



Grant Thornton

The Highland Council

**External Audit Annual Report to Members and the Controller of Audit
For the financial year ended 31 March 2019**

30 September 2019

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Introduction

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2019.

Our work has been undertaken in accordance with International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016.

Our report is addressed to the Members of the Highland Council. In addition, in accordance with our reporting responsibilities the report is jointly addressed to the Controller of Audit.

This final report will be made publically available on the Audit Scotland website (www.audit-scotland.gov.uk).

Our report was presented as a draft to the Highland Council Audit and Scrutiny Committee on 19 September 2019. Once all outstanding matters were completed the report was updated and finalised.

We would like to thank the Council's Officers for all their support and assistance in the audit process during the year.

Structure of this report

In accordance with the Audit Scotland Code of Practice 2016, in addition to our core financial statements audit we provide conclusions on the four dimensions of wider-scope public audit, alongside considering the Accounts Commission strategic priorities. Our report is structured as follows:

Financial statements – Section 1

Financial management – Section 2

Financial sustainability – Section 3

Governance and transparency – Section 4

Value for money – Section 5

Wider scope

Our audit the four dimensions of wider-scope public audit incorporated Audit Scotland's best value guidance and the Accounts Commission's priorities. During 2018/19, the Council has been subject to a Best Value Assurance Report (BVAR). We have supported Audit Scotland's Performance Audit Group in undertaking the review building on our wider scope work. The BVAR is due to be published by the Accounts Commission in November 2019.



Our Opinion

For the financial year ended 31 March 2019 we have issued an **unqualified** audit opinion on the financial statements and that:

- They give a true and fair view of the financial statements in accordance with applicable law and the 2018/19 Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 (the 2018/19 Code);
- They have been prepared in accordance with IFRSs as adopted by the EU, as interpreted and adapted by the 2018/19 Code and in accordance with applicable legislation;
- The information given in the Management Commentary is consistent with the financial statements and in accordance with the Local Government in Scotland Act 2003;
- The information given in the Annual Governance Statement for the financial year is consistent with the financial statements and prepared in accordance with the Delivering Good governance in Local government: Framework (2016); and
- The audited part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.



The audit process

The unaudited accounts were presented for public inspection by 30 June 2019 in line with statutory requirements. Officers provided working papers and supporting documentation to support the audit process.

We identified no unadjusted differences to report to the Audit and Scrutiny Committee. During the course of the audit we identified that defined benefit pension scheme liabilities were materially understated as they required to be amended to reflect the estimated impact of a recent court judgement impacting local government pension schemes (McCloud case). Management obtained a revised actuarial valuation and adjusted the net defined pension scheme liability. A number of adjustments were required to the financial statements, including a revised presentation of the Comprehensive Income and Expenditure Statement to remove internal recharges, as no longer allowable under the 2018/19 Code. These adjustments are included in Appendix one.



Our financial statements audit at a glance



We have fulfilled our responsibilities per International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice throughout our work and this final report to Members and the Controller of Audit.



We have agreed seven audit recommendations. These are detailed within Appendix 2 along with follow up of prior year recommendations.



We have performed suitable audit testing around our identified areas of significant risk, set out in our audit plan: management override of controls; risk of fraud in revenue recognition; and the risk of fraud in expenditure recognition in accordance with the Financial Reporting Council's Practice Note 10.

Financial statements audit founded on ensuring audit quality



Materiality has been updated to reflect the 2018/19 unaudited financial statements. This has been set in line with our audit plan at 1.2% of gross expenditure (£9.275 million) (Group: £9.55 million). Reflecting the inherent risk of material misstatement, performance materiality has been set at 65% of overall materiality (£6.028 million) (Group: £6.2 million).



A number of adjustments were required to the financial statements, including a revised presentation of the adjustments to remove internal recharge transactions from the Comprehensive Income and Expenditure Statement which are no longer allowable under the 2018/19 Code. These are detailed within Appendix 1.



We have issued an unqualified audit opinion. The financial statements were presented for audit inspection in line with agreed requirements.

Financial statements audit



The financial statements include the Highland Council and its group. The Highland Council group accounts consolidate the Highland Council with its subsidiaries: High Life Highland Ltd; Inverness Common Good Fund, and Nairn Common Good Fund. It also consolidates the results of its associates: Highland and Western Isles Valuation Joint Board and Highland and Islands Transport Partnership.



Testing provided assurance on areas of significant audit risks and there were no unadjusted audit differences arising in those areas of significant risk during the course of our audit.



Materiality was updated from our audit plan to reflect the 2018/19 unaudited annual accounts. Materiality has been set at 1.2% of gross expenditure (£9.275 million) (Group: £9.55 million). Reflecting the adjustments in our prior year audit, there is an increased risk of material misstatement. Therefore, performance materiality has been set at 65% of overall materiality (£6.028 million) (Group: £6.2 million) for 2018/19 as set out in our audit plan.



We have issued a true and fair audit opinion on the financial statements. We have confirmed that the information contained in the annual report is not inconsistent with the financial statements. The audited parts of the Remuneration Report are free from error.



There were a number of changes required to the draft accounts including the removal of Internal transactions from service income and expenditure in the comprehensive income and expenditure statement and recognition of the impact of the McCloud case on IAS 19 defined benefit liabilities. These have all been reflected in the signed financial statements.

Audit approach and materiality

Our audit approach was set out in our annual audit plan presented to the Audit and Scrutiny Committee on 27 March 2019. As set out in our plan, we have updated our materiality calculations to be based on the unaudited 2018/19 financial statements. Overall materiality has been set at £9.275 million (1.2% of gross expenditure) (Group materiality: £9.55 million) and performance materiality is set at £6.028 (65% of materiality) (Group: £6.2 million). Our materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements, and performance materiality reflects our assessment of the inherent risk of material misstatement. We report to management any audit difference identified over £0.250 million (Trivial as defined within the Code of Audit Practice).

The unaudited financial statements were presented for public inspection by the required legislative date of 30th June 2019. Management provided reasonable quality working papers and supporting documentation to support our audit process.

Audit opinion

For the financial year ended 31 March 2019 we have issued an unqualified audit opinion on the financial statements and that:

- They give a true and fair view of the financial statements in accordance with applicable law and the 2018/19 Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 (the 2018/19 Code);
- They have been prepared in accordance with IFRSs as adopted by the EU, as interpreted and adapted by the 2018/19 Code and in accordance with applicable legislation;
- The information given in the Management Commentary is consistent with the financial statements and in accordance with the Local Government in Scotland Act 2003
- The information given in the Annual Governance Statement for the financial year is consistent with the financial statements and prepared in accordance with the Delivering Good governance in Local government: Framework (2016); and
- The audited part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.

Internal control environment

During the year we sought to understand the Council's overall control environment (design) as related to the financial statements. In particular we have:

- Sought to understand procedures and controls around related parties and journal entries
- Performed procedures around entity level controls and there are no significant matters that we wish to draw to your attention.
- Performed walkthrough procedures on key controls around identified risk areas including non-grant related service revenue, expenditure, and payroll expenditure.

No material weaknesses in the accounting and internal control systems were identified based on our work undertaken during the audit which could have an adverse impact on 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. We adopted a substantive based approach to the audit of the financial statements and therefore do our review is limited to the design of controls rather than the operating effectiveness of controls.

Key audit issues – Our response to significant audit risks

	Identified audit risk at planning	Work completed	Our conclusion
Risk of fraud in revenue	<p>As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. For annual grant funding we consider this to be well forecast and agreed directly to grant confirmations. Likewise, for council tax and non-domestic rate income streams, we consider these revenue streams to be well forecast and not inherently at risk of manipulation. For these revenue streams, we therefore rebut the presumed risk of fraud in revenue recognition. We consider the risk to be prevalent in other service income with a focus around the year end transactions and balances where financial performance is subject to highest scrutiny including review of the financial statements. Therefore we focus our testing on cut-off of service income.</p>	<ul style="list-style-type: none"> Developed our understanding of the Highland Council's material revenue streams including walkthrough of key transactions. Performed targeted review and testing of key revenue streams during the year, including analytical procedures and transaction testing Performed revenue cut off procedures and substantive testing over pre and post year end balances Tested the existence and recoverability of balances at the year end 	<p>From our audit procedures performed we are satisfied that revenue is not materially misstated. We are satisfied that revenue has been recognised in the appropriate financial year.</p>
Operating expenditure is not treated correctly	<p>Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As set out in Practice Note 10 (revised) which applies to public sector entities. We consider the risk to be most prevalent in transactions and balances at the year end.</p>	<ul style="list-style-type: none"> Developed our understanding of the Highland Council's material expenditure streams including walkthrough of key transactions. Performed a targeted review and testing of key expenditure streams during the year, including analytical review of expenditure and targeted transaction testing. Performed cut-off testing of expenditure transactions around the year end to ensure these had been allocated to the appropriate financial year. Reviewed post year end payments for any potential unrecorded liabilities. 	<p>Assurance gained that expenditure has been recorded within the appropriate financial year and that payables are free from material misstatement.</p>
Management override of controls	<p>As set out in ISA 240 there is a presumed fraud risk that management override of controls is present in all entities. Override of controls is present in all entities.</p>	<ul style="list-style-type: none"> Developed our understanding of the entity level controls in place at the Highland Council that reduce the risk of management override Performed a review of journal transactions for unusual transactions or balances. Evaluated key areas of judgement within the Financial statements and the basis for these judgements / application of accounting policies Reviewed unusual and/or significant transactions 	<p>We did not identify any significant areas of bias in key judgements by management. We have not identified any unusual or significant transactions during the course of the year that would indicate management manipulation. Key areas of judgement and estimation have been agreed to supporting evidence and accounting policies applied consistently. During our audit we identified that the defined benefit pension scheme estimates required updating to reflect the impact of the McCloud case (Page 9) on the scheme liabilities. We are satisfied that this misstatement was not indicative of fraud or management bias as it was primarily due to developments in an ongoing external legal case.</p>

Identified audit risk at planning

Under the Code of Practice on Local Authority Accounting, the Council is required to hold property, plant and equipment at fair value. For land and buildings this requires assets to be valued to ensure their carrying amount reflects fair value as at the balance sheet date. In accordance with the Code of Practice, the Council undertakes a rolling programme of valuations with asset categories valued on a five yearly cycle. For assets not subject to full revaluation, the Council is required to ensure that the carrying value is not materially different than the value that would be obtained through a formal valuation. Based on the prior year accounts, over £740 million of land and buildings will not have been valued more than four years ago by the balance sheet date. Given the value of the assets there is an increased risk that the carrying value may materially differ from that value obtained through a formal valuation.

Work completed

- Reviewed the work performed by the Council, including any work done by the Council's internal valuations team, to gain assurance over the valuation of PPE at the balance sheet date.
- Reviewed the key assumptions used in the valuation approach of PPE to ensure these are reasonable and appropriate.
- Target tested of specific valuations where these deviate from expectation to scrutinise and challenge the basis of the valuation
- Agreed the carrying value of assets at the 31 March 2019, to internal valuation reports

Our conclusion

From audit procedures performed we are satisfied that the basis of valuation of PPE is appropriate and that PPE is recognised in the financial statements in accordance with the 2018/19 Code and reflects internal experts valuations.

Highland Council holds property, plant and equipment (PPE) of £2.68 billion. In accordance with IAS 16, land and buildings are held at their fair value (infrastructure, community assets and assets under construction are held at depreciated historical costs). For land and buildings, including Council dwellings, this includes regular revaluation. To comply with the requirements of the 2018/19 Code, Officers revalue land and buildings under a five-year programme of professional valuations. Where there has been material capital expenditure on land and buildings or market movements that would materially impact on the value of land and buildings further revaluations are undertaken in between the five year cycle. Valuations are undertaken as at 31 March each year.

The 2018/19 Code requires valuations to be undertaken with sufficient frequency to ensure that the carrying value of PPE is not materially different to its current value i.e. the value of the assets if they had been revalued as at 31 March 2019. During our audit further work was required from Officers and the internal valuer to demonstrate that its assets not subject to revaluation in the year were not materially misstated. Through consideration of Officers assessment, we are satisfied that PPE is not materially misstated. However, we recommend that Officers, working with in-house valuers, review the rolling programme of valuations to ensure these are conducted with sufficient regularity to ensure not materially misstated.

The 2018/19 Code requires Council houses to be measured at Existing Use Value – Social Housing as a measure of fair value. Council houses have not been subject to revaluation since 2017 and therefore two years worth of additions are valued at cost. While we are satisfied Council houses are not materially overstated, we recommend that Officers review the frequency of revaluations to ensure that Council house additions are considered as part of this process.

Action Plan Point – 1

Key aspects of your financial statements

As set out in our audit plan we consider particular aspects of your financial statements in relation to officers judgements including estimates and where officers may have particular options or choices in what accounting standards or disclosure requirements to apply. We have summarised where these apply, and our conclusions below.

Commentary:

Highland Council's Accounting policies are in accordance with IFRS as interpreted and adapted by the 2018/19 Code of Practice on Local Authority Accounting in the United Kingdom (the 2018/19 Code). These have been applied consistently to the previous year with the exception of the adoption of two new accounting standards IFRS 9: *Financial Instruments* and IFRS 15: *Revenue from contracts with customers*. While these resulted in minor disclosure changes to the accounts including accounting policies and financial instruments disclosures, there was no impact on the primary financial statements.

Accounting estimates and judgements

Highland Council's significant accounting estimates and judgement impacting on the annual accounts, excluding those covered through our significant audit risks, were as follows:

Contingent liabilities

Remains consistent with prior year and based on professional legal advice from external counsel. We have reviewed these and discussed with the Head of Corporate Governance to understand the legal position with these cases and are satisfied they are appropriately disclosed in the financial statements as contingent liabilities. We are satisfied that there is no indication of management bias in the Council's consideration of ongoing legal liabilities.



IAS 19 Defined Benefit Pension Scheme:

The Council operates the Highland Pension Fund, a defined benefit pension scheme. The Council recognises its share of the net assets and liabilities of the pension scheme within the Council's accounts.

In December 2018, the Court of Appeal ruled that the transitional protection offered to some members of public sector pension schemes as part of reforms to those schemes amounts to unlawful discrimination ("McCloud/Sargeant"). This ruling was subject to potential right to appeal from the UK Government, leading the Pension Fund to exclude any potential impact from the IAS 19 valuation included in the draft accounts. On 27 June 2019, the Supreme Court ruled that the government had not raised an arguable point of law, the court of appeal ruling was upheld. Consequently, given the increased certainty around future economic output arising from the ruling, the McCloud/Sargeant Case should be incorporated into the IAS 19 valuation.

As the initial IAS 19 valuation included within the draft accounts did not incorporate the impact of the McCloud/Sargeant case, Officers have obtained a revised IAS 19 valuation from the scheme's actuary. This valuation increased the net liability by £9.426 million.

We are satisfied that following the adjustment (Appendix 1), the Council has appropriately disclosed its share of the defined benefit pension schemes assets and liabilities within the financial statements in accordance with IAS 19. We have reviewed the key assumptions used in the actuarial valuation and are satisfied that these are reasonable and appropriate for the Council. We have performed audit procedures around the underlying data used in the valuation to gain assurance around the reasonableness of the accounting estimate.

In 2016, the Government announced that Public Sector Pension Schemes needed to review pension data which linked LGPS benefits to contracted-out employment and the State Pension. This is known as the Guaranteed Minimum Pension (GMP) data reconciliation review. The purpose of this review is to ensure that records held by the scheme and HMRC are correct. Where the data is incorrect then this could result in an overpayment or underpayment in pension. The treatment of overpayments has yet to be finalised by Scottish Ministers and the Council has therefore excluded any potential impact from the IAS 19 defined benefit pension calculation. The Council has considered the impact to be immaterial to the pension scheme as a whole, expected to be between 0.2% and 0.3% of scheme liabilities. We agree with Officer's assessment and does not identify any material issues with the pension entries in the financial statements.



Other key areas of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. These are areas of judgement, estimation, fundamental accounting principal or unusual transaction during the year.

Going concern



The Council has an approved budget for 2019/20, which reflects the agreed local government settlement from the Scottish Government. The Council has also agreed a provisional budget for 2020/21 and 2021/22. While the Council faces significant financial challenges over the coming years, including actions to address a potential budget gap of over £60 million over the three year period, we are satisfied that it has sufficient resources to continue to meet its obligations over at least the next 12 months as they fall due and continue to deliver statutory services. We therefore agree with the Council's conclusion that it continues to represent a going concern.

The Council will continue to receive Scottish Government funding and generate revenue through local taxes and fees and charges to deliver statutory services. Whilst we recognise that Officers anticipate that there will be reductions in Scottish Government Funding the Council is exploring income generating initiatives including potential tourist levies. The Council recognises that significant savings are required over the coming years to remain financially sustainable.

Consolidation

The Highland Council group accounts consolidate the Highland Council with its subsidiaries: High Life Highland Ltd; Inverness Common Good Fund, and Nairn Common Good Fund. It also consolidates the results of its associates: Highland and Western Isles Valuation Joint Board and Highland and Islands Transport Partnership. We have reviewed the Council's consolidation process and adjustments and are satisfied that the Group accounts have been appropriately prepared. We note that the adjustment to defined benefit pension scheme asset valuations also impacted on the net assets of the Council's subsidiaries and associates and the group financial statements adjusted accordingly



Prior year reclassification



The unaudited financial statements included internal recharges between services of £72.177 million in the Comprehensive Income and Expenditure Statement (CIES). The 2018/19 Code and subsequent LASAAC advisory note, prohibited the inclusion of income and expenditure on a trading basis between segments in the CIES. Officers have updated the financial statements to exclude internal income and expenditure recharges between services (Appendix 1). Note the net impact on total comprehensive income and expenditure was nil.

Significant Trading Operations

The Council has one trading operation, Fishery, Piers and Harbours, which operates in a commercial environment. The Local Government (Scotland) Act 2003 requires significant trading operations to break even over a rolling three year period. The operations financial results are summarised below:

	2016/17 £'000	2017/18 £'000	2018/19 £'000	3 year rolling £'000
Surplus / (deficit)	652	2,532	1,859	5,043

We are satisfied that the Council's Fishery, Piers and Harbours operation has met its STO target to breakeven over a rolling three year period.

Highland Charities Trust and Highland Council's Charitable Trusts

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

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



Common Good Funds

Highland Council administers the Common Good Funds of the former Burgh Councils of Inverness; Nairn; Ross and Cromarty; Badenoch and Strathspey; Grantown and Kingussie. As at 31 March 2019 the Common good funds held total net assets of £42.742 million, primarily in long term investment.

Funds are held for the benefit of the residents of those former burghs and must be used in the first instance to maintain the assets of the Common Good. Thereafter, funds can be used for purposes which are in the interests of the community for which the Common Good Fund was established. The Council continues to explore opportunities to utilising the funds for the purposes intended.



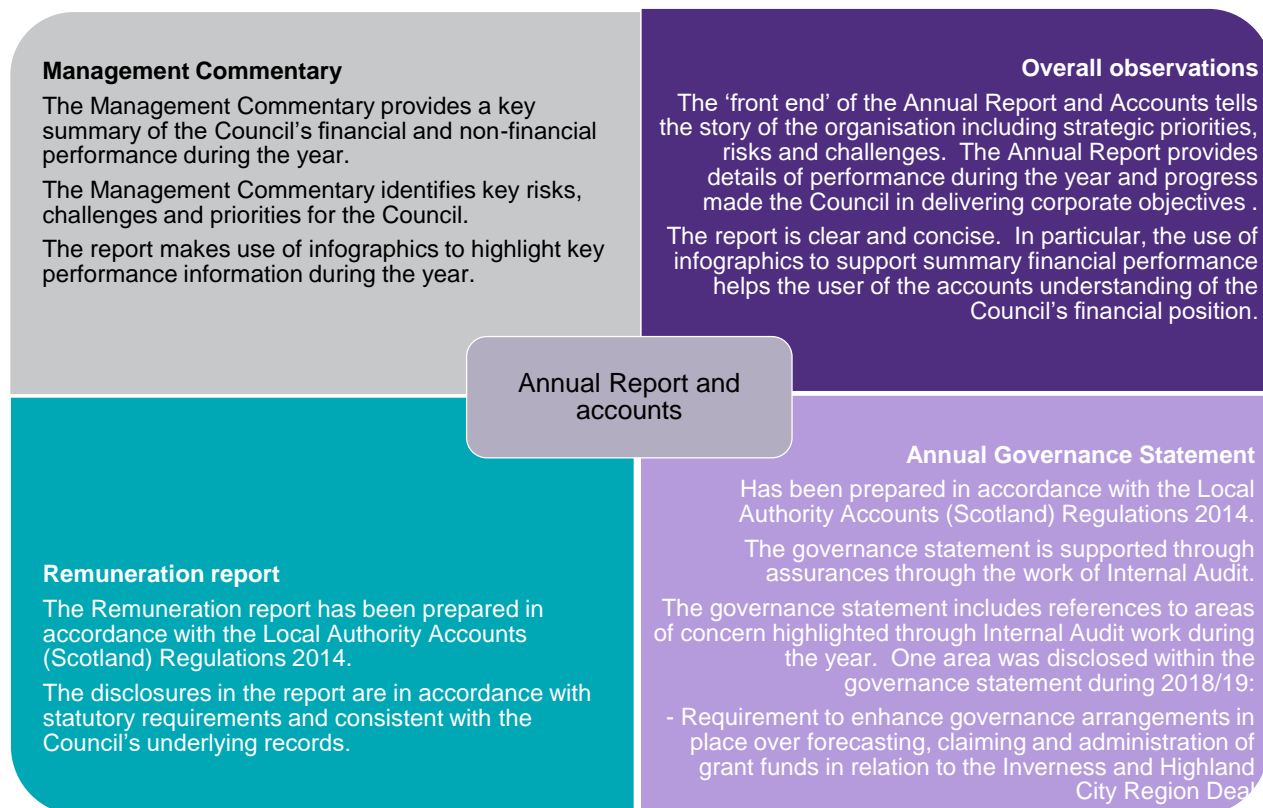
Internal Audit

As set out in our external audit plan we have not placed formal reliance on the work of the Council's Internal Audit function during 2018/19. We have reviewed the internal audit plan and individual reports issued to date, to consider if any impact on our audit approach. During 2018/19 no material control weaknesses have been identified in these arrangements. We also consider Internal Audit's annual Report and overall opinion on the Council's internal control environment and consider any potential impact on the assurances noted in the Annual Governance Statement. Furthermore, we are satisfied that Internal Audit has a process for ensuring ongoing compliance with Public Sector Internal Auditing Standards.

Internal audited concluded "*reasonable assurance can be placed upon the adequacy and effectiveness of the Councils internal control systems for the year to 31 March 2019*". We are satisfied that there are no issues identified by Internal Audit that would impact on our audit work or conclusions. From review of the work undertaken by Internal Audit, there is an opportunity for potentially greater focus on key strategic risk areas facing the Council to provide independent assurance over these areas, reducing focus on operational processes.

Narrative elements of your annual accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts. We have considered the consistency of this narrative with our understanding and the financial statements and have set out our observations below. We have also audited the required information in the remuneration report (marked audited) and have no matters we wish to bring to your attention.



Adding value through our external audit work

First and foremost our objective is to ensure we deliver a quality external audit which fully complies with International Standards on Auditing (ISAs) UK and the Audit Scotland Code of Practice (2016). By ensuring our audit is efficient and effective, gives you assurance over our opinion.

Through this Annual Report we seek to provide insight and commentary over certain aspects of the Highland Council's arrangements, sharing relevant practices with the Audit and Scrutiny Committee and Officers. This is reflected in our audit recommendations which allow you to address gaps in your arrangements, and to continually improve.

We have continued to build on our working relationship with officers and our understanding of the Highland Council as an organisation. During 2018/19 we supported Officers in the development of training material for members on understanding of local government accounts. In addition, we have met with the new Chief Executive and members of Executive Leadership Team to continue to develop our knowledge and understanding of the Council and opportunities and risks faced.



Executive Chief Officer for Resources and Finance

Under Section 95 of the Local Government (Scotland) Act 1973, the Council is required to secure that an officer has the responsibility for the proper administration of its financial affairs. The Executive Chief Officer for Resources and Finance has been appointed as this role (Section 95 Officer). The Officer did not take up post until August 2019, after the financial year had ended and unaudited accounts had been prepared. To support the Section 95 Officers sign off of the financial statements, assurances were provided from the former Section 95 Officer that sufficient arrangements were in place around the responsibilities for the preparation of the annual accounts and compliance with the 2018/19 Code. We consider these arrangements to be appropriate.

Our wider scope audit work, including Accounts Commission strategic priorities

In accordance with the Audit Scotland Code of Audit Practice (2016) our audit responsibilities extend beyond the audit of the financial statements. Our wider scope audit work is a risk based approach informed through our understanding of the Council as well as consideration of the following areas:

Wider scope audit dimensions

Audit Dimensions	The Code sets out a framework for all audit work conducted for the Auditor General for Scotland and the Accounts Commission covering: financial management; financial sustainability; governance and transparency; and best value.
Accounts Commissions strategic Audit Priorities	The Accounts Commission's Strategy sets out an overall aim of holding Councils to account for their pace, depth and continuity of improvement facilitated by effectiveness governance. The Council sets out five Strategic Audit Priorities: <ul style="list-style-type: none"> • Having clear priorities with a focus on outcomes, supported by effective long term planning • Demonstrating the effective appraisal of options for changing how services are delivered in line with their priorities • Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future • Empowering local communities and involving them in the design and delivery of local services and planning for their local area • Reporting the council's performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.
Local Area Networks	We consider the work being undertaken by other scrutiny bodies to inform our audit planning and wider scope conclusions.
Best Value	The Accounts Commission refreshed the approach to auditing Best Value in council's in 2016. Best Value is assessed over a five-year period, building on the work performed by external auditors as part of the annual audit process. Highland Council's best value assurance report is currently being drafted and will be presented to the Accounts Commission in November 2019
Statutory Performance Indicators	The Accounts Commission's Statutory Performance Information (SPI) Direction (2015) requires Council's to report a range of information in accordance with, but not confined to, the requirements of the Local Government Benchmarking Framework. We have considered these arrangements during 2018/19.

Audit response

Through our wider scope audit work we consider each of these areas as well as our wider understanding of the Council's priorities and risks. Our audit report concludes on the key areas identified during our audit work and our overall assessment of the Council's Best Value arrangements.



We have fulfilled our responsibilities the Audit Scotland Code of Audit Practice throughout our work across financial management; financial sustainability; governance and transparency; and value for money. We conclude an overall assessment and assurance on Best Value.



The Council faces significant financial challenges over the coming years with the Council's scenario planning forecasting a budget deficit of between £50.2 million (most optimistic) to £77.3 million (most pessimistic) over the next three years. The Council has a change programme "*A sustainable Highland*" to deliver the transformation required to address this funding gap. Delivery of these will represent a significant challenge for the Council.



The Council reported an overspend of £2.3 million for the year ended 31 March 2019. The overspend was due to operational costs pressures in year, particularly around the Care and Learning Service as well as failure to deliver in year corporate savings targets, agreed as part of the budget setting process.

Wider scope work based on areas of key risk to the Council



During 2018/19 Highland Council appointed a new Chief Executive. The Council has also recently refreshed its Senior Management Team structure as it looks to align operational delivery alongside a focus on community needs and issues.



Delivery of savings required to deliver financial plan 2019/20 are challenging for the Council. Financial projections as at 30 June 2019, forecast an overspend of £2.7 million for the financial year. The Council has implemented a number of cost control measures, particularly around workforce management and recruitment but it is critical decisions are not taken in isolation of longer term strategic priorities.



The Council has undertaken a self-assessment of governance arrangements across the Council recognising the opportunity to enhance scrutiny, governance and oversight. While it is too early to determine how effectively these new arrangements are operating, the changes made are reasonable.

Financial management



Recognising the financial challenges faced, Officers have established a Resources Governance Board to provide greater oversight and control over resource related expenditure. This will further enhanced the financial management arrangements in place at the Council.



The Council continues to operate within a challenging financial environment. The Council reported an overspend of £2.3 million for the year ended 31 March 2019. The overspend was due to operational costs pressures in year as well as failure to achieve £2.7 million of the required savings in year, as budgeted.



In March 2018, the Council approved a revised five year capital programme encompassing £490 million of capital investment. During 2018/19, the Council incurred £96.2 million of capital expenditure, £14.3 million lower than the budgeted spend. The main areas of investment during the year were schools (£24.9 million) and roads and bridges (£8.7 million). The underspend was primarily due to programme slippage and has been reprofiled across the remainder of the capital programme.

Within our audit plan we identified risk around financial management at the Highland Council. In accordance with the Code of Audit Practice, we have undertaken audit procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial sustainability. This includes review of financial performance during the year and discussions with management.

Identified audit risk at planning

The Council's 2018/19 annual budget identified a budget gap between available finances and planned expenditure of £11.7 million. Approximately £3.1 million of this gap is being addressed through additional revenue generation and £8.6 million through delivery of savings. In addition to the identified savings, the Council face challenges in delivering a breakeven position by the year end. As at December 2018, the Council were forecasting an overspend of £5.5 million against services. This predominantly reflected a £3.1 million overspend against budget for looked after children and additional support needs. In response, additional budgetary controls have been established including oversight and approval required over recruitment as well as utilising devolved schools management balances to support financial pressures. In addition, Officers are reviewing earmarked reserve to determine if these can be utilised to support the delivery of financial targets in the year.

Our Response:

We have reviewed the arrangements in place to identify and support the delivery of in year savings and how these will be achieved. We have considered the budget setting and monitoring arrangements and how these support the Council deliver its financial targets. Our work has been undertaken in line with our audit work supporting the Council's Best Value Assurance Report.

Conclusion

The Council continues to operate under a challenging financial environment. For the year ended 31 March 2019, the Council reported an overspend of £2.3 million. The deficit for the financial year was primarily due to the following:

- Failure to deliver £2.7 million of the £13 million required savings included within the budget for the year;
- Overspend of £2.8 million within Care and Learning, primarily due to overspends in looked after children, staffing overspends in special schools and overspends on Additional Support Needs (ASN) in mainstream schools.
- Various underspends primarily through vacancy management and other staffing costs savings across other service areas including Corporate Resources, Development and Infrastructure and Community Services offsetting the additional costs incurred in year.

In year transformational savings

In recent years the Council has had to make savings in order to balance its budget. Within the annual budget for 2018/19, the Council had budgeted savings of £13 million. The Council delivered £10.3 million of these savings in the year through a combination of service level efficiency savings as well as the delivery of the transformational savings programme.

We recognise the savings delivered in year by the Council. However, the outturn position highlights the importance of having robust and resilient financial plans in place that support contingency spend if required. We have further explored this in *Financial Sustainability* section of this report.

Financial management controls

Recognising the financial challenges faced, Officers established a Resources Governance Board to provide greater oversight and control over resource related expenditure. The Board consisting the Chief Executive, the Chair of the Council's Corporate Resources committee and members of the Executive Leadership Team, meet weekly to monitor and approve resource related expenditure including recruitment and vacancy management. The scope of the Board's activities is being extended to encompass agency and procurement spend to provide greater oversight and control over a wider cost base. This has further enhanced the financial management arrangements in place at the Council.

In addition, during 2018/19 Officers implemented a freeze on non-essential spend with oversight of senior management. The controls established during the year resulted in the outturn position of 2018/19 being a significant improvement on the £5.112 million overspend forecast as at quarter one.

Housing Revenue Account

The Council owns over 14,000 houses which it charges rent. All expenditure associated with these houses must be funded through rental income generated. During 2018/19, the Council invested £42 million in the housing estate, representing the Council's continued commitment to housing across the region in line with the capital programme.

Capital Expenditure

	£ million
2018/19 Capital Budget	110.5
Actual Capital Expenditure	96.2
Under / (Over) spend	14.3

In March 2018, the Council approved a revised five year capital programme encompassing over £490 million of capital investment. During 2018/19, the Council incurred £96.2 million of capital expenditure, £14.3 million lower than the budgeted spend. The main areas of investment during the year were:

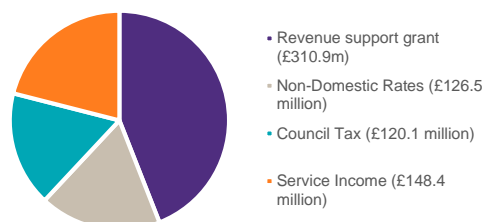
- Investment in schools (£24.9 million); and
- Investment in roads and bridges (£8.7 million).

The underspend against budget primarily relates to slippage on key projects of £18.638 million, partly offset by overspends of £4.298 million in development and infrastructure through accelerated expenditure on flood prevention schemes. The slippage relates to a number of individual programmes where project expenditure was behind schedule or planned investment deferred to future years. While this can reduce short term revenue impact of reduced levels of borrowing, it can put increased pressure on future years of the capital plan and on the use of the existing asset base. The most significant areas of slippage related to capital programmes across Care and Learning, including schools development programmes. As the Council's capital programme is funded partly through capital grant funding and receipts as well as external borrowing, the slippage in capital expenditure and borrowing helped the Council manage its in year revenue position through reducing financing costs. While the level of slippage represents a significant element of the overall programme, this was a significant improvement from prior years where the net underspend was £59.3 million representing over 40% of the plan.

Changing the landscape for public financial management

Recognising the changing landscape of Scottish public finances, including significant tax raising powers as well responsibility for 11 social security benefits provides the Scottish Parliament with more policy choices. Subsequently, there is potentially greater volatility and complexity around Scottish budget and greater focus on the use of Scottish funds. The Council's financial statements demonstrate the range of funding used to support operational delivery.

Revenue support grant (RGG) from the Scottish Government continues to represent the most significant source of funding. Maximising local taxation and service income are key elements of the Council's financial plans. Consequently, there is an expectation that public bodies, including councils, will be subject to greater scrutiny through parliamentary committees.



Financial management

Financial performance is monitored by officers and through service committees with corporate financial reporting through the Corporate Resources Committees on a quarterly basis. From our review of the financial reports and committee papers, including minutes:

- Financial performance reports were concise and there is challenge and scrutiny of performance in the year and key variances between actual and outturn performance. However, we found inconsistencies on how this information was prepared.
- Financial pressures and challenges are discussed and savings profiles revised during the year to ensure realistic forecasting.
- Management are continuing to enhance reporting arrangements, including clearer reporting of budget movements in each quarter as well as ensure greater operational controls over expenditure.
- Based on review of committee minutes and papers there appears to be alignment between financial planning and operational plans. The alignment between financial and operational plans is increasingly important with pressures on resources.



Our audit testing found inconsistent practices on how budget monitoring reports were prepared across the Council. While most services receive information based on live financial ledger data, Welfare Services financial reports are based on ledger data updated for known or expected costs. While not material to monitoring of underlying performance, it is important that financial monitoring reports are prepared on a consistent basis across the organisation.

Action Plan Point - 2

Impact of the UK withdrawal from the EU

There is considerable uncertainty around the potential impact of Brexit. Likely areas to impact the Council are: workforce implications; funding; and regulation. We have used Audit Scotland's EU Withdrawal guidance to evaluate the Council's readiness for EU withdrawal across workforce (People and Skills); Finance; and Regulations.

The Council has considered the potential impact of EU withdrawal. These are kept under review through the Council's internal risk management and monitoring arrangements as EU withdrawal is considered a significant risk to the Council.

While the full implications are not yet known the Council continue to assess and monitor the potential implications on them and, where appropriate, put arrangements in place to address these. In particular, officers have undertaken a review of potential workforce implications of EU withdrawal and potential implications on services. While we are satisfied that adequate consideration is being given by the Council to short terms and longer term EU withdrawal preparations, the Council recognise that it must continue to focus on the impact of withdrawal as and when there is increasing clarity around this implications. Overall, we conclude that the Council is partly prepared for the impact of EU withdrawal.

Dependency on key suppliers

The collapse of Carillion and the subsequent impact across the public sector, has brought into focus the risk of key supplier failure and underperformance. We considered the arrangements in place at the Council for identifying key supplier and risks, if any associated with these and how effectively these are being managed.

The Council use a range of third party suppliers to support operational delivery. To support delivery of Best Value/Value for Money, a varied and competitive market place and to create opportunities for Supported Businesses, Social Enterprises and Small and Medium Enterprises (SMEs), the Council utilises a shared Procurement Services with Aberdeen City and Aberdeenshire Councils to support the Council's procurement activity.

The Council have a range of significant third party suppliers providing a range of services. These range from ICT core services to construction contracts and service providers such as care provision. While the Council has a number of third party suppliers providing goods and services to the Council or on behalf of the Council, officers are satisfied that there are sufficient contingency arrangements in place in the event of a supplier failure. It is essential that as part of ongoing business continuity planning, the Council ensure that key supplier dependencies are identified and monitored to ensure contingency plans remain robust.



Financial sustainability



The Council faces significant financial challenges over the coming years with the Council's scenario planning forecasting a budget deficit of between £50.2 million (most optimistic) to £77.3 million (most pessimistic) over the next three years. The Council has established a change programme "*A sustainable Highland*" to deliver the transformation required to address this funding gap. This programme initially targeted savings of £37 million for 2018/19 and the Council faces significant challenges in the delivery of both these and addressing the further budget deficit identified.



"*Local Voices, Highland Choices*" outlines Highland Council's strategic priorities over the five year period of the programme. The Corporate Plan 2019-22 defines how the Council will deliver these priorities over the period. Critical to the delivery of the plan is a clear and concise financial strategy that enables resources to be aligned to the Council's key priorities.



The 2019/20 financial planning assumptions are based on the Council's historic levels of expenditure, updated to reflect known cost or demand pressures. The delivery of the required level of savings is becoming increasingly challenging for the Council. Financial projections as at 30 June 2019, forecast an overspend of £2.7 million for the financial year. With the general fund reserve (both earmarked and unearmarked) being one of the lowest in Scotland, there is little capacity for the Council to absorb overspends.

Within our audit plan we identified risk around financial sustainability at Highland Council. In accordance with the Code of Audit Practice, we have undertaken appropriate procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial sustainability.

Identified audit risk at planning

Conclusion

The Highland Council face significant financial challenges over the short to medium term. The Council aims to address these through additional revenue generation as well as the deliver of a programme of savings "A Sustainable Highland". To support this a £2.5 million Change Fund has been set aside to support the transformational change required to achieve these savings.

As at 31 March 2018, the Council held non-earmarked reserve fund balances of £8.6 million (1.6% of the Council's revenue budget). This leaves limited capacity for the Council to absorb unforeseen costs or budget overspends or to support strategic investment in savings activity

Our Response:

We reviewed the Council's financial plans and progress made against these including the delivery of "A Sustainable Highland". Our work has been undertaken in line with our work supporting the Council's Best Value Assurance Report.

In February 2019, the Council approved a three year budget covering the period 2019/20 – 2021/22. The Budget identified an initial estimated budget gap of £60.3 million and introduced a change programme, "A Sustainable Highland" aimed at delivering the transformational change. The programme has been informed through staff and public engagement and focuses on:

- Making the Council more efficient;
- Commercialism and income generation;
- Redesign and improvement; and
- Flexible and well managed workforce.

In addition to the delivery of A Sustainable Highland, the Council has explored options to increase Council Tax, in accordance with Scottish Government framework. The change programme aims at delivering £37.5 million over the three year period and the Council established a change fund of £2.5 million to support this. The programme covers 16 major transformational projects. Given the scale of the financial challenges and transformation required the level of change fund appears to be relatively low.

In August 2019, Officers undertook an exercise to forecast the financial outlook over the next three years covering 2020/21 to 2022/23. This highlighted the scale of the financial challenges facing the Council with a potential funding gap of between £50.2 million (most optimistic) and £77.3 million (most pessimistic) over the three year period. While this incorporates the previously identified financial pressures, it represents a significant challenge for the Council to deliver and will require transformational change.

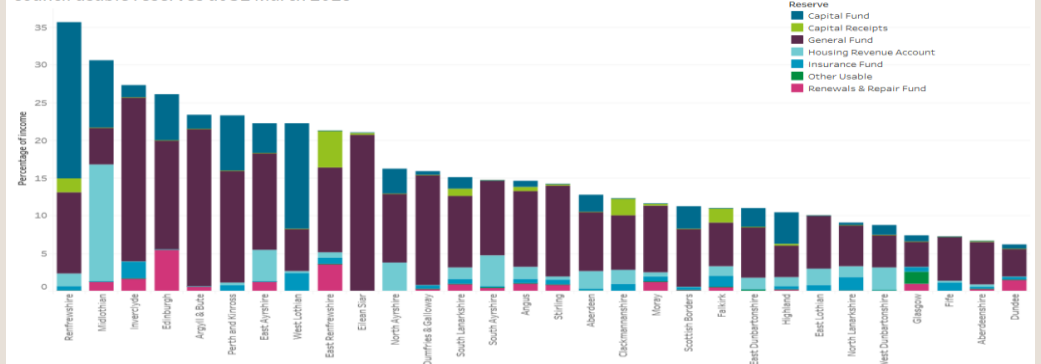
During 2018/19, the Council failed to deliver £2.7 million of the targeted £13 million savings targets. This has been a recurring theme at the council over the last three years with shortfalls in delivering savings of £1 million and £0.5 million in 2016/17 and 2017/18 respectively. In addition, the Council's Care and Learning Service has failed to operate within budget over the last three years as the Council has challenges in managing where looked after children and Additional Support Needs where demand is increasing

Action Plan Point - 3

Reserves and sustainability

The Council's non-earmarked reserves play a critical role in supporting the Council meet any additional investment required in strategic transformational programmes as well as manage any unforeseen expenditure that could not be met through in year resources. The table below highlights the position of the Council's reserves in comparison to other authorities.

Council usable reserves at 31 March 2018



Source: Audit Scotland Financial Overview 2017/18

As at 31 March 2019, the Council's non-earmarked reserves balance represents 1.4% of the annual revenue budget. This was a reduction of 0.2% from the position as at 31 March 2018. Overall General Fund balances are one of the lowest across Scotland. As part of the February 2019 budget the Council committed to increasing general fund balances by £2 million annually from 2020/21, plus agreed a target for the non-earmarked General fund reserve of 3% of annual revenue budget.

While we recognise the significant work done to date and financial controls established by the Council, the Council faces significant risk in delivering the level of transformational change required with limited reserves to support in year investment to undertake this work or absorb any unforeseen costs. It is therefore critical that the Council assess the level of resources (reserves and change fund) available to deliver the transformation required.

Action Plan Point – 4

Identified audit risk at planning

Conclusion

Workforce planning

The Council's Corporate Plan recognises the need for the Council to downsize as an organisation and to focus on new ways of delivering services while focusing on improving performance across areas of strategic priority. With limited non-earmarked reserves to support significant investment in service redesign or restructure, it is important that there is a clear and strategic approach to workforce management to maximise the use of the Council's human resources.

Our Response:

Delivery of the Board strategic priorities in a sustainable manner will require the efficient and effective use of the Council's workforce. We have assessed the progress made by the Council in refreshing its workforce strategy and underlying workforce plans. We have considered how these are aligned to the delivery of the wider strategic objectives of the Council while supporting a sustainable operating mode. Our work has been undertaken in line with our work in supporting the Council's Best Value Assurance Report.

The most significant area of expenditure at the Council is staff costs. During 2018/19 the Council spent £295 million on staff across a workforce of over 10,000 people. During 2018/19 the Council established the Resources Governance Board establishing tighter controls over vacancy management and recruitment. The remit of the Board has recently been extended to cover agency and procurement arrangements.

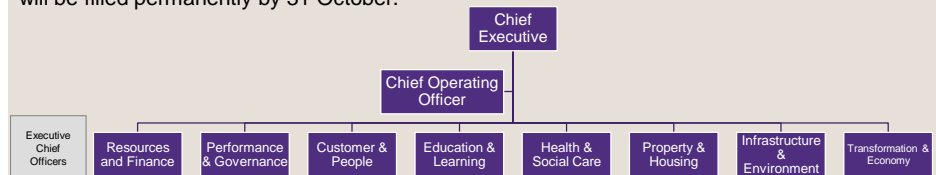
The Council has developed a Workforce Planning strategy for the Council based on a set of strategic objectives that recognise the need for transformation across the Council while reflecting the Council's ambitions and need to develop the workforce fit for the future. Underpinning the strategy are Service Workforce Plans. These align the individual Service Plans with the Council's priorities and service operational demands.

The Council agreed three year pay settlements with staff covering 2018/19 to 2020/21, the Council has assumed similar increases of 3% per annum for 2021/22 and 2022/23 within its financial plans. With a commitment to no compulsory redundancies and limited resources through the change fund or through reserves to absorb potential costs of a significant voluntary severance programme, the Council is limited in options in terms of addressing financial challenges through reducing staffing resource costs. Given the short term financial pressures facing the Council, there is a risk that there is a focus on in-year cost control. We recognise the work being undertaken by the Resources Governance Board in ensuring tighter control over payroll costs. However, it is critical that resource decisions continue to focus on the Council's long term strategy.

Action Plan Point - 5

Council redesign

During 2018/19 the Council undertook a review of senior-level organisational design. The focus of the review was linked to the Council's strategic theme of "a connected highland" by ensuring that not only was the senior-level of the organisation delivering clear leadership and oversight but enabling services to align to local priorities and enable continuous improvement. The redesign of the senior-level of the organisation created a Chief Operating Officer role and introduces eight Executive Chief Officer posts, supported by Heads of Services. Currently five of the eight positions have been recruited and Officers are confident that the remaining posts will be filled permanently by 31 October.



The new structure is expected to deliver moderate savings. However, it is recognised that this may vary depending on final costs of appointment and balance between internal and external candidates and the key driver is not cost savings but enhancing strategic leadership and management. The Council established interim arrangements with a number of posts being filled on an interim capacity with Officers acting up in roles until the positions were filled.

The new arrangements will take time to embed within the Council. The restructure has introduced a number of new roles and a significant change across the senior level of the organisation. Below the senior level of the organisation, it is likely that change will be required across services as they feed into the new structure. While we recognise the rationale for the restructure, it is important that the Council takes time to monitor the effectiveness of the new arrangements as they embed in supporting the organisation deliver its strategic objectives.

Financial planning 2019/20

The financial challenges facing the Council are not only through revenue resources. As approximately 50% of the Council's capital programme is funded through borrowing which in turn has subsequent implications on annual expenditure, the revised five year capital programme has been developed to reflect the restrictions of available revenue budget to service borrowing. While we recognise that this is prudent from the Council, it demonstrates the implications of the challenging financial environment on strategic capital investment decisions.

The Council's 2019/20 budget was approved in February 2019. The budget is developed using a detailed budgeting approach to ensure that forecast income and expenditure is developed on key planned activity during the year. Financial forecasts are reviewed during the year to ensure these remain appropriate.

The annual budget identified a budget gap of £27.891 million (which includes £2.5 million to establish a change fund). The budget gap is partly offset by the impact of a 3% annual council tax increase (£3.6 million) and 2nd homes Council Tax of £2.85 million, leaving required savings of £21.439 million to be delivered during the year through savings proposals and the corporate change programme "A sustainable Highland". As at June 2019, the Council reported that 73% of these savings had been achieved or were expected to be achieved in the year, demonstrating clear commitment to deliver these in the current year. However, we recognise that these remain projected savings and there remains uncertainty around their delivery.

Key assumption	Budget £ million	Considered reasonable	Comment
Revenue grant	456.766	✓	Revenue allocation received from the Scottish Government.
Council tax	124.196	✓	The Budget includes the approved uplift in Council tax of 3% (£3.448 million).
Base line budget	(566.289)	✓	This is based on an incremental budgeting approach based on the net revenue budget in 2018/19 budget and includes already agreed savings
Cost / budget pressures	(35.116)	Challenging	The budget includes forecast Staff cost increases of £12.237 million which is based on the agreed three year pay settlement. The Council has also identified £6.431 million of budget pressures on services reflecting non-staffing cost pressures. A further £16.448 million of costs/ budget pressures have been identified reflecting to changes in funding, primarily around Early Years and Health and Social Care that have been passed on to services. While we recognise the cost control measures that the Council has established should support the Council meet budget pressures, we note that over the last three years the Council's Care and Learning Service and Community Services have experienced challenges operating within budget.
Investment	(4)	Challenging	This includes the creation of a £2.5 million change fund to support strategic change programmes in future years. It also includes budgeted for £1.5 million of investment in roads infrastructure as a budget commitment. Given the level of savings required by the Council and transformation likely to be required at the council to deliver these, the Council will need to key the funding available under close scrutiny to ensure this is sufficient.
Service revenue	3.004	✓	The Council's budget includes proposals for increasing service revenue through commercial activity including fees and charges.
Savings required	21.439	Challenging	The budget incorporates a combination of savings including cost controls and redesign of services, particularly across Care and Learning. As at June 2019, the Council were reporting that 90% of these savings had "been achieved" or likely to be achieved. However we note that this is based on Officers confidence on the delivery of savings across the full year. The Council continues to face challenges in delivering targeted savings.
Forecast surplus / (deficit)	-		

Source: The Highland Council 2019/20 Budget Paper

European Social Fund

One budget area that is currently under officers focus relates to European Social Fund (ESF) revenue. In May 2019, the Council were notified by the Scottish Government that following an audit of the Scottish Government systems, the European Commission had suspended payment of claims submitted until the issues were resolved. The Scottish Government have notified lead partners, including the Council, that they “cannot afford to fund programmes of this size without the ability to reclaim the full costs from the European Commission”. The Council has a number of ongoing ESF programmes that are due for payment or to be claimed totalling approximately £1.6 million. The Council is working with Scottish Government to understand implications of this and potential impact on future ESF related programmes. We will review this in our 2019/20 audit.

Governance and transparency



The Council undertook a review of governance arrangements. Officers and Members have recognised opportunities to enhance governance arrangements both to enhance oversight and scrutiny as well as ensuring a continued focus on local issues and priorities. Key areas of focus have been around enhancing the work of the Audit and Scrutiny Committee as well as enhancing strategic governance arrangements. These developments are expected to be considered in September / October and we will monitor progress during our 2019/20 external audit.



We welcome the Council's review of the Audit and Scrutiny Committee. In particular, the reduction in committee membership should support greater debate and governance on strategic risks and issues.



Risk management arrangements have continued to embed within the Council following the revised strategy approved in March 2018. These arrangements will continue to develop as the organisation enhances its governance and scrutiny arrangements, including enhancing the role of the Audit and Scrutiny Committee in respect of Risk Management.

We considered, through discussions with management and review of minutes, the Council's overarching governance arrangements

Identified audit risk at planning

Governance arrangements

The Council continues to review and consider the design and operating effectiveness of governance arrangements in place. During 2018/19, the Audit and Scrutiny Committee is in the process of evaluating its effectiveness including consideration of its membership and size and how it can enhance its scrutiny activity.

Officers have recognised the need to enhance governance and scrutiny arrangements. In addition to the normal service and governance committees and officer meetings, additional scrutiny arrangements are being introduced through:

- A cross member Resources and Improvement Governance Board which meets on a monthly basis
- An officer lead Resources and Improvement Implementation Board which will have a weekly rolling programme of reporting so that each improvement priorities will be considered once a month and support reporting to members.

The Council recognises the strategic importance of the delivery of identified areas for improvement as well as effective management of resources. These new governance arrangements will play a critical role in the oversight and delivery of these.

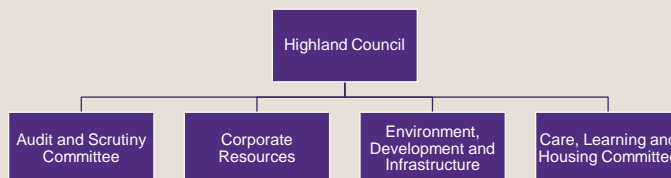
Our Response:

We considered the Council's governance arrangements in place, including the newly established Resources and Improvement Governance Board and how this operates within the existing governance framework. We also considered any proposed or implemented changes to the Audit and Scrutiny Committee and how these support effective governance and scrutiny.

Conclusion

Governance Committee structures

The current Committee structure was developed in 2017 with a focus on streamlining strategic committees and therefore enabling focus on greater community participation through local communities. The structure has the Council supported through three strategic committees and the Audit and Scrutiny Committee:



Governance review

During 2018/19 the Council initiated a review of governance arrangements. The remit of the review is broad, considering governance at both a strategic and local level. The focus has predominantly been around the role played by Members, although also considers the relationships between Members governance, senior officer governance and organisational performance. The work is being delivered through an officer lead Governance Review Steering Group with oversight from Members.

The review identified a number of areas of improving governance across the Council and these are in the process of being implemented with further work underway to continue to review and develop governance across the Council. To date the review has identified the following areas of improvement:

- Changes to the Audit and Scrutiny Committee to reduce the number of members from 26 to 14 to enhance the focus of scrutiny and debate as well as developing committee member training and development to support them in their role.
- Reviewing the current committee structures and remits as there is currently concern around the scope of these committees and the extent to which that facility oversight and governance
- Recognising the changing organisational structure and whilst acknowledging committees should be driven around ensuring effective governance rather than operational structures, the committees should align to operations.
- Engagement with local committees, including reviewing local community boundaries. The steering group is undertaking additional work to ensure local steering groups are sufficiently resources to support local empowerment and engagement.

Recommendations for overall strategic governance arrangements are expected in September / October Council with further recommendations around local communities in future meetings. A number of the recommendations raised are in line with our own observations as the Council's external auditors. It is important that throughout and after the review there is continuous self assessment and engagement with members to ensure these new arrangements are effective.

Action Plan Point- 6



Risk Management

The Council has made progress in developing and enhancing its risk management arrangements. The Council's risk management strategy and framework was refreshed in March 2018 and refreshed during the year. The strategy was established by the Council working in conjunction with Zurich Municipal. The Corporate Risk Register is clearly aligned to the Council's strategic objectives and the risks and challenges the Council faces in the delivery of these. The Corporate risk register is scrutinised by the Audit and Scrutiny Committee on a bi-annual basis. Underpinning the Corporate Risk Register are Service Risk Registers with significant risks escalated appropriately.

As part of the governance review, the Council has recognised that proposed enhancements to governance structures and arrangements should support improved oversight and management of risks. Greater focus and scrutiny on strategic risks should enhance risk identification, scrutiny and management across the Council.

Openness and transparency

The Council demonstrates commitment to clear and transparent public reporting. Council and committee meeting minutes and supporting papers are published online as well as a range of corporate publications detailing the Council's underlying performance and activities. Meetings are also webcast and available live to watch.

The Council produces a quarterly performance report 'High Points magazine' to summarise the Council's performance in the period and to keep the public informed of key developments in Council performance.



Fraud and Irregularity

Highland Council has arrangements in place to help prevent, detect and mitigate the risk of fraud or irregularity, including whistleblowing policy and confidential helpline for reporting fraud. While we consider these to be reasonable, no arrangements can fully prevent against the risk of fraud, theft or irregularity. We are not aware of any material frauds at the Highland Council during the course of the year and have confirmed this with officers and report to Audit Scotland through quarterly fraud reports.

The Council participates in the National Fraud Initiative (NFI), a counter fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and the National Audit Office to identify fraud and error. We found Highland Council's arrangements for participation in the NFI exercise during 2018/19 to be satisfactory. The Council has effective arrangements in place for the submission of data and investigation of potential matches.

Partnership – Lead Agency Model



Under the partnership with NHS Highland, the Council are the lead agency for integrated children services and NHS Highland is the lead agency for the delivery of integrated adult services. During 2018/19 both NHS Highland and Highland Council appointed new Chief Executives. While the arrangements face considerable pressures, both Chief Executives reiterated their commitment to review the Lead Agency partnership agreement to re-look at how both organisations can support the model to make it a success. This review is due to be completed in 2020.

Value for money



Highland Council has looked to enhance its performance management arrangements, providing a greater focus within the measures on outcomes. However, it is too early to determine whether the reporting and monitoring of these will also focus on wider benchmarking data and the extent to which these measures stretch and challenge the Council. It is key that the Council ensure that there is continued focus on targeted outcomes and not just improvement on prior year measures.



The Council faces significant financial and operational challenges. Effective partnership working with strategic partners including NHS Highland as well as local engagement with areas and communities will be increasingly important to support the delivery of the Council's strategic goals.



Given the financial challenges facing the Council, Officers recognise the importance of developing a culture that drives continuous improvement and delivering services as efficiently and effectively as possible. Whilst quarter one 2019 performance information indicates that the Council is on a trajectory of performance improvement, it is recognised that an improvement culture is embedded within the Council over the medium to longer term to continue to drive learning and service improvement.

Identified audit risk at planning

Performance management

The Council's Corporate Plan identifies 22 strategic priorities and Council's ambitions over the next three years. Underpinning these are a number of key performance indicators and outcomes.

The Council has recognised that the delivery of the strategy requires a culture of improvement. The Council is currently developing the agreed strategic improvement priorities and targets for approval in May. To support the delivery of these and embed a culture of improvement, is the Highland Improving Performance Programme (HIPP). The Council aim to deliver a sharper focus on improving performance across the Council. A number of mechanisms are being used to facilitate this process including:

- Communication, celebration and learning from strong performance
- Pursuing improvement collaboratively, with a focus on overarching ownership and avoiding silo working
- Utilising performance data to provide both an inward and outward view of the Council's performance
- Embracing peer review, benchmarking and external scrutiny.

Delivering efficient and effective performance is critical for the Council to deliver its strategic priorities.

Our Response:

We will consider the Council's performance management framework and how this is developed to support the key strategic priorities. We will assess how officers capture and measure performance and outcomes. We will consider the progress made by the Council in embedding a culture of continuous improvement including how it has embraced benchmarking, peer review and external performance assessment to identify areas for improvement.

Our work will support the work undertaken as part of the Council's BVAR review.

Conclusion

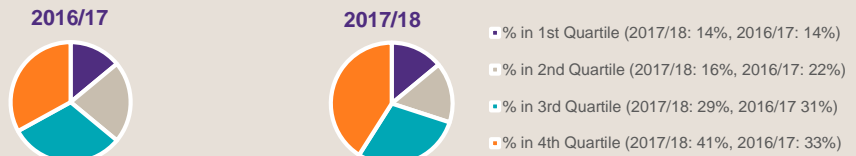
Oversight and scrutiny of performance

The Council utilise a suite of performance reports to monitor and challenge the Council's performance during the year. These are reported through Committees and an overall summary of performance against KPIs is included within the 'Local and National Statutory Performance Indicators' report is presented to council on an annual basis. The most recent report presented in March 2019 (covering the 2017/18 reporting period). The report shows that 22 (81 per cent) of 27 indicators are either improving or being maintained. The Council report that this demonstrates that KPIs are performing well. However, the transparency of reporting could be improved by using targets as well as trend analysis as well as greater benchmarking at a national level.

The Local Government Benchmarking Framework (LGBF)

LGBF allows councils to compare their performance to the Scottish average for a variety of indicators. Performance relative to other councils can be gauged by considering how all councils are performing, from highest to lowest for each indicator, and dividing relative performance into four equal bands or quartiles. Quartile 1 contains the best-performing councils and Quartile 4 contains the poorest-performing councils.

The council reports annually on performance against national performance indicators in the annual SPI report. Analysis of Highland Council's LGBF indicators published in the *National Benchmarking Overview Report 2017/18* by the Improvement Service in February 2019 identified that while overall performance was improving, the Council still had considerable areas for improvement.



Source: Audit Scotland analysis of LGBF performance indicators. Note this is based on indicators the 49 indicators reported over the last five years and therefore does not include all reported indicators in 2018.

From analysis above of HCBF indicators, there are clearly areas of improvement with 70% of indicators within the bottom two quartiles. Key areas where performance was in the lower quartiles included children services and priority areas such as education and sickness absence days per teacher.

Monitoring arrangements

On a quarterly basis, performance against key performance measures including Statutory Performance Indicators are reported to the Corporate Resources Committee and relevant service committees. While performance information is regularly reported to Members, the Council has acknowledged that improvement is required to this process. A recent survey carried out by the council across a sample of elected members highlighted the need for more concise reporting to improve scrutiny of performance at committee level. Feedback obtained by the council in the recent survey also identified the need for a greater focus on performance against priorities and the use of targets and benchmarking to deliver improvement. At present, performance information reported to committee is focussed mainly on trend information, rather than performance against targets. Overall, the results of the recent member survey show that there is still some disconnect between what is produced in terms of performance information and how to use this to improve the council.

Looking forward

The Council's Corporate Plan for 2019-22 provides a framework required to deliver and monitor the Council's strategic program "Local Voices, Highland Choices" along with the strategic, operational and improvement priorities of the Council as reflected within the Council's budget strategy and change programme "A Sustainable Highland".

During 2019, the Council has acknowledged that it requires greater focus on improving performance across the Council and that pivotal to this is a positive cultural change through embedding a consistent approach to improvement and constructively challenging performance and ways of working.

The revised Corporate Plan covers over 70 Corporate Plan targets or set actions and the 22 strategic improvement priorities. While we recognise that there is a greater focus within the measures on outcomes, it is too early to determine whether the reporting and monitoring of these will also focus on wider benchmarking data and the extent to which these measures stretch and challenge the organisations. It is recommended that the Council ensure that there is continued focus on targeted outcomes and not just improvement on prior year measures.

Action Plan Point – 7

Statutory performance indicators

The Accounts Commission has a statutory power to define the performance information that councils must publish for performance comparison and benchmarking purposes. It fulfils this power by issuing a Statutory Performance Information (SPI) Direction to councils.

In recent years the Commission has used the power to emphasise what it sees as the prime importance of councils reporting performance to their citizens and communities. The Direction sets out the performance information that the Commission requires councils to publish.

Between 2016/17 to 2018/19 the Accounts Commission prescribed two SPIs:

- SPI 1: covering a range of information relating to areas of performance such as improving local public services, improving local outcomes, engaging with communities and achieving best value
- SPI 2: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.



The Council publishes the information for both SPIs up to 2017/18. We concluded that the council's arrangements for publication are satisfactory.

Looking forward, the Accounts Commission published an updated direction in December 2018. This requires the Council to report on SPI1: Improving local services and local outcomes, and SPI 2: Demonstrating best value with effect for financial year ended 31 March 2020. We will monitor the Council progress with this in the coming years.

Implementing a transformational culture



During 2018/19 the Council has implemented some significant changes, particularly across senior leadership team as well as enhanced budgetary/financial controls. These changes appear to be resulting in greater focus on financial performance and greater disciplines of financial management across the Council. There is also a focus on increasing the pace of change across the Council and we have observed a clear commitment to working with local communities in focusing the Council's key priorities.

Given the financial challenges facing the Council, Officers recognise the importance of developing a culture that drives continuous improvement and delivering services as efficiently and effectively as possible. While quarter one 2019 performance information indicates that the Council is on trajectory of performance improvement, it will be critical that an improvement culture is embedded within the organisation over the medium to longer term.

Community engagement

The rural and remote population covered by the Council means it is key that the Council has effective arrangements in place to engage with local communities both to inform and communicate Council strategy. Through the Community Planning Partnership (CPP), overseen by the Community Planning Board, the Council aims to work with a range of key partners and groups covering thematic issues. In response to the thematic issue, the group develops its own delivery plan and reports progress to the Community Planning Board. The Council aims to embrace the Community Empowerment (Scotland) Act 2015 through providing greater opportunities for interaction with the Council (including 'Participation requests' as well as opportunities for community asset transfers).



During 2018/19 the Council initiated a review of Community Council Scheme of Establishment. This included reviewing community council boundaries. Phase 1 of the consultation was run between March 2019 and June 2019 and recommendations considered by the Council, including restricting the community areas. A second phase of consultation has been launched and will be considered through the Council over the coming months. We will follow up on this during our 2019/20 external audit.

ICT transition and transformation

The Council is undertaking a programme to transform its ICT arrangements. The Programme aims to update much of the Council's core ICT infrastructure to support the Council's redesign plans, including enhancing ways of working and delivering services. A fundamental part of the programme has been the transition of ICT Service providers from Fujitsu to Wipro, including the management of services.

Due to issues with the technical implementation of the ICT solution and overall programme management, there have been delays in programme delivery.

Oversight of the programme has been both through project management groups as well as the Corporate Resources Committee. During 2018/19 Management, working with Wipro revised programme delivery plans and agreed contractual changes that help protect the Council from significant additional costs from any further delays. Following these revisions and oversight from the ICT Implementation Board, the Council has reported that overall good progress has been made with project delivery and that the overall risk of the programme has reduced. The ICT transformation is a key element in shaping future service delivery at the Council and maximising the use of ICT to support efficient and effective ways of working. While progress has been made during the year and work to mitigate the financial exposure of the Council, the delivery of the programme remains complex and continued partnership working with Wipro both in terms of project delivery and future service provision a key element of this.



Appendices

Audit adjustments

Action plan recommendations for 2018/19

Follow up of 2017/18 recommendations

Fees, independence and fraud arrangements

Communication of audit matters

Audit adjustments

Uncorrected and corrected misstatements

We are pleased to report that there were no uncorrected misstatements to the financial statements arising during our audit.

The following adjustments were identified during the course of the audit and corrected in the financial statements. These impact on both the Group and Council financial statements.

Item	Dr (£'000)	(Cr) (£'000)	Description
1	Other operating costs (Pension reserve)	9,426	<i>Being adjustment to recognise defined benefit pension scheme net liabilities reflecting the impact of the McCloud case on defined benefit liabilities (Note includes £9.302 million to CIES net cost of services and £0.124 to finance and interest costs both charged to the Pension Reserve)</i>
	Defined benefit pension liability	(9,426)	
2	CIES Revenue	72,117	<i>Being reversal of internal recharges from CIES in line with the Code</i>
	CIES Expenditure	(72,117)	
3	Short term debtors		<i>Being adjustment to reflect repayment of loans due in next 12 months (NHT Loans)</i>
	Long term debtors	16,033	
4	Council Dwellings		<i>Being Council Dwellings componentisation</i>
	CIES - HRA Cost of Services	1,490	
	Capital Adjustment Account	1,490	
	MirS – Rev Depreciation and Impairment	(1,490)	
5	Capital Grants - Community Services	1,843	<i>Capital Items recoding between Community Services and Development & Infrastructure (had been coded to wrong service originally)</i>
	Capital Grants - Development & Infrastructure	(1,843)	
	Non-Enhancing Expenditure - Community	1,843	
	Non-Enhancing Expenditure – Development & Inf	1,843	
	Depreciation - Community Services	(267)	
	Depreciation - Development & Infrastructure	31	
	Depreciation - Community Services	236	
6	Revaluation Reserve	412	<i>Revaluation Reserve correction for Airdferry Resource Centre</i>
	Capital Adjustment Account	(412)	
	CIES -C&L Cost of Services	(412)	
	Reversal of Depreciation & Imp	412	
	Revaluation Losses in the Year (GF)	412	
	Revaluation Losses in the Year (Appropriations to Revaluation Reserve)	(412)	
7	CIES Revenue – Prior year	75,906	<i>Being prior year adjustment for the reversal of internal recharges from CIES in line with the Code (Note prior year balances restated across lines (detailed within Note 10a of the financial statements))</i>
	CIES Expenditure – Prior year	(75,906)	

Audit adjustments

The following adjustments were made to the group financial statements in relation to the Group only accounts

Item	Dr (£'000)	(Cr) (£'000)	Description
1	Group – CIES – Care and Learning Expenditure	(97)	<i>Being adjustments to High Life Highland accounts reflected in consolidated accounts.</i>
	Group - Inventory	(3)	
	Group – Short Term Debtors	(135)	
	Group – Short Term Creditors	235	

Disclosure misstatements

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow Audit and Scrutiny Committee to evaluate the impact of these matters on the financial statements. The following disclosure misstatements were made to the draft financial statements:

Item	Description
1	<i>Prior year reclassification Where prior year restatement has been made to the draft financial statements, IAS 8 requires specific disclosures around the impact of these. The Council has amended the financial statements to ensure appropriate disclosures around the amended prior year Comprehensive Income and Expenditure Statement figures.</i>
2	<i>Management Commentary Minor disclosure adjustments required to ensure information presented consistent with primary financial statements</i>

Note minor casting and disclosure amendments were identified during the course of the audit and raised with Officers. We do not consider these of significance to require reporting to the Audit and Scrutiny Committee.

Action plan recommendations for 2018/19

We have set out below, based on our audit work undertaken in 2018/19, those risks and recommendations we consider are of a higher risk to the Council that Management may wish to consider in the future.

Recommendation

Agreed management response

1. Valuation of property, plant and equipment:

To comply with the requirements of the 2018/19 Code, items of property, plant and equipment are required to be held at their current value. For assets subject to valuation, this requires valuations to be undertaken with sufficient frequency to ensure that the carrying value of PPE is not materially different to its current value i.e. the value of the assets if they had been revalued as at 31 March 2019. During our audit further work was required from Officers and the internal valuer to demonstrate that those items of PPE not subject to revaluation in the year were not materially misstated. Through consideration of Officers assessment, we are satisfied that PPE is not materially misstated. However, we recommend that Officers, working with in-house valuers review the rolling programme of valuations to ensure these are conducted with sufficient regularity to ensure not materially misstated.

The 2018/19 Code requires Council houses to be measured at Existing Use Valuer – Social Housing as a measure of fair value. This is lower than cost. Council houses have not been subject to revaluation since 2017 and therefore two years worth of additions are valued at cost. While we are satisfied Council houses are not materially overstated, we recommend that as part of Officers review of revaluation programmes they ensure that Council house additions are considered as part of this process.

Management response: The rolling programme will be reviewed to ensure asset values are reported as accurately as possible and in compliance with the CIPFA code

Action owner: Finance Manager
Timescale for implementation: 31st March 2020

2. Financial management

Our audit testing found inconsistent practices on how budget monitoring reports were prepared across the Council with some services receiving actual spend to date information based on live financial ledger data, while others were based on adjusted data. While not material to monitoring of underlying performance, it is important that financial monitoring reports are prepared on a consistent basis across the organisation.

Management response: A review of reporting arrangements will take place to ensure all reports are produced on a consistent basis

Action owner: Head of Corporate Finance
Timescale for implementation: 31st December 2019

3. Financial challenges

In August 2019, Officers undertook an exercise to forecast the financial outlook over the next three years covering 2020/21 to 2022/23. This highlighted the scale of the financial challenges facing the Council with a potential funding gap of between £50.2 million (most optimistic) and £77.3 million (most pessimistic) over the three year period. While this incorporates the previously identified financial pressures, it represents a significant challenge for the Council to deliver and will require transformational change.

During 2018/19, the Council failed to deliver £2.7 million of the targeted £13 million savings targets. This has been a recurring theme at the council over the last three years with shortfalls in delivering savings of £1 million and £0.5 million in 2016/17 and 2017/18 respectively. In addition, the Council's Care and Learning Service has failed to operate within budget over the last three years as the Council has challenges in managing Looked after children and Additional Support Needs in a financially sustainable operating model.

Management response: Council acknowledges the scale of the financial challenge and has a well-established change programme and change fund in order to deliver the transformation required. The change programme focuses on savings which are challenging to deliver. Increased governance of spend is resulting in better management of historic areas of overspend and plans to provide long term solutions to these issues will be factored into the 2020/21 budget process.

Action owner: Executive Leadership Team and Members
Timescale for implementation: Ongoing

Recommendation

Agreed management response

4. Reserves and sustainability

The Council faces significant financial challenges over the coming years. The Council's non-earmarked reserves play a critical role in supporting the Council meet any additional investment required in strategic transformational programmes as well as manage any unforeseen expenditure that could not be met through in year resources. As at 31 March 2019, the Council's non-earmarked reserves balance represents 1.4% of the annual revenue budget. This was a reduction of 0.2% from the position as at 31 March 2018. Overall General Fund balances are one of the lowest across Scottish Local Authorities.

It is critical as the Council develop savings plans that consideration is made of reserve balances to ensure these are sufficient to provide contingency and opportunity for future strategic investment.

Management response: The Council agreed in February 2019 as part of its approved 3 year revenue budget that it would seek to restore non-earmarked balances to a 3% of revenue budget target level. Budget assumptions from 2020/21 onwards factor in an annual £2m increase in this reserve. It is intended that the Change fund will continue into 20/21 to provide funding for strategic investment in change.

Action owner: Executive Leadership Team and Members

Timescale for implementation: Ongoing – review date 31 March 2020

5. Workforce planning

With a commitment to no compulsory redundancies and limited resources through the change fund or through reserves to absorb potential costs of a significant voluntary severance programme, the Council is limited in options in terms of addressing financial challenges through reducing staffing resource costs. Given the short term financial pressures facing the Council, there is a risk that there is a focus on in-year cost control. It is critical that resource decisions continue to focus on the Council's long term strategy.

Management response: Resource decisions, in particular around staffing, are taken with both the short and long term implications in mind. The Resources Governance Board, which has senior officer and Member representation, has a key focus on all workforce-related decisions

Action owner: Resources Governance Board

Timescale for implementation: Ongoing – review date 31 March 2020

6. Governance arrangements

Officers and Members have recognised opportunities to enhance governance arrangements both to enhance oversight and scrutiny as well as ensuring a continued focus on local issues and priorities. Recommendations for overall strategic governance arrangements are expected in September / October Council with further recommendations around Local Communities in future meetings. A number of the recommendations raised are in line with our own observations as the Council's external auditors. It is important that throughout and after the review there is continuous self assessment and engagement with members to ensure these arrangements remain effective.

Management response: Arrangements for the review of the Audit and Scrutiny Committee were agreed at Council in June 2019 and will be implemented from September 2019 Committee. Currently self-assessment is through Council Redesign and Peer Review supported by Lean processes, the Council has recognised this needs to be strengthened and the first steps are to work with CIPFA on supported self-assessment using the CIPFA FM Model with the ambition to be a 5-star accredited organisation for financial management. Further work is starting to review approaches to corporate self-assessment in local government in Scotland with early options being considered of adopting an existing EFQM based model or building a bespoke model for Highland.

Action owner: Executive Chief Officer- Performance and Governance

Timescale for implementation: Changes of Governance of Audit & Scrutiny Committee – September 2019. Wider self-assessment – June 2020.

7. Performance management

The Council's Corporate Plan for 2019-22 provides a framework required to deliver and monitor the Council's strategic programme "*Local Voices, Highland Choices*" along with the strategic, operational and improvement priorities of the Council as reflected within the Council's budget strategy and change programme "A Sustainable Highland".

During 2019, the Council has acknowledged that it requires greater focus on improving performance across the Council and that pivotal to this is a positive cultural change through embedding a consistent approach to improvement and constructively challenging performance and ways of working. While we recognise that there is a greater focus within the measures on outcomes, it is too early to determine whether the reporting and monitoring of these will also focus on wider benchmarking data and the extent to which these measures stretch and challenge the organisations. It is critical that the Council ensure that there is continued focus on targeted outcomes and not just improvement on prior year measures.

Management response: Following Member engagement on SMART indicators and targets the new Corporate Plan (CP) approved in May 2019 (targets in September 2019) will be first reported to Council September 2020 for 2019/20 financial year. This new approach will enable reporting against the stretch targets set as well as trends over time establishing a more robust approach to measuring the outcomes set in the plan. As the CP measures are almost exclusively made up of the Council's 27 KPIs and LGBF benchmark indicators against a 2017/18 baseline there will be an early opportunity to report against both targets and trends for 2018/19 to Council in March 2020 through the Local & National SPI annual report.

Action owner: Executive Chief Officer- Performance and Governance

Timescale for implementation: March 2020 SPI report, September 2020 Annual Performance Report (CP)

Follow up of 2017/18 recommendations

Follow up of 2017/18 External Audit Recommendations

Action as at September 2019

Heritage assets

Heritage assets are distinct from property, plant and equipment as they are those assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. These assets are held based on estimated value, typically based on insurance valuation. The Council's last formal valuation was based on independent insurance valuation in 2013. In accordance with the CIPFA Code, we recommend that management look to obtain valuations, with sufficient regularity to ensure that the assets are held at their fair value.

Complete

IAS 19 Actuarial valuation

During our audit we identified that the Council's defined benefit pension scheme assets were understated by £17.781 million. This was due to the actuarial valuation using forecast asset position rather than actual and we understand has impacted on other Scottish local authority defined benefit schemes.

Where these are materially different to the actual fund assets we would recommend that management engage the actuary to provide a revised calculation.

Complete

The Council's actuarial valuation asset values were not materially misstated as at 31 March 2019.

Capital expenditure

During 2017/18 the Council underspent against capital by budget by £59.3 million. This was due primarily relates to slippage on key projects of £66.8 million, partly offset by overspends of £7.4 million. The slippage relates to a number of individual programmes where project expenditure was behind schedule or planned investment deferred to future years, putting increased pressure on future years.

While we recognise that some of the programme slippage was intentional to support financial position, there is a opportunity with the new, more affordable plan to deliver the capital programme in line with planned budget and thus avoid delayed investment in Council assets or pressure on operations in future years.

Ongoing

While the level of programme slippage had significantly reduced from previous years there remained £14 million of slippage as at 31 March 2019. It is critical the capital programme remains a key area of focus to ensure strategically important capital investment is completed in line with capital programme.

Financial challenges

The financial planning strategy identifies a three year budget gap of approximately £66.7 million. The level of required savings represent a significant challenge to the Council to deliver and existing approaches to identify and deliver savings are unlikely to be sufficient.

Over the coming months the Council will use different workstreams: elected members, wider public and partners; and Council officers, to evaluate and develop proposals that will deliver the required level of budget reductions over the next three years. It will be critical that this activity is clearly aligned to the Council's core objectives to ensure that there is clear prioritisation of available resources around council priorities

Superseded in the current year – see action plan point 3

Availability of reserves

The Council's non-earmarked reserves play a critical role in supporting the Council meet any additional investment required in strategic transformational programmes as well as manage any unforeseen expenditure that could not be met through in year resources. As at 31 March 2018, the Council's non-earmarked reserves balance represents 1.6% of the annual revenue budget and represents one of the lowest across Scotland's local authorities. This puts the Council in significant risk of being unable to meet unforeseen events or support Council investment to support transformational change. It is critical as the Council develop savings plans that consideration is made of reserve balances to ensure these are sufficient to provide contingency and opportunity for future strategic investment.

Superseded in the current year – see action plan point - 4

Follow up of 2017/18 External Audit Recommendations

Action as at September 2019

Financial position

Financial projections as at 30 June 2018, forecast an overspend of £5.1 million for the financial year. This is predominantly through service pressures across Care and Learning as well as challenges in delivering corporate savings totalling £1.7 million. The Council is currently implementing a number of initiatives across services to meet the shortfall. It is critical that the Council look to address these issues urgently as failure to do so could significantly impede the Council's current service delivery or available reserves to invest in the transformational change required over the medium term.

Superseded in the current year – see action plan point 3 and point 4

Strategic leadership and tone from the top

Elected Members and senior management team play a critical role in both developing and delivering the Council's strategic goals. During 2017/18, the Council's Chief Executive announced his retirement effective from November 2018 and the Director of Care and Learning, the Council's largest service is also due to retire. The Council is currently in the process of recruiting for positions. Given the financial and operational challenges facing the Council and likely difficult decisions that it will face, it is critical that there is a strong leadership team in place to meet these challenges

Ongoing

The Council has made significant progress during the year in senior level redesign and is in the progress of identifying suitable individuals to fill these roles. As at September 2019, the Council has still to recruit a Chief Operating Officer and three of the eight Executive Chief Officer positions. While where arrangements have been put in place on an interim basis, it is important given the financial and operational challenges facing the Council that filling these positions on a permanent basis is prioritised.

Fees, independence, fraud arrangements

External Audit Fee

Service	Fees £
External Auditor Remuneration	242,450
Pooled Costs	23,510
Contribution to Audit Scotland costs	15,220
Contribution to Performance Audit and Best Value	130,780
2018-19 Fee	411,960
Audit of Highland Council Charitable Trusts and Highland Charities Trust	2,000
Total 2018-19 Fee	413,960

The audit fee was calculated in accordance with guidance issued by Audit Scotland and agreed with Management.

Fees for other services

Service	Fees £
We can confirm there are no non-audit fees for the 2018/19 financial year	Nil

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.

We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.

We can confirm no independence concerns have been identified.

Client service

We take our client service seriously and continuously seek your feedback on our external audit service. Should you feel our service falls short of expected standards please contact Joanne Brown, Head of Public Sector Assurance Scotland in the first instance who oversees our portfolio of Audit Scotland work (joanne.e.brown@uk.gt.com). Alternatively, should you wish to raise your concerns further please contact Jon Roberts, Partner and Head of Assurance, 30 Finsbury Square, London, EC2A 1AG. If your feedback relates to audit quality and we have not successfully resolved your concerns, your concerns should be reported to Elaine Boyd, Assistant Director, Audit Scotland Quality and Appointments in accordance with the Audit Scotland audit quality complaints process.

Fraud arrangements

In assessing our audit risks, the audit team was alert to the possibility of fraud at the Highland Council.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relation to management override of controls.
- Leading a discussion with those charged of governance (for the Highland Council this is assumed to be the Audit and Scrutiny Committee) on their view of fraud. We did this when presenting our audit plan and discussions with those charged with governance.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit. – None were identified in-year

As auditors we obtain reasonable but not absolute assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from officers regarding officers assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

It is **The Highland Council's** responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we worked with the Highland Council to review specific areas of fraud risk, including the operation of key financial controls.

We also examined certain policies in place, strategies, standing orders and financial instructions, as relevant to the fraud framework, to ensure that they provide a reasonable framework of internal control.

No material suspected frauds or irregularities have been identified by Officers and reported in-year. Some minor frauds have been identified by Officers during the year but these did not impact on our overall audit approach or the financial statements.

Anti-Money Laundering Arrangements

As required under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 there is an obligation on the Auditor General (as set out in the planning guidance) to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. Should we be informed of any instances of money laundering at the Council we will report to the Auditor General as required by Audit Scotland.

Communication of audit matters

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity	•	•
We are independent of the Highland Council and have not identified any conflicts of interest		
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
We have not incurred any non-audit fees during the year and no threats to independence identified		
Significant matters in relation to going concern	•	•
No significant going concern matters identified		
Views about the qualitative aspects of the Highland Council accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
Set out in the Financial statements Section		
Significant findings from the audit		•
All matters of significance are referred in this report		
Significant matters and issues arising during the audit and written representations that have been sought		•
Letter of representation was signed by the Chief Executive Officer – Finance and Resources. This is our standard, unmodified letter of representation.		
Significant difficulties encountered during the audit		•
No difficulties encountered		
Significant deficiencies in internal control identified during the audit		•
None identified		
Significant matters arising in connection with related parties		•
None identified		
Identification or suspicion of fraud involving officers and/or which results in material misstatement of the financial statements		•
None identified. Quarterly fraud returns have been submitted to Audit Scotland during the year in line with Audit Scotland planning guidance. No material frauds identified (threshold of £5,000 or above)		
Non-compliance with laws and regulations		•
None noted		
Unadjusted misstatements and material disclosure omissions		•
None noted. Minor disclosure amendments only and these were not material in nature		
Expected modifications to the auditor's report, or emphasis of matter		•
None, an unqualified opinion		

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table above.

We communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to Highland Council Officers and the Audit and Scrutiny Committee.



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