital grants and contributions are overstated and non current assets (infrastructure assets) are overstated by £0.214 million.	The Director of Finance has chosen not to amend the audited annual accounts for this misstatement. The amount is not material to our opinion on the annual accounts.

Issue	Resolution
14. Employee related claims - in previous years, we commented that the council had made a provision to meet the costs arising from equal pay compensation claims. As a result of a recent decision by the European Court of Justice, the council reviewed its provision and concluded that there was no need to increase the provision in 2014/15. The level of provision is considered to be adequate at this time; however, the ultimate cost to the council remains uncertain.	Management will review the equal pay provision annually to take account of any legal developments.
15. Charitable Trusts – the Highland Council Charitable Trusts' financial statements submitted for audit did not comply with the Charities Statement of Recommended Practice. There was limited evidence that these financial statements, or those for the Highland Charities Trust, had been fully reviewed prior to submission for audit.	Refer to paragraph 21 for details of the amendments made to the Highland Charities Trusts financial statements. Refer to paragraph 22 for details of the amendments made to the Highland Council Charitable Trusts financial statements
16. Charitable Trusts – governance costs included in both charities' financial statements exceed the trigger (25% of total resources expended) set by OSCR as indicative of a possible failure to apply funds for charitable purposes. Governance costs account for 29% of the resources expended by the Highland Council Charitable trusts and 90% of the resources expended by Highland Charities Trust. These governance costs are payable to The Highland Council. We asked for evidence that the Trustees had approved these governance costs but none could be provided.	There is no impact on our audit opinion of the financial statements. Refer to paragraph 78 for our conclusions on the charitable trusts' governance arrangements. A copy of this report will be sent to the Office of Scottish Charities Regulator for their information.

Issue	Resolution
17. Charitable Trusts governance documentation – the governance documentation for three trusts included within the Highland Council Charitable Trusts could not be located as a consequence of the age of these trusts. The classification of these funds between restricted, unrestricted and endowment funds could not readily be established. We were also unable to verify whether spend in these areas was in line with the original stated purpose for these individual trusts.	Disclosures in the accounts have been amended to highlight for which trusts governance documentation is not held and on what basis the trustees account for and use these funds. All funds are treated as endowments and where there is an absence of governance documentation the council relies on custom and practice to inform any decisions by the trustees in respect of the Trusts' expenditure and use of assets. We are not aware of any matters which would materially impact on the financial statements.

Future accounting and auditing developments

Revisions to the Code of Practice

25. The financial statements of the council are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which interprets and adapts International Financial Reporting Standards (IFRS) to the local authority context. The following paragraphs set out the most significant changes to accounting requirements introduced by the 2015/16 Code.

26. **(IFRS) 13 Fair value measurement:** Although the measurement requirements for operational property, plant and equipment will not change, enhanced valuation disclosures will be required. The 2015/16 Code, however, requires surplus assets to be measured at fair value in accordance with IFRS 13. The council will need to make the necessary preparations to ensure that the new requirements are addressed for the 2015/16 financial statements.

27. **Transport infrastructure assets:** The council's highway assets are currently carried, within infrastructure assets in the balance sheet, at depreciated historic cost. The 2016/17 Code will require highways to be measured, for the first time, on a depreciated replacement cost basis. This is a major change in the valuation basis for highways and will require the availability of complete and accurate management information on highway assets.

28. The council's Whole of Government Accounts return highlights that it will not be able to fully implement the Code in 2016/17. Sufficient, appropriate and robust inventory data for land and footways and cycle tracks is currently unavailable and the council is not confident that it will be in place by 2016/17. Condition and age data is also not available for footways and cycle paths and again the council is not confident that this can be achieved by 2016/17.

Action plan no. 3

Financial management and sustainability

Net service budget expenditure £607.8 million

- Service outturn £604.2 million
- Service budget underspend £3.6 million

Planned capital expenditure £168.1 million

- Outturn capital spend £145.6 million
- Capital slippage £22.5 million

Planned use of reserves £6.1 million

- Actual increase in usable reserves £1.6 milion
- Outturn usable reserves £86.9 million

Financial management

29. In this section we comment on the council's financial outcomes and assess its financial management arrangements.

30. The council sets an annual budget to meet its service and other commitments for the forthcoming financial year. The setting of the annual budget impacts directly on residents as it determines council tax and other fees and charges. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

Financial outcomes

31. The council's annual accounts reported a surplus of £10.134 million on the provision of services in 2014/15. After adjusting this balance to reflect the statutory funding arrangements in place, and transfers to its other statutory reserves have been taken into account, the council increased its general fund balance by £1.900 million.

32. The council reported an underspend against its 2014/15 general fund budget of £5.921 million (1%). All services delivered under budget except for Scottish Welfare Fund grants which were overspent by £0.116 million. Loan charges were £2.505 million less than budget due to continued low interest rates and delayed borrowing due to slippage on the council's capital programme. Council tax income contributed £2.076 million to the underspend due to improved recovery of prior year debt and review of the provision for non collection of council tax arrears.

33. The council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set to at least cover the costs of its social housing provision. Rent levels are therefore a direct consequence of the budget set for the year. In January 2014, the council set a breakeven budget for its HRA. This included a planned revenue contribution to capital expenditure of £4.325 million.

34. Overall, the HRA broke even in 2014/15, although within this outturn there were overspends on repairs and maintenance expenditure (£1.257 million) and underspends on loan charge (£0.615 million). Income was £0.255 million more than budget due to other income being greater than expected. Capital expenditure funded from revenue was slightly less than budget at £4.198 million.

35. The management of the council's budgets is satisfactory. As noted at paragraphs 57 and 58, the council has to find savings totalling £46.288 million in the next three years in order to balance its budgets. Services will need to build on the underspends they reported for 2014/15 in order to meet the financial challenges ahead. Savings on treasury management costs (£1.953 million) have already been included in the council's Transformational Savings Programme.

Capital programme 2014/15

36. The council spent £102.352 million on its general services capital programme in 2014/15 against a planned budget of £116.589 million, resulting in an underspend of £14.237 million (12%). The majority of the programme was focused on improving the school estate through new builds and refurbishment and repair of existing schools; the River Ness flood prevention scheme; and roads and transport infrastructure. Slippage on the council's priority projects is being carried forward to enable them to continue to completion.

37. The Housing Revenue Account capital programme focused on the replacement of major components (e.g. heating systems) and new council houses. Actual spend was £43.240 million against a budget of £51.534 million, resulting in an underspend of £8.294 million (16%). We have been advised that this slippage is due to delays in letting heating contracts and the award of contracts for the council's new build programme.

38. The council has a history of slippage within its capital programmes and has previously taken steps to include more projects in the programme than funding available to provide flexibility in managing the scheduling of projects to maximise expenditure. These steps, however, have not prevented slippage against both its programmes.

Action plan no. 4

39. The council's capital financing requirement (the amount it has to borrow to finance capital expenditure after other sources of finance, including government grants, are taken into account) increased by £34.1 million in 2014/15. The Director of Finance reviews the council's capital financing requirement on an annual basis and reports on a series of prudential indicators as recommended by the Prudential Code (a professional code of practice designed to support local authorities in taking capital investment decisions). Performance against these indicators is regularly reported to the Resources Committee and this helps the council to plan its capital investment.

Financial management arrangements

40. As auditors, we need to consider whether councils have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the proper officer has sufficient status within the council to be able to deliver good financial management
- financial regulations are comprehensive, current and promoted within the council
- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge and question budget holders on significant variances.

41. The Director of Finance, as section 95 officer and a member of the council's Executive Leadership Team, has sufficient status to oversee the financial management of the council.

42. The council's financial regulations are reviewed regularly and are available on the website. We reviewed the regulations, as part of our 2014/15 audit, and concluded that they were comprehensive.

43. Financial monitoring reports (both revenue and capital) are submitted to the Executive Leadership Team on a monthly basis and to the Resources Committee each quarter. Service Committees receive more detailed budget monitoring reports for their service areas. Reports are comprehensive and provide explanations for significant variances.

44. During the year, we reviewed the council's financial management arrangements. We compared its five year revenue budget (2014 to 2019) against the important features of a financial strategy set out in exhibit 3 in Audit Scotland's national report 'Scotland's public finances: a follow up audit'. We concluded that the five year budget could be improved by including:

- scenario planning – only one scenario (the most likely) is included in the council's revenue budget papers
- capital investment activity – only a broad brush assumption is included (assumes £2.5 million increase in loan charges per annum)
- demand – no analysis of service demand or projected income
- links to council strategies – no clear links to workforce, asset management, risk management, treasury management strategies included
- risks and timescales – risks and timescales associated with achieving financial sustainability could be better presented.

45. The 2014/15 capital and revenue budgets reflected the priorities set by the previous administration in *'Working together for the Highlands 2012/17'.* We noted that budgets could be better linked to outcomes as some of its targets are unclear. The Director of Finance acknowledges that it is not always clear how spending decisions link to outcomes. Achieving this will be easier for some services than for others but more could be done through the council's performance management system to evidence this.

Action plan no. 5

46. As auditors we attend a number of council and committee meetings each year. Members provide a good level of challenge and question officers on significant variances and service performance levels.

ICT project failure

47. The council sustained a significant financial loss, during 2014/15, following the failure of an ICT project aimed at providing a corporate arrears recovery system. The Director of Finance has estimated that the council lost £0.288 million on this project, although he acknowledges that this does not include the costs of internal staff time spent on the project. Internal audit investigated the reasons for this project failure and found significant weaknesses in governance,

reporting and accountability. Recommendations have been made to improve these arrangements, all of which are due to be completed by 31 March 2016.

48. In the last year the council has also reported failures in the financial management of the Common Good Funds. As a result, the council has agreed pay restitution to these Funds of £0.312 million (refer to paragraphs 109 to 115 for details).

Conclusion on financial management

49. We have concluded that the council's financial management require improvement in some areas. The council suffered a significant financial loss during the year and its failure to properly administer the Common Good Funds meant that income due to these Funds was lost. Improvements could also be made to the content of the council's medium term budget (financial strategy) and to better evidence how spending decisions link to outcomes.

Financial sustainability

50. The council delivers a broad range of services, both statutory and discretionary, to its communities. Financial sustainability means that the council has the capacity to meet the current and future needs of its communities.

51. In assessing financial sustainability we are concerned with whether:

- there is an adequate level of reserves
- spending is being balanced with income in the short term
- long term financial pressures are understood and planned for
- investment in services and assets is effective.

52. Effective long-term financial planning, asset management and workforce planning are crucial to sustainability.

Reserves

53. Usable reserves form part of the council's financial management strategy. Exhibit 1 shows that the overall level of usable reserves held by the council increased by £1.6 million compared to the previous year and totalled £86.896 million as at 31 March 2015.

Exhibit 1: Usable reserves

Description	31 March 2014 £ million	31 March 2015 £ million
General fund	40.340	42.240
Housing revenue reserve	7.328	7.328
Repair and renewal fund	1.669	1.711
Capital Fund	31.703	30.631
Capital receipts reserve	1.885	2.202
Insurance fund	2.409	2.784
Total usable reserves	**85.334**	**86.896**

Source: The Highland Council 2014/15 annual accounts

54. The General Fund balance increased by £1.9 million during the year. This was due to the transfer of developers' contributions from the Capital Fund to the General Fund. The closing balance at 31 March 2015 is made up of earmarked commitments of £22 million and an unallocated balance of £20.2 million, 3.6% of annual running costs (2013/14: 3%). This position is in line with the council's policy which is to maintain uncommitted reserves at a minimum of 2.5% of the revenue budget over the medium term.

55. The most significant earmarked balances include:

- Strategic Change and Development Fund - £4.5 million
- IT Investment Fund - £2.6 million
- Devolved School Management - £2.6 million

56. Exhibit 2 shows how the council's usable reserves position in relation to its net revenue stream (including dwelling rents) compares to other Scottish councils. The council's position has improved slightly in comparison with other councils since last year.

Exhibit 2: total usable reserves as a proportion of net revenue

Source: Scottish councils' unaudited accounts 2014/15 (excluding Orkney & Shetland)

Financial planning

57. In December 2014 the council approved its revenue budget for 2015/16 and an indicative budget for the following three years. The 2015/16 budget was set at £588.347 million, an increase of 4.4% on that budget set for 2014/15. In setting its revenue budget the council identified the need for savings of £17.409 million to be delivered in 2015/16.

58. The council's initial indicative budget highlighted that it needed to make savings of £13.521 million in the three years to 2018/19. It subsequently revised its forecast savings to £46.288 million for this period to reflect expected reductions in the Scottish Government cash grant settlement and increases in staff pay awards, teachers' pension contributions, and national insurance contributions.

59. The council has identified £14.4 million of savings for the three years to 2018/19 (see paragraphs 142 and 143). Difficult decisions involving reduction and cessation of services and downsizing of the workforce will require to be made if the council is to deliver the remaining savings and balance its budgets over the next three years.

Action plan no. 6

Treasury Management

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

61. In the current financial climate, many councils have relatively high levels of internal borrowing, utilising available cash balances and deferring external borrowing. The council's level of borrowing in 2014/15 increased by 3% from the previous year. This is in line with the council's Treasury Management Strategy for 2014/15, which was to access attractive long term borrowing rates while at the same time aiming to balance the maturity profile of its overall debt portfolio.

62. As at 31 March 2015 the council had total borrowings of £771.564 million (2013/14 £750.881 million), of which 86% is at a fixed rate of interest and is a repayable over the long term. Interest payable and similar charges rose by £2.165 million in 2014/15 to £46.332 million.

63. Audit Scotland published 'Borrowing and treasury management in councils' in March 2015. This report concluded that councils are meeting professional requirements but need to do more to set out the longer term implications of borrowing and other debt on their finances. The March 2015 report was considered by the council's Resources Committee in May 2015.

Workforce Management

64. Effective workforce management is essential to ensure that the council maximises the effectiveness of its employees. In December 2014, the council agreed a package of savings totalling £42.8 million to be phased over four years, with an estimated reduction of 313 full time equivalent staff posts over this period. Workforce planning will play a key role in the delivery of these savings.

65. Internal audit reviewed the council's approach to workforce planning as part of their 2014/15 annual plan. As part of this exercise they reviewed:

- the extent to which the council's workforce planning arrangements addressed the recommendations set out in the Audit Scotland's national report *'Scotland's public sector workforce',* published in November 2013

- progress made in achieving the key stages within the council's workforce planning model.

66. Internal audit concluded that the council's workforce planning arrangements addressed the recommendations set out in the Audit Scotland report, and that progress had been made towards adopting a consistent approach to workforce planning across all council services. Two key actions had still to be implemented, and internal audit expressed concern that the timetable for publishing workforce plans and service learning plans (by 1 April 2015) would not be met by all of the council's services. An agreed action plan was included within the internal audit report to address the outstanding actions. A recent report to the Resources Committee confirmed that all Service workforce plans would be submitted to the council's strategic committees by the end of August 2015.

Pension liability

67. The council is a member of The Highland Council Pension Fund which is a multi employer defined benefit scheme. In accordance with IAS 19 (Retirement Benefits), the council has recognised its share of the net liabilities for the pension fund in the balance sheet.

68. The pension liability represents the difference between expected future pension payments and the underlying value of pension fund assets available to meet this cost.

69. The valuation as at 31 March 2015 provided by the scheme's actuaries increased the council's share of the deficit from £392 million last year to £418 million this year. This is mainly due to the decrease in the real gilt yield which increased the value placed on the pension fund's liabilities.

70. At the last triennial valuation The Highland Council Pension Fund was 96.2% funded and had assets of £1,279 million. The next valuation will take place in 2017. The 2014 triennial valuation slightly increased the employer contribution payable by the council from 18% of pensionable pay in 2014/15 to 18.5% in 2015/16.

Conclusion on financial sustainability

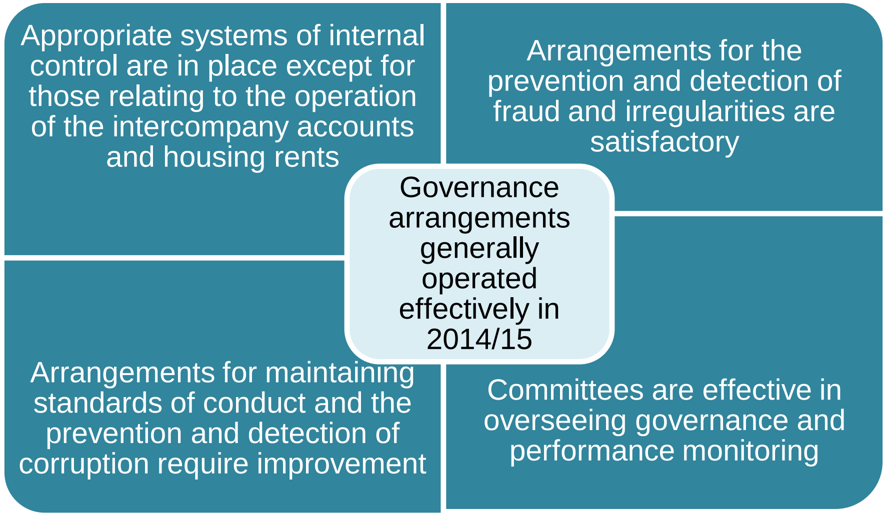
71. We have concluded that the council has an adequate level of reserves, and is containing its expenditure within annual budgets. A medium term plan is in place but the council has a significant funding gap to bridge over the next three years. Rising demand for and costs of services will continue to place a strain on the council's capacity to deliver services at the current levels.

Outlook

72. Councils face increasingly difficult financial challenges. Public sector budgets are reducing and demand for council services is increasing. Increased national insurance charges will create further cost pressures on the council.

73. In common with other councils, The Highland Council has highlighted the need to identify significant savings over the next few years. With further reductions expected, councils face tough decisions to balance their budgets. These decisions must be based on a clear understanding of the current financial position and the longer term implications of decisions on services and finances.

Governance and transparency



74. Elected members and management of the council are responsible for establishing arrangements to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

75. The corporate governance framework is centred on the council which is supported by the following strategic committees:

- Community Services Committee
- Education, Children & Adult Services Committee
- Planning, Development & Infrastructure Committee
- Resources Committee

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

77. In June 2015, the council announced that a new, minority, Administration had been formed to lead the council. The new Administration, made up of 32 Independent councillors, replaces the former SNP led Administration. The new Administration has set out its priorities in *'Highland First'* . This programme will run alongside the commitments set out in the council's original programme *'Working together for the Highlands*' and progress against both will be monitored and reported to council in September 2016. *'Highland First'* will form the basis of the council's future corporate and service plans. We will consider the impact of these revised governance arrangements as part of our 2015/16 audit.

78. The council's two charitable trusts are governed by trustees. Last year we reported that no trustee meetings had been held during 2013/14 and recommended that regular meetings should be held to enable trustees to consider and agree how charitable funds are to be managed and disbursed. In response, we were advised that a review of the charitable trusts' governance arrangements would be undertaken by December 2014. This year we again noted that no trustee meetings had taken place. Without these it is unclear how trustees are able to demonstrate proper stewardship of the funds.

Action plan no. 7

Local code of corporate governance

79. The council has developed and adopted a local code of corporate governance which reflects the key components as set out in the CIPFA/SOLACE *'Framework Corporate Governance in Local Government: A Keystone for Community Governance'*. The local code is subject to annual review and update by the Depute Chief Executive. Each year, internal audit review the council's compliance with the local code and report their findings to the Audit and Scrutiny Committee.

Internal control environment

80. As part of our audit we reviewed the high level controls in operation within the financial systems which are fundamental to the preparation of the financial statements. Our objective was to obtain evidence to support our opinion on the council's annual accounts.

81. We reported our findings to the Audit and Scrutiny Committee in September 2015. We did not identify any material weaknesses in the accounting and internal control systems, except for those for housing rent income, which could adversely affect the 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.

82. Our report, however, included a number of recommendations to enhance the control systems in operation. In particular, we noted that the council needs to improve its reconciliation processes so that reconciling items are timeously investigated and cleared. Similarly, suspense account balances should also be regularly reviewed, investigated and cleared. The Director of Finance has confirmed that reconciliation processes will be reviewed during 2015/16.

Internal audit

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

84. Our review of internal audit concluded that the council's internal audit service operates in accordance with the majority of the Public Sector Internal Audit Standards. In order to achieve full compliance, an external assessment is required to take place at least every five years. The Scottish Local Authorities Chief Internal Auditors Group has developed a framework for this assessment and plans are in place for West Dunbartonshire Council to assess the council's internal audit service during the 2015/16.

85. We placed formal reliance on internal audit's work on the following systems used to prepare the accounts: the general ledger, payroll, the council tax and non domestic rates billing and collection systems, and on the focussed testing of the other main accounting systems undertaken to support the Head of Audit and Risk Management's opinion on the adequacy of the council's internal control system.

ICT audit

86. The council's initial contract with Fujitsu Services for the provision of managed ICT services came to an end in March 2015. In 2013, the council agreed a service continuation with Fujitsu until September 2016 covering all elements of the contract except network support services relating to the local area network (LAN) and telephony.

87. The council has recently tendered for computing in schools and council offices, managing technology infrastructure, application systems and desktop services. Contracts for other areas including telephony and cabling will be issued separately. This reflects the council's decision to move away from the large single supplier model in favour of working with a number of different suppliers.

88. The Public Services Network (PSN) allows the council to share electronic data with other public bodies. In order to use the network the council must comply with the strict security measures of the PSN Code of Connection, which, if fully met, results in the issue of a compliance certificate. The council retained its PSN accreditation in the April 2015 reassessment.

89. Last year we reported that the lack of appropriate business continuity planning had been recognised as a risk within the council's corporate risk register. Progress was made in developing business continuity plans for the council's services in 2014/15, but the timetable has slipped and a revised date of October 2015 has been set for all services to have their business continuity plans in place. We will continue to monitor progress in this area as part of our 2015/16 audit.

Arrangements for the prevention and detection of fraud

90. Overall, we concluded that the council's arrangements in relation to the prevention and detection of fraud and irregularities were satisfactory. We noted, however, that the Audit and Scrutiny Committee's role in managing the council's exposure to the risks of fraud could be more clearly expressed within its terms of reference through inclusion of the following duties:

- to review the assessment of fraud risks and potential harm to the council from fraud and corruption
- to monitor the counter fraud strategy, actions and resources.

91. As part of this year's audit we also reviewed the council's whistleblowing policy against the guidance set out in 'Whistleblowing in the Public Sector: A good practice guide for workers and employers' and found that the council's policy is fit for purpose. We shared our suggestions for further refinement with the council's Head of Performance and Personnel and he agreed to consider them as part of the ongoing review of personnel policies.

National Fraud Initiative in Scotland

92. The National Fraud Initiative (NFI) in Scotland brings together data from councils, the police board, the fire and rescue board, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. Matching data obtained from the systems of participating bodies allows the identification of potentially fraudulent claims on the public purse including housing benefit fraud, occupational pension fraud and payroll fraud.

93. The NFI exercise identified 2,156 cases recommended for investigation and, although progress was initially slow, as at September 2015 the council had dealt with 873 of these. Whilst the exercise did not identify any frauds, 64 overpayment errors were identified totalling £13,254. Of these, two were in excess of £3,000 due to non declaration of occupational pensions by benefit claimants.

94. As part of our audit we reviewed the council's NFI arrangements and concluded that there was scope for improvement. In particular, we noted that the

- Audit and Scrutiny Committee did not review the self-appraisal checklist included in the 2014 NFI Report as a means of monitoring the body's planning and progress with the 2014/15 NFI exercise
- there was limited reporting of progress with and outcomes from the NFI exercise to members. Since we completed our review, a report on NFI has been submitted to the Resources Committee (August 2015).

95. The council undertook a review of all single occupancy discounts in late 2014/15 as part of the Finance Service's budget savings for 2015/16. All 37,000 accounts in receipt of single person discount were reviewed by Northgate, the council's supplier of its council tax, non domestic rates and benefits systems. Any anomalies identified by this 'intelligence matching' exercise were raised with the council tax payer and reminders sent where no response was received. Discounts have been removed where appropriate and this includes where customers have not responded.

96. The council estimates that it will save around £0.294 million in single person discounts in 2015/16. The council has started recovery action where it has been established that the customer is not entitled to the single person discount and they will continue to recover any sums outstanding during the months ahead.

Arrangements for the prevention and detection of corruption

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

Arrangements for maintaining standards of conduct

98. Our audit of the annual accounts identified that a business connected to an elected member owed the council £48,000 at the year end. Analysis of this debt confirmed that £20,000 (42%) of the amount outstanding was overdue at 31 March 2015.

99. The 2014/15 Code requires that 'authorities shall identify related party relationships and transactions, identify outstanding balances between the authority and its related parties, and identify the circumstances in which disclosures are required, in accordance with IAS24 Related Party Disclosures except where adaptations to fit the public sector are detailed in the Code.' This applies to all chief officers, elected members and other persons having the authority and responsibility for planning, directing and controlling the activities of the authority, including the oversight of these activities.

100. The unaudited accounts did not include a related party disclosure for the balance owed by the elected member. When we queried the process for identifying such related party balances, we were advised that finance staff email all chief officers and members as part of the year end processes and if a response is not received a reminder is sent. If no response is received to the reminder, finance staff assume a nil return. Review of the council's records identified that 33 members, including the elected member referred to in paragraph 97, did not respond to this request/reminder in 2014/15. The audited annual accounts have been amended to include a disclosure for this related party.

Action plan no. 8

101. The Councillors' Code of Conduct, at section 3.21, sets out a councillor's responsibilities to the council as a member of the public:

'If you owe a debt to the Council, for example, in relation to rent due for a council house or commercial premises where the council is the landlord, you must put in place at the earliest opportunity arrangements for repayment. You must avoid being in a situation which might lead the public to believe that preferential treatment is being sought. You must not participate in any decision which may create suspicion of conflict of interest. For example, where you are in arrears of rent for a council house, you must not participate in decisions affecting the levels of rent to be paid by council house tenants'.

102. It is not clear how the elected member has discharged his responsibilities in connection with this duty as we understand that no such repayment arrangement is in place.

Correspondence referred to the auditor by Audit Scotland

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

104. During 2014/15, we received correspondence in relation to the Inverness West Link road and the Common Good Funds. The following paragraphs set out our findings from the work undertaken on these areas in 2014/15.

Inverness West Link

105. We continued to monitor progress made in delivering this major capital project in 2014/15. A number of key milestones were reached during the year:

- planning permission was granted for the West Link road, for the new Golf Course, and for the Canal Parks enhancement project
- the compulsory purchase orders and footpath orders were approved by Scottish Ministers allowing the project to move to the next stage
- an advance works contract was let for tree removal and services diversions and work on this commenced in September 2015.

106. Stage 1 of the West Link and the Canal Parks enhancement project are due to commence in March 2016, and the council expects to invite tenders for this contract in November 2015. Construction of the new Golf Course is scheduled for Spring 2016. Stage 2 of the West Link will commence once this is completed, in March 2019, with final completion expected to be in 2020.

107. The council has acknowledged the need to engage with the communities most affected by this major project and has set up a community liaison group to provide a forum for discussing project delivery, the construction phases, and the likely impact of the construction on the local communities.

108. In previous reports we have highlighted the importance of providing members with regular updates on progress and cost so that they can effectively monitor developments with this major capital project. In March 2015, a revised 10 year capital plan was submitted to the council covering the period to 2024. Separate reports were provided on the West Link project and the Torevan Golf Course and Canal Parks enhancement projects. Regular updates are provided to the Planning and Development Committee, the most recent being in August 2015.

Common Good Fund

109. The council administers the Common Good Funds of the former burghs of Inverness, Nairn, Dornoch, Cromarty, Dingwall, Invergordon, Tain, Grantown, Kingussie and Fortrose and Rosemarkie. As at 31 March 2015 these Funds had a combined net asset value of £43.427 million with usable reserves of £7.763 million.

110. As part of our 2014/15 audit we reviewed the arrangements for the governance and financial management of Inverness Common Good Fund (ICGF), the largest of these Funds. As at 31 March 2015, ICGF had net assets of £34.195 million and usable reserves of £6.739 million.

111. The council delegates the administration and management of the ICGF to the Inverness City Committee. In the period April 2011 to March 2014, the ICGF spent £2.2 million more than it generated in income. This depleted all of its cash balances and as a result, by 31 March 2014, the ICGF owed the council's loans fund £0.361 million. As noted in our Report on the 2011/12 Audit, the council's loans fund is not permitted to make advances to Common Good Funds and so the ICGF had to sell long term investments to reimburse the loans fund the amount owed.

112. The ICGF holds a portfolio of investment properties which include the Town House, the Victorian market, offices and industrial sites. Over the next two years the ICGF will incur significant capital expenditure on repairs to the Town House's stonework (£4.2 million) and on the refurbishment of offices at 1-5 Church Street (£1.9 million). In order to fund this capital expenditure, the majority of the ICGF's stock market investment portfolio will be sold, reducing investments from £10 million to £3.5 million once this work is complete. It is not clear from our reading of committee minutes and council agenda papers that other options (including external borrowing) were considered by members before the decision was taken to liquidate the majority of the ICGF's investment portfolio.

113. In the last year, there have been three instances where the council has had to pay restitution to the Common Good Funds due to deficiencies in its administration and financial management arrangements:

- £187,000 was paid to the Nairn Common Good Fund as the council had not adequately administered the lease of the Fund's land at Lochloy Caravan park, Nairn
- £18,000 was paid to the Inverness Common Good Fund as the council had not adequately administered the lease of the Fund's property at Grant Street, Inverness

- £12,500 was paid to the Dingwall Common Good Fund as it has not received its 50% share of the income from the lease of land at Jubilee Park. All of this income was instead credited to the council's Education Service. The council has agreed to credit all income received for the foreseeable future to the Common Good Fund to fully compensate it for lost income totalling £106,500.

114. From the above, we concluded that the council needs to review and improve its arrangements for the financial management and administration of the Common Good Funds.

Action plan no. 9

115. There continues to be considerable public interest in the Common Good Funds. The Community Empowerment (Scotland) Act 2015 aims to increase transparency about the existence, use and disposal of Common Good assets and to increase community involvement in these processes. Decisions to sell or change common good property will need to reflect the views of community groups and so longer timescales for decision making will need to be programmed.

Transparency

116. Local residents should be able to hold the council to account for the services it provides. Transparency means that residents have access to understandable, relevant and timely information about how the council is taking decisions and how it is using its resources. We have considered this under various headings including:

- clarity and presentation of annual accounts – a copy of the council's unaudited accounts were made available on the website. The format of the accounts complies with the Code
- budget monitoring reports – refer paragraph 43
- performance reporting – refer paragraphs 148-151
- register of interest – these are available on the council's website.

117. Meetings of the council are advertised on the council's website and agendas, supporting papers and minutes are made available in advance of all meetings. Committee meetings are filmed and broadcast over the internet, and are available for viewing for 12 months after the date of the meeting.

118. We have not encountered any evidence to suggest that information is routinely and unjustifiably withheld from public scrutiny.

Freedom of Information requests

119. The Freedom of Information (Scotland) Act 2002 (FOI) established a general public right of access to all information held by Scottish public authorities. The authority must respond to requests for information within 20 working days by providing the information requested or an explanation, with reference to legislation, of why the information is exempt from disclosure. The council's performance in relation to FOI requests is reported to the Executive Leadership Team and annually to the council in the review of the corporate plan.

120. The council received 1,483 FOI requests in 2014/15, a 12% increase over the previous year continuing the upward trend experienced since financial year 2008/09. Individuals account for the largest proportion of requests (37%) followed by commercial organisations (25%) and the media (21%).

121. The statutory requirement to respond within 20 days was met for 88% of requests exceeding the council's target of 80%. This level of compliance was last achieved in financial 2007/08 when the council received only 496 requests.

122. Overall, the council's approach to managing FOI requests received is effective.

Integration of health and social care

123. The Public Bodies (Joint Working) (Scotland) Act received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland.

124. The council and NHS Highland have operated integrated arrangements for the delivery of health and social care for adults and children, under a Partnership Agreement, since 1 April 2012, three years ahead of other councils. Over 1600 staff transferred from the council to NHS Highland as a result of the Partnership Agreement and around 200 transferred from the health board to the council.

125. The first two years of the partnership were financially challenging for both partners and a further financial settlement was reached during 2013/14 in an effort to get budgets on to a sound financial footing. The partners anticipated that it would take up to five years to demonstrate efficiencies (based on the experience of similar integration models in England).

126. The new legislation will have no impact on the partnership's arrangements for the management, leadership and governance of the integrated service, and the lead agency model will continue as before. The Partnership Agreement has, however, be replaced by a five year strategic scheme (The Highland Health and Social Care Partnership Integration Scheme) which was approved by Scottish Ministers in June 2015 and by the council on 3 September 2015.

127. Separate financial statements will not be required under the lead agency model adopted by the council and NHS Highland. Each partner will continue to account for their transactions under the existing model and these will be audited as part of their statutory audit.

Welfare reform

128. The council recognises the impact that the changes to the UK welfare system could have on resources and service provision, and has estimated that the overall financial loss arising from welfare reform in council's area to be £56 million a year or £340 per working age adult.

129. Inverness was the first jobcentre in Scotland to administer claims for universal credit and this has now been rolled out to the remaining five jobcentres within the Highlands. Council officers have provided evidence to the Scottish Parliament Welfare Reform Committee, and delivered presentations to the Convention of Scottish Local Authorities (COSLA), the Institute of Revenues, Rating and Valuation (IRRV) and the Scottish Federation of Housing Associations (SFHA) to share their experiences and help other councils to prepare for the introduction of universal credit.

130. The council administers the Scottish Welfare Fund on behalf of the Scottish Government. This fund provides community care and crisis grants to people who do not have alternative means of paying for what they need. The fund was overspent by £80,000 (10%) in 2014/15.

131. The Director of Finance provides a quarterly update to the Resources Committee on Welfare Reform. The council spent a total of £67.5 million on welfare (including housing benefits and council tax reduction scheme payments) in 2014/15. The majority of this was funded by grants from the Scottish Government and Department of Work and Pensions.

Local scrutiny plan

132. The 2015/16 Local Scrutiny Plan (LSP) prepared by the Local Area Network (LAN) of scrutiny partners for the council was submitted to the council on 14 May 2015.

133. The LSP identified nationally driven scrutiny work as well as the routine, scheduled audit and inspection work taking place through the annual audit process and the ongoing inspection of school and care establishments by Education Scotland and the Care Inspectorate respectively.

134. The LAN concluded that no additional scrutiny activity was required at the council although three areas were highlighted as requiring ongoing monitoring by the scrutiny bodies

- use of resources – in recognition of the significant budget savings that the council is required to find
- education (leadership and governance) – as when the LAN met in December 2014, it was too early to assess the impact of the service restructure on the leadership of the council’s education services
- self evaluation arrangements in primary and secondary schools -whilst the overall quality of self evaluation is improving it remained a concern in some schools.

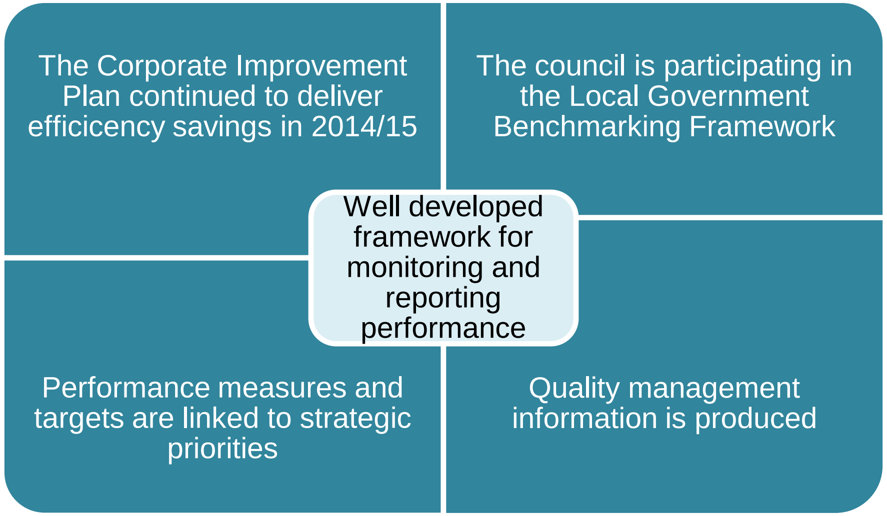
135. A joint inspection of adult services by the Care Inspectorate and Health Improvement Scotland took place in early 2015. The results of this inspection have yet to be published.

Outlook

136. Councils will continue to operate in a changing environment within continuing financial constraints. Under these circumstances councils will be obliged to consider the delivery of services by different means. Good governance will be particularly important where council resources and service delivery are devolved to third party organisations.

137. Partnership, joint working and arms length organisations have become increasingly popular vehicles for planning and delivering council services and there is a sustained national focus on their use. Where council services are being delivered by third party organisations it will be crucial that the council implements robust assurance and governance arrangements to deliver best value while at the same time ensuring an appropriate level of accountability for public money. Community planning and health and social care integration will require an ongoing focus on governance and assurance to ensure that the council's priorities are being achieved.

Best Value



138. Best value is a key factor to consider when planning policies, programmes and projects and when taking any spending decisions. The council should have systems and processes to ensure that it can demonstrate that it is delivering best value by assessing and reporting on the economy, efficiency, effectiveness and equality in service provision.

139. As noted at paragraph 76, the new Administration has recently set out its priorities in '*Highland First'* and this will form the basis of the council's future corporate and service plans.

140. The Highland Public Services Partnership's single outcome agreement (SOA) covers the period from 2013/14 to 2018/19 and is structured around the seven national priority areas. Positive feedback was received from the Scottish Government on the SOA and on the partnership itself which was described as mature and results orientated. The Community Empowerment (Scotland) Act 2015 places new duties on the partnership (and the council) and provides new rights for community bodies. The partnership has undertaken some preparatory work while it awaits the statutory guidance being prepared to support the implementation of the Act.

Corporate Improvement Plan

141. 2014/15 was the final year of council's second Corporate Improvement Plan. The council delivered £5.3 million of efficiency savings in the two years to 31 March 2015, against a target of £6 million. This was mainly due to slippage in savings from the business support and customer contact transformation projects.

142. The council has recently agreed a new Transformational Savings Programme aimed at achieving £18.3 million of efficiency savings in the four years to 2018/19. These projects include:

- waste disposal – total saving £2.8million – replacing the current disposal regime with energy from waste
- transport programme – total saving £2.246 million – which seeks to reduce the costs of school and public bus service provision, including home to school travel

- treasury management – total saving £1.953 million – reducing costs through tactical borrowing and utilising cash balances as an alternative to new borrowing
- digital first – total saving £1.3 million – aims to achieve 40% of all transactions carried out online by April 2017
- transferring council assets into community ownership – total saving £1 million – supporting the transfer of assets to the community who will run and be responsible for ongoing maintenance
- offshore wind farms – total saving £1 million – secure community benefit income from the development of offshore wind farms.

143. Progress against the 2015/16 efficiency savings target (£3.9 million) was reported to the Resources Committee in August 2015. Savings of £2.1 million (54%) have already been achieved. Each project is assessed in terms of progress against its target and projects which are not on track to deliver the expected savings are brought to the attention of members, together with the remedial action planned to get them back on track.

Procurement

144. In 2009 the Scottish Government introduced an annual evidence-based assessment, the procurement capability assessment (PCA), to monitor public bodies' adoption of good purchasing practice and as a basis for sharing best practice.

145. The council's Procurement Strategy for the four years to 2014/15 was focused on improving in the areas identified by the PCA. The council was assessed at the second highest level of performance in its most recent PCA, and in 2014/15 reviewed its procurement policy and strategy in order to align these with the council's wider improvement programme.

146. In February 2015, the Resources Committee approved a new Procurement Policy and Strategy for the period 2015 to 2020 based on the council's core values of listening, openness, valuing, improving, supporting partnering and delivering. An action plan to help deliver the strategy is to be developed showing in greater detail what will done, by when and by whom.

147. Due to legislative changes around procurement the assessment is in need of updating and a new assessment regime (the Procurement & Commercial Improvement Plan (PCIP)) will replace the PCA in 2015. PCIP focuses on policies and procedures driving procurement performance and the results delivered. As this approach adopts new assessment methods and scoring, the results will not be comparable with the previous PCA. It is expected that all councils will be assessed in 2015/16 under the PCIP and then every two years thereafter.

Performance management

148. The council has a strong focus on performance management and has a sound framework for monitoring and reporting performance against the council's priorities. A number of performance measures are in place including service specific indicators, council wide indicators, single outcome agreement (SOA) indicators and statutory performance indicators.

149. Performance information is recorded and reported on an electronic performance and risk management system, with service performance reviewed through quarterly performance reviews where service directors and senior managers are held to account.

150. The council prepares an annual report of corporate performance against the council's commitments and corporate performance indicators as set out in the performance framework for the council programme *'Working together for the Highlands 2012-17'*.

151. The council also participates in the Local Government Benchmarking Framework (LGBF) which brings together a wide range of information about how all Scottish councils perform in delivering services to local communities.

Overview of performance targets in 2014/15

152. The council's annual report on corporate performance for 2014/15 was considered at the Council meeting on 3 September 2015 and is available on the council's website. This report sets out performance against the former Administration's commitments and corporate performance indicators as set out in *'Working together for the Highlands 2012-17'*.

153. As at 31 March 2015, 130 (94%) of the council's 139 commitments were either complete, progressing well or performance was being maintained. For the remaining 9 (6%) commitments, performance was mixed with one commitment, to achieve the Scottish Housing Quality Standard (SHQS), not met. The council expects to complete its SHQS programme in January 2016.

154. Key commitments delivered or progressing well in 2014/15 include:

- construction of 173 council homes in 2014/15 exceeding the target of 120
- completion of phase 1 (River Ness to Friars Bridge) of the River Ness Flood Alleviation project
- supporting 424 business start-ups (compared with 250 in 2013/14).

155. The Local Government Benchmarking Framework data for 2014/15 is currently being collected. In March 2015, the council considered its performance against the LGBF indicators published by the Improvement Service. The Improvement Service ranked the council's performance across fifty of the LGBF benchmarking indicators compared to other Scottish councils:

- 20% were in the top quartile
- 24% were in the upper middle quartile
- 28% were in the lower middle quartile
- 28% were in the lower quartile.

156. The council performed well in sickness days lost per employee, street cleanliness, leisure facilities (cost/attendance), cost per pre-school registration and cost of maintenance per km of road. Areas where the council performed less well compared with other councils include:

- % of over 65's with intensive care needs receiving care at home
- asset management – current use
- central support services as a percentage of running costs

157. Reports giving more detailed analysis of the LGBF indicators and planned improvement activity were submitted to the council's strategic committees.

Statutory performance indicators (SPIs)

158. The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report but expects councils to provide citizens with fair, balanced and engaging performance information reporting.

159. For 2014/15 three SPIs were prescribed:

- SPI 1: covering a range of information relating to areas of corporate management such as employees, assets and equalities and diversity
- SPI 2: covering a range of information relating to service performance
- SPI 3: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

160. Overall we are satisfied that appropriate SPI arrangements were in place within the council for 2014/15.

161. An evaluation of all Scottish councils' approaches to public performance reporting was carried out by Audit Scotland's Performance Audit and Best Value group during 2014/15 and reported to the Accounts Commission in June 2015. An individual assessment for The Highland Council was issued to the Leader of the Council and the Chief Executive in July 2015.

162. The Highland Council was rated as fully meeting the requirements in 11 (42%) of the 26 PPR categories, with the remaining 15 categories assessed as areas for improvement. Key areas for improvement include increased use of graphics, comparators, trend information and benchmarking to provide the reader with context with which to assess the published performance information.

163. The review also highlighted areas of interesting practice that may be useful to other councils. The following example was given for The Highland Council:

- effective use of customer satisfaction information – the council has a Citizen's Panel and asks its members each year for their views on the council's performance. The council uses this information to look at how views vary over geographical location.

164. Officers have reviewed the assessment and developed an action plan to improve the council's approach to public performance reporting. A report on the assessment and the action plan was recently discussed and agreed by the Executive Leadership Team. We have been advised this report and action plan will be considered by members at the meeting of the Audit & Scrutiny Committee on 30 September 2015.

National performance audit reports

165. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which are of direct interest to the council. These are outlined in appendix III.

Equalities

166. The Equality Act 2010 introduced a new public sector 'general duty' which encourages equality to be mainstreamed into public bodies' core work. The Act requires that by no later than 30 April 2015 and every two years thereafter, public bodies must publish a report on the progress made to achieve the quality of outcomes it has set.

167. The council's approach to mainstreaming equality and developing equality outcomes and associated actions is set out in the Fairer Highland Plan 2012-2017. Progress reports on equality outcomes and mainstreaming were submitted to the Community Safety, Public Equalities Committee in March 2015. The reports are available on the council's website.

Outlook

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

Appendix I – Significant audit risks

The table below sets out the audit risks we included in our annual audit plan and how we addressed each risk in arriving at our opinion on the annual accounts.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Risk of material misstatement		
Management & supervision of the accounts process: a number of significant audit adjustments were made to the council's unaudited accounts in previous years. Appropriate management and supervision is required at all stages of the preparation process to ensure that the unaudited accounts comply with the Code. There have been changes to the team preparing the 2014/15 accounts which increases the risk that the accounts and working papers will not be prepared to the required quality and by the agreed timescales.	***Management Assurance*** • an additional level of review involving Finance Managers will be introduced for 2014/15 • a detailed timetable will be prepared and followed. ***Audit procedures*** • early financial statements planning meeting • review council's process for managing and supervising the accounts preparation process • early discussion of emerging issues	The unaudited accounts and supporting working papers were delivered by the 30 June 2015 deadline. The unaudited accounts contained material errors which could have been prevented through a more robust and challenging internal review process. We have highlighted in the main body of the report the significant audit issues.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Capital accounting: in the last three financial years we raised concerns about the council's capital accounting arrangements. Considerable additional work required to be done by finance staff and ourselves before we were able to certify the 2011/12 and 2012/13 accounts. Last year we worked closely with the capital accountant and overall the audit process was much smoother. However, we again identified a lack of audit trail of how key figures in the accounts agreed to the council's asset registers, and a lack of internal consistency in disclosures within the financial statements. A number of areas have also been carried forward for further discussion with officers in 2014/15 including accounting for non-enhancing capital expenditure, investment and heritage properties, and the operation of the capital fund.	***Management Assurance*** • capital accounting procedures will be reviewed and amended to reflect the previous year's audit findings. ***Audit procedures*** • early financial statements planning meeting • increased audit testing in this area • early discussion of emerging issues	Early audit work investment properties and heritage assets enable us to agree with the capital accountant how these items would be treated in the 2014/15 financial statements. The operation of the capital fund was reviewed as part of our final accounts audit. Accounting issues arising from the operation of the fund are included in the main body of the report.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Housing rents: last year we identified that the unaudited accounts included an erroneous debtor of £1.372 million. We also reported that the rent account reconciliations provided to audit contained small differences between the ledger position and that recorded in the Housing Information System for which satisfactory explanations could not be provided. In response, the Director of Finance requested that internal audit investigate the rent account reconciliation process to identify why this erroneous debtor (and income) had been included in the council's accounts, and to confirm that differences identified as part of the reconciliation process are promptly investigated and resolved. This work has yet to be concluded but we understand from discussions with internal audit that the Housing Service has made little progress with improving its reconciliation process or explaining the erroneous debtor.	***Management Assurance*** • actions arising from the internal audit report will be implemented • if issues remain from output from the Housing Information System for accounting purposes at the year end, the housing revenue account will be prepared using only validated debtor balances. ***Audit procedures*** • early financial statements planning meeting • increased audit testing in this area • early discussion of emerging issues.	A reconciliation of the rent accounting system was only performed as a year end exercise. A small reconciling difference was written off. The arrears and prepaid balances included in the financial statements were in agreement with the Housing Information System. Work is ongoing to implement internal audit's recommendations.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Intercompany accounts: our 2013/14 audit identified the need to improve the operation and management of the intercompany accounts used to manage transactions between the council and the pension fund. Officers have continued to review their processes for managing and monitoring these accounts during 2014/15.	***Management Assurance*** • the intercompany accounts have been reviewed up to December 2014 with a view to identifying and resolving issues prior to the year end. Plans are in place to share this work with external audit so that any emerging issues can be identified and resolved prior to the preparation of the financial statements. ***Audit procedures*** • early financial statements planning meeting • increased audit testing in this area • early discussion of emerging issues.	We reviewed the reconciliation during 2014/15 and were satisfied with the process undertaken to identify the reconciling items. The council is due to receive £2.687 million from the pension fund in 2015/16. A debtor for this has been included in the audited annual accounts. Procedures have been revised during 2014/15 to simplify the intercompany accounting between the council and the pension fund.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Local Authority Accounts (Scotland) Regulations 2014: the 2014 regulations introduced a number of key changes with regard to the processes for approval and publication of both the unaudited and audited financial statements. In addition, they require a management commentary to be included in the financial statements for the first time. This requires greater disclosures than have been included to date as part of the explanatory foreword.	***Management Assurance*** • changes to regulations and codes are considered and where necessary incorporated as part of the accounts closedown process. ***Audit procedures*** • early financial statements planning meeting • review of the management commentary for compliance with the 2014 regulations • early discussion of emerging issues.	Changes to local authority accounts advert, management commentary and annual governance statement were not fully incorporated into a revised accounts closedown process. This resulted in the unaudited accounts being advertised under the incorrect regulations, a management commentary that did not fully comply with the guidance and the failure to produce an annual governance statement in the required format.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Asset decommissioning: in September 2014, LASAAC issued guidance on 'Asset Decommissioning Obligations' setting out how authorities should account for these obligations, particularly where a retrospective adjustment is required for previously unrecognised liabilities. The council has previously included the costs of decommissioning two landfill sites within its financial statements. The council also leases a number of buildings which will require to be returned to their original leased condition at the end of the lease. The council currently does not recognise the costs associated with this future reinstatement work within its financial statements but has agreed to investigate, as part of its asset management strategy, whether a reliable estimate can be established in order to make provision for these costs within the financial statements.	***Management Assurance*** • a review of this asset category will be undertaken by finance staff and the council's valuer. ***Audit procedures*** • early financial statements planning meeting • review of accounting treatment against the requirements set out in the LASAAC guidance • review progress made in estimating the costs of future reinstatement work required to return leased properties to their original condition at the end of the lease • early discussion of emerging issues.	We reviewed the accounting treatment of the council's landfill sites against the LASAAC guidance. We concluded that the balance sheet values were not significantly different from those calculated in the LASAAC model and agreed with the council's decision not to change the reported values in the accounts. Provision was included in the accounts for building dilapidations based on information provided the council's Estates section.

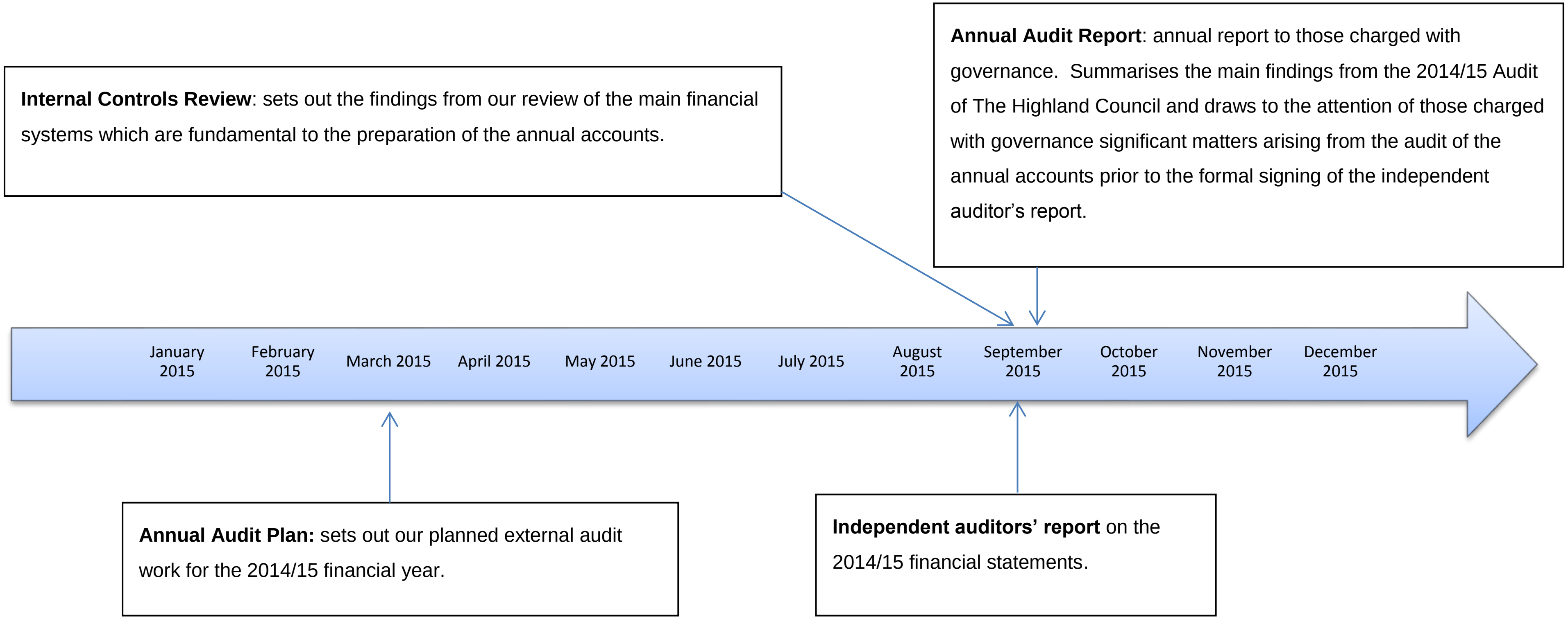
Audit Risk	Management assurance and audit procedures	Results and conclusions
Group accounts and whole of government accounts (WGA) return: the 2014/15 Code includes a revised definition of control which requires the council to review its group boundary prior to preparation of the group accounts. Procedures for completing the WGA consolidation pack and management review checklist should also be reviewed to ensure that the pack submitted for audit is in line with the council's financial statements.	***Management Assurance*** • the group boundaries will be reviewed during the accounts closure process • WGA consolidation pack and management review checklist will be reviewed at year end to ensure in line with the group accounts workings prior to submission to audit. ***Audit procedures*** • early financial statements planning meeting • review of council's group boundary • review of management and supervision of procedures for completing the WGA consolidation pack and management review checklist • early discussion of emerging issues.	We reviewed the council's group boundary and concluded that there were no material omissions from the council's group accounts. The WGA consolidation pack was received by the deadline date, although the management review checklist was not provided. The consolidation pack will require to be updated for the significant matters arising from the audit of the accounts and so we have still to complete our audit of this area.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Income recognition: ISA 240 requires auditors to presume a risk of fraud where income streams are significant. While the council receives a significant amount of funding from the Scottish Government, there are also a range of other sources including council tax, housing rents and charges for services. The extent/complexity of income means there is an inherent risk that income could be materially misstated. The ISA requires auditors to evaluate which types of revenue transactions give rise to such risks.	***Management Assurance*** • the council operates robust internal controls around the various income streams. ***Audit procedures*** • review of the systems of internal control for income recognition • perform analytical procedures on significant income streams • detailed substantive testing of income transactions early financial statements planning meeting.	Revenue Support Grant, Distribution from the Non Domestic Rate Pool and General Capital Grant agreed to Scottish Government notification letters. Predictive tests provided assurances over council tax and housing rental income. We tested a sample of other income transactions and found no errors or evidence of fraud.
Management override of controls: as stated in ISA 240, management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	***Management Assurance*** • the council has a strong internal control environment which is regularly tested by internal audit. ***Audit procedures*** • detailed testing of journal entries • review of accounting estimates for bias • evaluating significant transactions that are outside the normal course of business recognition	We found no evidence from our testing of sample of journal entries to suggest any management override of controls We found no evidence from our testing of non current assets, debtors, creditors, provisions and contingencies of bias in accounting estimates. Based on our 2014/15 audit work we did not find any transactions outwith the council's normal course of business.

Audit Risk	Management assurance and audit procedures	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
Financial management and sustainability: in December 2014 the council agreed a package of savings totalling £42.8 million to be phased over four years, with an estimated reduction of 313 full time equivalent (FTE) staff posts over this period. This allowed a balanced revenue budget to be set for 2015/16. A further £13.3 million of cuts remains to be identified over the three years to 2018/19.	***Management Assurance*** • the council operates robust budget setting and budget monitoring processes • corporate savings targets which are not directly removed from service budgets will be the subject of regular reports to the Transformational Savings Board ***Audit procedures*** • monitor financial position • comment in Annual Audit Report as appropriate	The Director of Finance has subsequently revised its forecast funding gap to £46.288 million for the three years to 2018/19 to reflect expected reductions in the Scottish Government cash grant settlement and increases in staff pay awards, teachers' pension contributions, and national insurance contributions. Work is ongoing to identify the savings required to bridge this gap.

Appendix II

Summary of The Highland Council local audit reports 2014/15

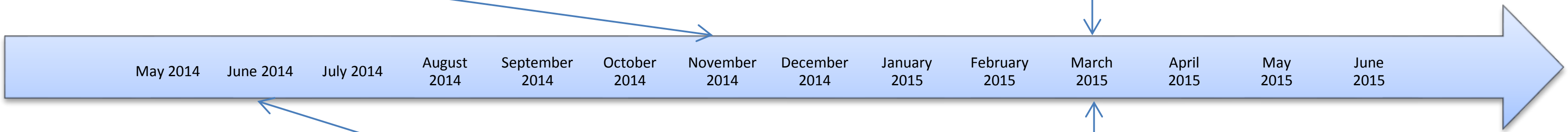


Appendix III

Summary of Audit Scotland national reports 2014/15

Community planning: Turning ambition into action – Many Community Planning Partnerships are still not clear about what they are expected to achieved. Local data should be used to help set relevant, targeted priorities for improvement that will address inequalities within specific communities.

Borrowing and treasury management in councils - Councils are meeting professional requirements but need to do more to set out the longer term implications of borrowing and other debt on their finances.



Scotland's public finances - a follow up: Progress in meeting the challenges – Leaders and managers must produce balanced budgets and hold people in their organisations to account for how the money is used and what is achieved. Councillors have an important role in ensuring that approved budgets are used to best effect. To do this they need good-quality and timely financial information. They need to take a longer-term view on: options available for services; services standards and affordability; and, the sustainability of financial plans.

An overview of local government in Scotland – A high level, independent view on the progress councils are making in managing their finances and achieving Best Value.

Appendix IV

Action plan

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
1 **8/10**	**Issue** The annual accounts submitted for audit did not fully comply with the requirements of the new accounting regulations. In addition, there was no evidence that significant year on year movements on figures within the CIES and balance sheet had been identified and investigated as part of the review process. This would have identified that some of the year end journal entries had been double counted and that a key loans fund working paper had not been updated. **Risk** The annual accounts do not give a clear view of the council's governance arrangements or financial position. **Recommendation** A more robust review process needs to be put in place in future years to improve the quality of the financial statements submitted for audit.	There are timing pressures on finance staff to meet the deadlines required for the submission of the accounts for audit. Reviews of the unaudited accounts were undertaken, however, it is accepted that in several areas the guidance was not fully complied with. Every effort will be made to improve the review process in future years.	Director of Finance	30 June 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
2 **12/24**	**Issue** Inverness Airport Business Park Ltd was due to repay a loan stock instrument to the council in May 2015. This payment was deferred and under the terms of the agreement there is uncertainty when, if ever, this loan will be repaid. **Risk** The loan will not be repaid and the council will suffer financial loss at a time when savings are required to balance the council's budget over the next three years. **Recommendation** The council should formalise a repayment schedule with Inverness Airport Business Park Ltd so it is clear when payment will be received or else recognises the impairment of the loan in its annual accounts.	The council is currently in discussion with Inverness Airport Business Park Ltd to produce a revised Development Plan that will include cashflow projections and revised estiamtes as to when the company will propose to repay the council. This will be reported to members in due course for consideration.	Director of Development & Infrastructure and Director of Finance	31 March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
3 **19/28**	**Issue** The council is currently predicting that it will be unable to fully implement the requirement to measure highways assets on a depreciated replacement cost basis with effect from 2016/17. **Risk** The annual accounts will not show a true and fair view of the council's non current assets. **Recommendation** The council should review its arrangements to ensure that it will comply with this major change in valuing highways assets as required by the 2016/17 Code.	The council will ensure that every effort is made to comply with this enw requirement.	Senior Engineer for Infrastrucutre and Asset Management Director of Community Servcies Director of Finance	31 March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
4 **22/38**	**Issue** The council has a history of slippage in the delivery of its capital programmes. It has previously taken steps to include more projects in the programme than funding available to provide flexibility in managing the scheduling of projects to maximise expenditure. These steps, however, have not prevented slippage against both its general fund and capital programmes in 2014/15. **Risk** The council is unable to deliver the priorities set out in '*Working together for the Highlands 2012-17' and 'Highland First'.* **Recommendation** The council should review its capital investment processes to minimise the level of slippage against its capital programmes.	Slippage in the capital programme does not prevent the delivery of priorities as project slippage is carried forward for all priority projects. A revised capital monitoring process will be developed in 2015/16 which will identify expenditure and re-profile slippage as early as possible.	Director of Finance	31 March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
5 **23/45**	**Issue** We compared the council's five year revenue budget (2014 to 2019) against the important features of a financial strategy set out in exhibit 3 in Audit Scotland's national report *'Scotland's public finances: a follow up audit'* and concluded that it could be improved. We also noted that budgets could be better linked to outcomes as some of its targets are unclear. **Risk** The council's medium term budget does not support delivery of the council's priorities. **Recommendation** The council should review its budgeting process against the guidance set out in Audit Scotland's national report report *'Scotland's public finances: a follow up audit'.* In addition, budgets should make clearer links between spending decisions and outcomes.	A review will be undertaken but the context of current grant funding needs to be considered. The council cannot plan ahead with any certainty when levels of funding and legislative requirements are not clear.	Director of Finance	31 March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
6 **26/59**	**Issue** The council estimates that it will need to find savings of £46.3 million in the three years to 2018/19. To date, savings of £14.4 million have been identified. Difficult decisions involving the reduction and cessation of services and downsizing of the workforce will require to be made if the council is to deliver the remaining savings and balance its budgets over the next three years. **Risk** The council is unable to deliver the level of savings required to deliver a balanced budget. The ongoing need to deliver savings will have an adverse impact on services and the delivery of strategic priorities. **Recommendation** The council needs continue to develop its strategy for delivering the savings required over the next 3 years.	Information on financial settlements beyond this financial year is not available, increasing the uncertainty around the council's future resources. However, the council has a robust budget setting process in place which will take account of actions required to produce a balanced budget.	Director of Finance	31 March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
7 **30/78**	**Issue** The council's two charitable trusts are governed by trustees. Last year we reported that no trustee meetings had been held during 2013/14 and recommended that regular meetings should be held to enable trustees to consider and agree how charitable funds are to be managed and disbursed. In response, we were advised that a review of the charitable trusts' governance arrangements would be undertaken by December 2014. This year we again noted that no trustee meetings had taken place. Without these it is unclear how trustees are able to demonstrate proper stewardship of the funds. **Risk** Trustees are unable to demonstrate proper stewardship of the trusts' funds. **Recommendation** Regular trustee meetings should be held to enable trustees to consider and agree on how funds are to be managed and disbursed including the level of governance costs to be paid to the council.	The two charitable trusts are in effect umbrella organisations established to reduce the burden of external audit. The governance arrangements for each trust within the umbrella reamin but are enhanced by the presentation of both the unaudited and audited accounts of the umbrella trusts to a meeting of the Full Council. Work will be carried out in 2015/16 to look at the operation of the individual trusts to ensure the governance arrangements remain robust.	Director of Finance	30 September 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
8 **33/100**	**Issue** The council's procedures for identifying and reporting related party transactions with elected members require improvement. **Risk** The annual accounts disclosures are not in compliance with the Code. Elected members are not complying with the Councillors' Code of Conduct and risk damaging the council's reputation and integrity. **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.	Procedures wil be reviewed and revised prior to closure of the 2015/16 annual accounts.	Director of Finance	31 March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
9 **36/114**	**Issue** In the last year, there have been three instances where the council has had to pay restitution to the Common Good Funds due to deficiencies in its administration and financial management arrangements. Funding decisions should be supported by a rigorous options appraisal to enable members to demonstrate best value in the use of the Fund's assets. **Risk** The Common Good Funds may continue to suffer financial loss due to poor administration and financial management of these Funds. **Recommendation** The council should review its financial management and administration arrangements for the Common Good Funds.	The re-establishment of Area Committees and a recent re-structure in the Finance Service allows greater scrutiny of the operation of Common Good Funds. However a review across the various Common Good Funds will be undertaken to ensure a consistent approach is taken to financial management and administration, subject of course to the varying scale of each Fund.	Director of Finance	30 June 2016