



# Highland Council

## External Audit Report for the financial year ended 31 March 2020

Annual Report to Members and the Controller of Audit  
Final Report

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# Financial statements 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. This final report is addressed to the Highland Council and the Controller of Audit concludes our work. We have issued an unmodified audit opinion on the annual report and accounts. Our audit opinion includes emphasis of matter paragraphs in relation to the material uncertainty over the valuation of land and building and investment property valuations (group) arising as a result of Covid-19 and resultant economic downturn.



The unaudited Annual Report and Accounts were presented for public inspection on 25 June 2020. In accordance with our annual external audit plan our audit work commenced on 27 July 2020. Due to the travel restrictions and social distancing measures introduced by the government in response to the Covid-19 pandemic, we have delivered the audit remotely. The 2019/20 audit was challenging. Our audit testing over the Council's property, plant and equipment valuations identified that these were materially misstated in the prior year. A significant level of additional work from both the Council's Finance Team and Council Valuers was undertaken to arrive at revised valuations for the prior year. This required additional audit procedures to be undertaken and updated disclosures within the financial statements leading to delays in finalising the financial statements. Consequently, the audit process took longer than planned with the final accounts submitted to a special meeting of the Audit and Scrutiny committee on 28 January 2021. We thank Officers for their support and assistance throughout the audit.



Significant audit risks were: management override of controls; the risk of fraud in revenue recognition (in accordance with ISAs UK); the risk of fraud in expenditure recognition (in accordance with the Financial Reporting Council's (FRC) Practice Note 10); the valuation of land and buildings (including council dwellings); and the valuation of defined benefit pension obligations. An additional significant audit risk was identified in relation to Covid-19 which caused significant disruption to all public sector entities in the later half of March 2020.



We updated our audit materiality to reflect your 2019/20 draft financial statements setting Group materiality at £10.083 million (Council only: £9.774 million) being approximately 1.2% of gross expenditure. The Group consists of the Council, the Council's subsidiaries: High Life Highland, Nairn Common Good Fund and Inverness Common Good Fund; and the Council's associates: Highland and Western Isles Joint Valuation Board and Highland and Islands Transport Partnership. Materiality is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements.



The accounts include a prior year adjustment in relation to the valuation of land and buildings, including council dwellings. During 2019/20 the Council undertook a substantial revaluation of land and buildings, covering approximately 57% of assets. The valuation identified material movements in the value of assets of which £210 million related to prior years. In addition, a prior period adjustment was required in relation to the valuation of Council Dwellings. In previous years the Council had incurred significant levels of subsequent expenditure on Council Dwellings but had not reassessed these to ensure valued in accordance with the Code of Practice on Local Authority Accounting. Council dwellings are valued based on an existing use value for social housing (EUV-SH). This value reflects a discounted market based valuation to reflect the lower rent from social housing. The value is materially lower than cost and therefore the Council has revised prior year valuations to reflect the valuation on basis consistent with EUV-SH. This resulted in a downward revaluation of £112 million within Council dwellings.

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### **Adding value through our external audit work**

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

We have continued to build on our working relationship with Officers and our understanding of the Council. Due to the impact of the COVID-19 pandemic, our audit work has been undertaken remotely. This included establishing remote access to the Council's key finance systems and developing new ways of working with Officers to deliver the audit including video calls and shared screen facilities. While we faced challenges during 2019/20, particularly surrounding gaining sufficient assurance over the valuation of property, plant and equipment, we worked with Finance Officers to agree suitable approaches to resolve the challenges faced to finalise the financial statements. Going forward we will work with Finance Officers to learn from the experiences in the 2019/20 audit and look to incorporate efficient and effective ways of working remotely into our 2020/21 audit.

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# Introduction

## Reporting

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2020.

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

Our report is addressed to the Members of Highland Council (the Council). In addition, in accordance with our reporting responsibilities, the report is jointly addressed to the Controller of Audit.. This final report will be published on the Audit Scotland website ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)).

Our report was presented as a final draft to the Council's Audit and Scrutiny Committee on 28 January 2021 and was finalised following approval of the annual report and accounts. We would like to thank the Council's finance team and senior officers for their support and assistance in the audit process.

## Covid-19

Due to the Covid-19 pandemic we considered whether an additional financial statement audit risk was required. As discussed with Officers in June 2020 and communicated to the Audit and Scrutiny Committee in September, we have recognised a further financial statement risk due to Covid-19. Further details on the risk identified and our response and conclusion to the risk is included within the Responding to Significant Risks section of the report.

## 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.

Our conclusions on wider scope risks identified in the audit plan are set out in the relevant wider scope sections of this report.

## The audit process

The unaudited accounts were published on 25 June 2020. In accordance with our annual external audit plan our audit work commenced on 27 July 2020. Due to the travel restrictions and social distancing measures introduced in response to the Covid-19 pandemic, we have delivered the audit remotely.

There were a number of adjusted misstatements to the financial statements. These included: misstatements in the recognition of the revaluation of property, plant and equipment; adjustments to the actuarial valuation of defined benefit pension scheme liabilities; errors in the recognition of short term debtors and a client identified error in relation to recognition of creditors as at 31 March 2020. Details of these adjustments are contained within Appendix 1.

## Our Opinion

For the financial year ended 31 March 2020 we have issued an unmodified audit opinion on the annual report and accounts:

- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2019/20 code
- prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003
- Other information in the annual report including Annual Governance Statement
- Other prescribed matters

## Emphasis of matter – property valuation

We draw attention to the Council's annual accounts Note 7 to the financial statements (and note 2 to the Group accounts), which describes the basis for valuing land and buildings and Investment Properties. Officers use an internal expert to value their land and buildings and Investment property portfolio on a rolling programme of revaluations. The expert's valuation included a 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty and a higher degree of caution should be attached to Officers valuation than would normally be the case. Our opinion is not modified in respect of this matter.

## Materiality

Our audit approach was set out in our audit plan (March 2020) at £10.083 million (Council only: £9.774 million) being approximately 1.2% of gross expenditure. The Council's Group consists of the Council, the Council's subsidiaries: High Life Highland, Nairn Common Good Fund and Inverness Common Good Fund; and the Council's associates: Highland and Western Isles Joint Valuation Board and Highland and Islands Transport Partnership. Materiality is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements. Our performance materiality for the Group was set at £6.554 million (Council only: £6.353 million), being 65% of overall materiality. Our materiality is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements.

We set a lower materiality level in respect of the remuneration report, given the interest to the users of the accounts. This was set at £5,000, linked to the bandings used. We report to management any difference identified over £250,000 (Trivial capped at £250,000 by Audit Scotland).

## 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:

- Considered procedures and controls around related parties, journal entries and other key entity level controls.
- Performed walkthrough procedures of key financial processes including income and expenditure recognition, journal postings, payroll, land and building valuations, and the IAS 19 valuation of the defined benefit pension scheme.

Our work over controls is limited to our ISA requirements in understanding an entities control environment. Our audit is not controls based and we do not place reliance on the operation of controls, as our audit is fully substantive in nature.

We identified no material weaknesses or areas of concern from this work which would have caused us to alter the planned approach as documented in our plan.

## Internal Audit

As set out in our external audit plan our audit approach is to comply with the ISAs and we did not place formal reliance on the work of the Council's internal audit function during the year. We have reviewed the internal audit plan and individual reports issued, to consider if any impact on our audit approach. For 2019/20 the Council's Internal Audit Service concluded:

*"On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However, as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems for the year to 31 March 2020."*

From our review we are satisfied that there were no areas arising from the work of internal audit that would impact on our audit of the financial statements and that appropriate disclosure is contained within the annual governance statement. We confirm that internal audit is independent and has sufficient capacity and capability in fulfilling its role and remit.

## Prior period adjustment

Note 3 to the Council Accounts and note 9 of the Group accounts describe prior year adjustments made to the financial statements. During 2019/20 the Council undertook a substantial revaluation of land and buildings, covering approximately 57% of assets. It was identified that a significant proportion of the revaluation movements related to prior years. The Council's valuer undertook a retrospective desktop valuation of assets held. The valuation identified material movements in the value of land and buildings relating to prior years which should have been reflected in the Council's accounts. The net impact of the valuation movements in the previous years was to increase the value of Property, plant and equipment by £43.554 million and £97.878 million as at 1 April 2018 and 31 March 2019 respectively. These adjustments do not impact the Council's General Fund position. The impact of these adjustments has been reflected in the financial statements prior year comparators and are summarised below:

	Previously reported balance as at 1 April 2018 (£'000)	Adjustment (£'000)	Restated balance as at 1 April 2018 (£'000)	Previously reported balance as at 31 March 2019 (£'000)	Adjustment (£'000)	Restated balance as at 31 March 2019 (£'000)
CIES – Deficit on the provision of services	N/A – Opening Balance sheet impact only			(25,077)	5,066	(20,011)
Other Comprehensive (income) / Expenditure	N/A – Opening Balance sheet impact only			(41,308)	6,995	(34,313)
<b>Total Comprehensive (Income) / Expenditure</b>	N/A – Opening Balance sheet impact only			<b>(66,385)</b>	<b>12,061</b>	<b>(54,324)</b>
Property, plant and equipment – Land and buildings as at 1 April 2018.(NBV)	1,198,743	139,460	1,338,203	1,236,307	203,280	1,439,587
Property, plant and equipment – Council Dwellings (NBV)	868,383	(116,432)	751,951	883,006	(125,344)	757,662
Property, plant and Equipment – Assets under construction (NBV)	39,983	20,526	60,509	51,589	19,942	71,531
<b>Net impact on Assets</b>		<b>43,554</b>			<b>97,878</b>	
Revaluation Reserve	534,789	13,837	548,626	554,682	47,420	602,102
Capital Adjustment Account	998,146	29,717	1,027,863	1,023,223	50,458	1,073,681
<b>Net impact on reserves</b>		<b>43,554</b>			<b>97,878</b>	

The Council's Group financial statements have been updated to separately disclose Investment Property on the Balance Sheet of £30 million. Previously these had been incorporated into Group Property, plant and equipment but as a material class of asset should be separately reported. This adjustment is of a disclosure nature only and do not impact the Council's reserves position.

# Responding to significant risks

Risk area	Identified audit risks at planning – From External Audit Plan
<b>Risk of fraud in revenue recognition</b>	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 allocation letters. 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 (2018/19 totalled £159 million) with a focus around the year end transactions and balances where financial performance is subject to greater external scrutiny. Therefore, we focus our testing on cut-off of service income.
Work completed	
<ul style="list-style-type: none"><li>• Walkthroughs of the controls and procedures over service income (for those services with material revenue streams);</li><li>• Substantive testing (at an elevated risk level) income recognised pre and post year end to identify if there is any potential misstatement</li><li>• Substantive testing (at an elevated risk level) of income recognised in the final two months of the year to identify if this has been potentially overstated</li><li>• Review and sample testing of accrued income, prepayments and debtors to gain comfort around the recoverability of balances at the year end.</li></ul>	
Our conclusion	
<p>Based on our testing we conclude:</p> <ul style="list-style-type: none"><li>• We did not identify any exceptions in our cut-off testing of year end income.</li><li>• We did not identify any material misstatements arising from our testing of accrued income, prepayments and debtors at the year end or material concerns around the recoverability of balances. As detailed in Appendix 1, during the course of there were two adjustments to debtors position as at 31 March 2020 where the Council had not recognised capital grants receivable. We are satisfied that these did not reflect material omissions and did not impact on the Council's outturn position for the year</li><li>• We did not identify any indication of fraudulent recognition of revenue transactions around the year end within our testing.</li></ul>	

## Risk area

### Risk of fraud in expenditure recognition

## Identified audit risks at planning – From External Audit Plan

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. As payroll expenditure is well forecast and agreeable to underlying payroll systems there is less opportunity for the risk of misstatement in this expenditure stream. Similarly, finance costs (2019/20: 58.5 million) which primarily relate to interest payment and finance charges are well forecast and relatively consistent year on year and therefore there is less opportunity for material misstatement. Similarly depreciation, amortisation and impairment costs and other capital movements (£2019/20: £123.6 million) relate to capital accounting movements and therefore subject to statutory adjustments and therefore less likely to be subject to manipulation. We therefore focus on other material non-pay service expenditure (2019/20: £349 million). As financial performance targets are measured externally on year end outturn, we consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of non-pay expenditure.

## Work completed

- Walkthroughs of the controls and procedures over non-payroll expenditure
- Substantive testing (at an elevated risk level) of expenditure recognised post year end to identify if there is any potential understatement of expenditure
- Substantive testing of post year end bank statements and review of minutes to identify any potential unrecorded liabilities.
- Reviewing accruals and deferred income around the year end to consider if there is any indication of understatement of balances held through consideration of accounting estimate and challenging management (Senior Officers) around the completeness and accuracy of these.

## Our conclusion

Based on our testing we conclude:

- The Council have historically applied a threshold of £250,000 when considering whether to accrue for post year end expenditure items received after the accounts closure process (being late April). Due to the impact of Covid-19, a number of third party invoices were delayed. Due to the volume of post year end expenditure we found that the application of the threshold of £250,000 was not appropriate. Consequently, our audit testing identified errors around the Council's expenditure cut-off. Following further Senior Officer review of expenditure transactions in April and May, Officers concluded that there was an understatement of £1.6 million as at 31 March. Our audit testing identified further errors which we have extrapolated across the total population. The total error (factual and extrapolated) is £5.12 million. Officers have not adjusted on the grounds the identified and extrapolated error does not represent a material misstatement to the accounts. Details provided in Appendix 1.
- We did not identify an indication of fraud in expenditure recognition. While errors were identified in our cut-off procedures these did not represent material misstatements to the financial statements.

Risk area	Identified audit risks at planning
<b>Management override of controls</b>	<p>As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. This risk area includes the potential for management (Senior Officers) to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.</p> <p>We consider those key judgements that are most susceptible to significant audit risk of management override are those over expenditure recognition. These are areas where management (Senior Officers) has the potential to influence the financial statement through estimate and judgement.</p>

### Work completed

#### Accounting estimates:

We assessed the risk of management override, consider those key accounting estimates and judgements that could impact on the organisations financial results and where there is an inherently increased risk of fraudulent misstatement or where management (Senior Officer) bias could result in a material misstatement. In particular we focused on estimates around material provisions, accruals and defined benefit obligations. In response to the significant audit risk we:

- considered the design of controls in place over key accounting estimates and judgements including: the valuation of land and building; valuation of defined benefit pension scheme obligations and provisions for bad or doubtful debts, including Council tax debtors.
- Reviewed accounting estimates for management bias / indication of fraud that could result in material misstatement. This included review of estimates as at 31 March 2020 and retrospective review of those estimates as at 31 March 2019.

#### Journals testing:

We performed risk based procedures to identify journals that, based on our planning assessment, presented a higher risk of fraud or error. In response to the significant risk we:

- Assessed the design of controls in place over journal entries, including how these are prepared, authorised and processed on the financial ledger;
- We risk assessed the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We tested these journals to ensure they are appropriate and that suitably recorded in the financial ledger;
- We performed targeted testing of transactions around the financial year end reviewing those journals are large or otherwise appear unusual to understand the rationale for the transaction.

### Our conclusion

Based on our testing we conclude:

- There was no evidence of management override in our testing.
- The Council's financial statements identify significant areas of estimation and judgement including: the Covid-19 impact on the valuation of property, plant and equipment; the useful economic life of property, plant and equipment; the valuation of the defined benefit scheme obligations; debtor provisions (arrears); PPP and service concession arrangements obligations; and fair value measurements. We have not identified any indication of management bias or fraud in the estimates applied.
- We have not identified any unusual or inappropriate transactions during the course of the year that would indicate management manipulation of the financial results.

## Risk area

## Identified audit risks at planning – From External Audit Plan

### Valuation of property, plant and equipment (Land and buildings)

In accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 ('the 2019/20 Code') property, plant and equipment is held at current value. The exact valuation basis depends on the nature and use of the assets. For land and buildings (where cost depreciated historical cost is not considered a reasonable proxy for current value), these assets need to be revalued with sufficient frequency to ensure the carrying value as at 31 March is not materiality different to that if they had been valued at that date. As at 31 March 2020, the Council held PPE of £2.835 billion, including Other Land and Buildings of £2.2 billion. Given the value of PPE held by the Council and the level of complexity and judgement in the estimation of valuations, there is an inherent risk of material misstatement in the valuation of land and buildings. The risk is less prevalent in non land and buildings assets as these are generally held at depreciated historic costs, as a proxy of fair value and therefore less likely to be materially misstated.

## Work completed

- Walkthrough of the controls and procedures over the valuation of land and buildings to gain an understanding of the arrangements in place at the Council for ensuring the carrying value of land and buildings remains appropriate and in accordance with IAS 16 and the Code.
- Challenged the underlying assumptions continued within the valuation of land and buildings and the reasonableness of these including the suitability of any indices used in the valuation.
- Reviewed the processes in place to support the valuers assessment of potential impairment of PPE and considering if there are any indications of impairment of PPE not recognised by the Council.
- Challenged officers to demonstrate that the valuation of land and buildings as at 31 March 2020 was materially consistent with the valuation that would be obtained if a full valuation had been undertaken at the balance sheet date.
- Using our auditor valuations expert, challenged the Council on the valuation instructions and approach adopted in valuing land and buildings as at 31 March 2020.

## Our conclusion

### Council Dwellings

- Our audit testing identified that Council Dwellings valuations in the draft accounts were not held in accordance with the CIPFA Code of Practice on Local Authority Accounting. The Code requires Council Dwellings to be held at current value, being *Existing Use Value – Social Housing* (EUV-SH), a valuation basis that reflects social rental rates. Assets should be valued with sufficient regularity that their carrying value at the balance sheet date is not materially different than if they had been subject to valuation. In the draft accounts, the Council held £147 million of Council Dwelling assets at cost, primarily relating to subsequent expenditure incurred since the last valuation date (2015/16). Consequently, these were not held in accordance with the Code representing a risk of material overstatement in the accounts. The issue was identified in the current year as it is the first formal valuation exercise over council dwellings since 2015/16.
- The Council's valuer subsequently undertook a retrospective desktop revaluation of these assets to arrive at a valuation as at 1 April 2018 and 31 March 2019. The net impact on the carrying value of Council Dwellings as at 31 March 2020 was a reduction in NBV of £112 million from the draft financial statements. This included an opening balance sheet prior year adjustment of a downward valuation of £139 million as at 1 April 2018. As this level of misstatement is material to the financial statements, the Council has amended the prior year figures (See prior period adjustment).

## Risk area

### Valuation of property, plant and equipment (Land and buildings)

## Our conclusion continued

### Land and Buildings

- The Council adopts a rolling programme of revaluations where assets are revalued at least every five years. During 2019/20 the Council undertook a significant revaluation exercise across land and buildings with over £1 billion of land and buildings (excluding Council Dwellings) revalued.
- The exercise resulted in a material movement in the carrying value of land and buildings. Audit procedures over revaluations, including comparing revaluation movement to market price fluctuations, identified that the movement was attributable to previous financial years. Subsequently, the Council's valuer undertook a retrospective valuation of those assets revalued in the year as well as assets not subject to revaluation to confirm that the carrying value in the accounts was not material different to that if formal revaluation had taken place (in accordance with the Code).
- From the retrospective revaluation work undertaken it was identified that land and buildings was cumulatively understated by £139 million and £203 million as at 1 April 2018 and 31 March 2019, respectively.

There are opportunities to enhance the Council's revaluation process. Our audit work in the year identified that the valuation programme did not ensure that asset values were being considered with sufficient frequency to confirm that these are appropriately valued at current value. In addition, the Council had not undertaken a comprehensive review of those assets not subject to revaluation as at 31 March 2020 to confirm that these assets carrying were appropriate. Our testing also identified errors in individual asset revaluations in year including errors in the valuation formula applied or assets missed from the initial valuation summary. Lastly, while the Council's valuer documents valuation assumptions on the revaluation database, there is no formal revaluation report provided to Senior Officers to enable effective scrutiny and challenge of the valuation assumptions adopted. Given the significance of the carrying value of property, plant and equipment and the level of estimation and judgement around the valuation, it is essential that Officers ensure they have clear processes in place for the effective review, scrutiny and challenge of the Council's valuation.

*Action plan point – 1*

### Emphasis of matter – Material uncertainty in relation to the valuation of land and buildings

The Royal Institute of Chartered Surveyors (RICS) have issued a valuation practice note regarding material uncertainties in valuations as a result of impacts to the market caused by Covid-19. The RICS Red Book defines material uncertainty as 'where the degree of uncertainty in a valuation falls outside any parameters that might normally be expected and accepted. Due to the impact of Covid-19 on markets, including reduced level of data points to support valuations, the Council's valuers have reported their valuation advice on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global Standards. Consequently, less certainty, and a higher degree of caution, should be attached to the valuation advice than would normally be the case. The Council have updated the accounts to disclose the material uncertainty within note 7 (Accounting policies). In addition, within the Group Accounts, the Group holds £30 million of Investment Properties. The valuer has reported a similar material valuation uncertainty in relation to these assets. This has been included within Note 2 to the Group Accounts. We have included emphasis of matter paragraphs within our independent audit report to highlight these matters to the reader of the accounts. Our audit opinion is not modified in respect of these matters.

## Risk area

### Valuation of defined benefit pension scheme (LGPS)

## Identified audit risks at planning – From external audit plan

The Council participates in the Highland Council Pension Fund, a local government pension scheme. The scheme is a defined benefit pension scheme and in accordance with IAS 19: Pensions, the Authority is required to recognise its share of the scheme assets and liabilities on the statement of financial position. As at 31 March 2019 the Council had pension fund liabilities of £338 million.

Hymans Robertson UK LLP provide an annual IAS 19 actuarial valuation of the Authority's net liabilities in the pension scheme. There are a number of assumptions contained within the valuation, including: discount rate; future return on scheme assets; mortality rates; and, future salary projections. Given the material value of the scheme liabilities and the level of estimation in the valuation, there is an inherent risk that the defined benefit pension scheme could be materially misstated within the financial statements.

## Work completed

- Walkthroughs of the controls over the valuation of pension scheme liabilities, including information and instructions provided to the pension fund and actuary
- Obtained an understanding the arrangements in place at the Council for reviewing the assumptions adopted by the actuary and suitability of these for the Council
- In accordance with Audit Scotland planning guidance, we used the work performed by PricewaterhouseCoopers (PwC) in undertaking a central review of actuarial assumptions and challenged the suitability and reasonableness of the Council's assumptions adopted by the actuary in arriving at the defined benefit pension scheme liability.
- We tested the underlying data supporting the valuation to ensure these are consistent with the Council's underlying records

## Our conclusion

Based on our testing we conclude

- The assumptions adopted by the Council in arriving at the IAS 19 actuarial valuation of the net defined benefit pension scheme liabilities were reasonable.
- The data used in the actuarial valuation was consistent with the Council's underlying records.
- The Council's actuarial valuation included an allowance for the estimate of the Council's likely future pension obligations in relation amounts arising in relation to unlawful discrimination ("McCloud/Sargeant") within historic changes to local government pension fund terms and conditions. In June 2020, the UK Treasury have proposed remedial action as to the settlement of these arrangements. The settlement is lower than the initial estimate made by the actuary. As the UK Treasury announcement reflects more accurate information around conditions that existed at the balance sheet date, this is considered an adjusting post balance sheet event. The Council obtained a revised IAS 19 actuarial valuation, incorporating a more accurate estimate of the McCloud obligation. This revised actuarial valuation reduced the net defined benefit liability by £5.876 million and has been included as an adjustment arising during the audit and is included in appendix 1.
- The Council's unaudited IAS 19 pension liability made no allowance for the impact of the Guaranteed Minimum Pension (GMP) on future pension obligations. GMP was accrued by members of the Local Government Pension Scheme between 6 April 1978 and 5 April 1997. The value of GMP is inherently unequal between males and females for a number of reasons, including a higher retirement age for men and GMP accruing at a faster rate for women; however overall equality of benefits was achieved for public service schemes through the interaction between scheme pensions and the Second State Pension. The introduction of the new Single State Pension in April 2016 disrupted this arrangement and brought uncertainty over the ongoing indexation of GMPs, which could lead to inequalities between male and female benefits. The Council's actuary estimated that the potential impact of GMP indexation would be an increase in the pension liability of £2.906 million for Highland Council. The Council received a further revised IAS 19 actuarial valuation incorporating the impact of GMP indexation and the ISA 19 liability was updated in the accounts. This is included as an audit adjustment arising during the audit in appendix 1.

## Risk area

### Covid-19

## Identified risk in June 2020 resulting in an amendment to the plan (Audit and Scrutiny September 2020)

The global outbreak of the Covid-19 pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We anticipated current circumstances would have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to:

- Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and restrict the evidence we can obtain through physical observation;
- Volatility of financial and property markets will increase the uncertainty of assumptions applied by Senior Officers to asset valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management (Senior Officer) estimates;
- Financial uncertainty will require Officers to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and
- Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties.

We therefore identified the global outbreak of the Covid-19 virus as a significant audit risk.

## Work completed

Worked with Officers to understand the implications the response to the Covid-19 pandemic has had on the Council's ability to prepare the financial statements and update financial forecasts, and assessed the implications for our materiality calculations. This included:

- Evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic.
- Evaluated whether sufficient audit evidence could be obtained through remote technology.
- Evaluated whether sufficient audit evidence could be obtained to corroborate significant estimates such as recovery of receivable balances.
- Evaluated Officer's assumptions that underpin the revised financial forecasts and the impact on the Council's going concern assessment (in the context of FRC Practice Note 10 and Audit Scotland guidance).

## Our conclusion

Based on our testing we conclude:

- Officer's assumptions underpinning financial forecasts and the going concern assessment have adequately considered the potential impact of Covid-19.
- We have not identified any significant impact on the Council's debtor recovery, although acknowledge that the majority of these are with other public bodies
- The impact of COVID-19 has resulted in a material uncertainty surrounding the valuation of property, plant and equipment (see Valuation of Property, plant and equipment significant risk).
- We noted in our expenditure cut-off testing that the impact of Covid-19 resulted in significant increase in delayed expenditure transactions around the year end. This contributed to identified misstatements in the recognition of expenditure relating to 2019/20. However, audit are satisfied that expenditure and creditor balances are free from material misstatement as at 31 March 2020.
- The Council have adequately assessed and disclosed the impact of Covid-19 on the Council's governance arrangements.

# Accounting policies

Accounting area	Summary of policy	Comments	Assessment
<b>Accounting policies</b>	Application of IFRS and deferral of IFRS 16 Leases.	The Council's Accounting policies are in accordance with the code of Practice on Local Authority Accounting in the United Kingdom 2019/20, supported by Internal Financial Reporting standards (IFRS), unless legislation or statutory guidance required different accounting treatment. These have been applied consistently to the previous year. No new International Financial Reporting Standards (IFRS) have been adopted in the year as the adoption of IFRS 16 for public bodies has been delayed until accounting periods beginning 1 April 2022 as a result of the Covid-19 pandemic.	 Green
<b>Revenue recognition</b>	Funding and income	The Council's accounting policies summarise the when income transactions are recognised in the Council's Comprehensive Income & Expenditure Statement. While we are satisfied that the Council's recognition of income and funding during the year is in accordance with the requirements of the Code, we note that accounting policies could be enhanced to meet the full requirements of IFRS 15: Revenue from contracts with customers. In particular, the Council's revenue recognition policy should outline the five step approach to cover the performance conditions to be satisfied to recognise material revenue streams. We are satisfied that the disclosure misstatement is not material to the user of the accounts. As part of the wider review of financial statements preparation process ( <i>Action Plan point -2</i> ) there is an opportunity for Officers to review accounting disclosures in accordance with the Code.	 Amber
<b>Judgements</b>	Critical judgements	The Council draft accounts disclosed critical judgments around future local government funding. Following our recommendations, Officers added critical judgements around the accounting treatment of PPP / Service concession arrangements on the basis that the assets and liabilities are recognised in accordance with the Code as qualifying as service concession arrangements. The current disclosure could be enhanced to provide the reader a greater understanding around the critical judgement made by Officers in preparing the accounts and the impact on the accounts. In addition, we do not consider local government funding uncertainty as a Critical Judgements in the accounts. (Appendix 1).	 Amber
<b>Estimates</b>	Assumptions made about future and other Major sources of Estimation uncertainty	The Council's unaudited financial statements included the following areas of significant risk of material adjustment in the forthcoming financial year: property, plant and equipment; LGPS pensions liability; debtor provisions; and Council tax provisions. From review of the disclosure, we do not agree with the Council's conclusion that debtors or Council tax provision as major sources of estimation uncertainty as given their current carrying value we do not consider these balances to be of significant risk of material misstatement in 2020/21. Furthermore, we raised an audit adjustment to reflect the material valuation uncertainty disclosure over property, plant and equipment within the accounts and enhance disclosure around the material uncertainty.	 Amber

## Assessment

-  Marginal accounting policy which could potentially be open to challenge
-  Accounting policy appropriate but scope for improved disclosure
-  Accounting policy appropriate and disclosures sufficient

Accounting area	Summary of policy	Comments	Assessment
<b>Group accounts</b>	Group accounts	<p>In accordance with the Code, the Council has prepared group accounts. The Group accounts consolidated the financial activities of the local authority group consisting of the Council, the Council's subsidiaries: High Life Highland, Nairn Common Good Fund and Inverness Common Good Fund; and the Council's associates: Highland and Western Isles Joint Valuation Board and Highland and Islands Transport Partnership.</p> <p>The Council administers Charitable Trust Funds: Highland Council Charitable Trusts and Highland Charities Trust. In addition it has non-material interests in Highland Opportunity Limited and Eden Court Highlands/ While these are disclosed within the financial statements, they are excluded from consolidation into the Group Accounts on the grounds of materiality. We are satisfied that the approach taken by Officers is appropriate and in line with the requirements of the Code. In accordance with Section 106 of the Local Government (Scotland) Act 1973, we are appointed auditors to provide an audit opinion on charitable trusts which are registered with the Office of Scottish Charities Regulator (OSCR) where the Council, or some members of the Council, act as Trustee. We have issued unmodified opinions for the financial statements for the year ended 31 March 2020.</p>	 Green
<b>Significant Trading Operations</b>	Significant Trading Operations	<p>The Council has one significant trading operation (STO), Fishery, Piers and Harbours, which operates in a commercial environment. In accordance with the Local Government (Scotland) Act 2003 the significant trading operation is required to break even over a rolling three year period. The STO reported a surplus of £1.409 million for the year ended 31 March 2020, and an three year surplus of £5.8 million. We are satisfied that the STO's financial performance has operated in accordance with the 2003 Act and performance has been appropriately reported in the financial statements.</p>	 Green
<b>General</b>	Financial statements preparation	<p>While the draft financial statements were produced and published for public inspection prior to the end of June 2020 in accordance with the legislative timeframe, our audit identified a number of significant misstatements in the quality of the financial statements and underlying records. This included significant prior period misstatements to property, plant and equipment and audit misstatements around transactions and balances around the accounting year end. As a consequence the audit process and finalising of the accounts was significantly delayed and the accounts will not be signed until January 2021. As noted in Appendix 1 our audit testing identified a number of quantitative and qualitative misstatements to the financial statements. While we recognise 2019/20 had unique challenges, including the impact of Covid-19 on financial reporting arrangements, it is important that the Council has sufficient resources to support the preparation of the accounts, including internal review and scrutiny prior to audit inspection.</p>	 Amber

*Action plan point - 2*

# Other financial statement areas

## Going concern

FRC Practice Note 10 provides guidance on applying ISA (UK) 570 Going Concern to the audit of public bodies. In the public sector, when assessing whether the going concern basis of accounting is appropriate, the anticipated continued provision of the services is more relevant to the assessment than the continued existence of a particular public body. In accordance with Audit Scotland guidance, we have considered the suitability in the Council preparing accounts on a going concern basis. We did not identify a concern that the Council would cease to exist twelve months from the date of signing the annual report and accounts (28 January 2021).

As part of responsibilities under the code of Audit Practice, as part of our wider scope audit work we consider the Council's financial position and financial sustainability. The findings and conclusions from our work in this area is included within the Financial sustainability section of this report.

## Objection to the financial statements

The Council received a statutory objection to the 2019/20 financial statements under Section 101 of the Local Government (Scotland) Act 1973. As appointed auditors, we have considered the objection in accordance with this Act and the Audit Scotland Technical Guidance Note (TGN) 2020/3 (revised): *Guidance on statutory objections to local government annual accounts*.

The objection was in respect of the Council's administration of the Insurance Fund and compliance with the Local Government (Scotland) Act 1975 around the administration of the Insurance Fund.

As at 31 March 2020, the Council held an Insurance Fund of £1.912 million. We have concluded our considerations and are satisfied that the Council has not applied the Insurance Fund illegally and are satisfied that there is no material misstatement to the Council's financial statements. Over the last three years, the Council has benefited from reduced external premium costs Insurance Fund due to higher insurance excesses. Our consideration found that while the Council had used the Insurance Fund in accordance with the provisions of the 1975 Act, there was an opportunity to enhance the transparency around the application of the Fund, including greater evaluation and reporting of the internal insurance risk being held by the Council through reducing the level of Insurance cover. Good practice recommends regular actuarial assessment of the Insurance Fund to quantify the risk being managed by the Council and therefore better inform Officers and Councillors around the level of Insurance Fund that the Council should maintain.

*Action plan point - 3*

### **Fraud and irregularity**

The 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 Council during the course of the year and have confirmed this with Senior Officers and reported 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 the Council's arrangements for participation in the NFI exercise during 2019/20 to be satisfactory. The Council has effective arrangements in place for the submission of data and investigation of potential matches.

### **Early retirement**

During 2019/20 two former Senior Directors left the organisation. The Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 make provision for authorities to make discretionary payments to local government employees to pay compensation for premature retirement. One former director was credited with 2 years additional period of service which is reflected as a lump sum of £95,701 and annual compensation for loss of office of £2,910 with strain on pension fund costs of £376,918. This, taken together, amounted to a total Exit Package of £475,529. In considering the early retirement, the Council evaluated the cost of the severance package against estimated savings. This was approved through the Early Release Sub-Committee and the Council's Corporate Resources Committee in May 2019.

# Narrative elements of your annual accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding and the financial statements and have set out our observations below.

## Management commentary

The information contained within the Management Commentary is consistent with the financial statements. Key issues and risk are well articulated within the report as well as Council performance for the year.

The Management Commentary has been prepared in accordance with the statutory guidance issued under the Local Government in Scotland Act 2003. There are opportunities to further develop the Management Commentary within the accounts. In particular, providing the reader of the accounts greater understanding of financial performance in the year. (*Action plan point – 2*)

## Overall Observations

The 'front end' of the accounts provides details on the overall Council's financial and non-financial performance during the year and key areas of focus looking forward. The front end of the accounts uses graphics to summarise key aspects of financial performance during the year.

The front incorporates the requirements and guidance continued within statute including; The Local Government in Scotland Act 2003, and Delivering Good Governance in Local Government Framework 2016.

Annual report and Accounts include the Management Commentary, Remuneration Report and the Governance statement

## Remuneration report

The remuneration report has been prepared in accordance with Local Authority Accounts (Scotland) Regulations 2014. The Remuneration disclosures were updated to include all named officers (including those who had left in the prior year).

## Governance Statement

The Governance Statement has been prepared in accordance with the Local Authority Accounts (Scotland) regulations 2014. The statement is supported by Officer assurances to the Council and the Council's Internal Auditors' assurance over internal controls. The Governance Statement has been prepared in accordance with CIPFA's Delivering Good Governance in Local Government: Framework (2016).

# Overview – Wider Scope

This external audit annual report predominantly focuses on the Council's arrangements during the 2019/20 financial year. It is acknowledged that the Covid-19 global pandemic fully emerged, impacting on the Council from the middle of March 2020. Therefore, for the financial year Council business and activities remained business as usually.

Due to the pandemic the Council needed to establish temporary governance arrangements. This report includes commentary on those initial arrangements and the governance established by the Council.

Whilst we will comment on certain aspects of the Council's response to Covid-19, in this report and in our 2020/21 annual report we are not auditing the Council's full Covid-19 response.

Our focus remains on considering the Council's arrangements to ensure best value and providing conclusions, relevant to our wider scope risk assessment.

Therefore in this report we have focused specifically on:

- Financial outturn for 2019/20
- Future financial sustainability with a focus on the financial position for 2020/21
- Governance and transparency as it relates to the immediate Covid-19 response (period March 2020 to summer 2020)
- Performance management
- Workforce planning

Although, due to financial reporting matters, our audit was not concluded until January 2021 our wider scope work was concluded by October 2020.

We anticipate new and/or emerging risks facing the Council, due to Covid-19 or other matters will be articulated in our 2020/21 audit plan.

We note in discussions with Officers that due to the ongoing pandemic there is a significant continued need to work with all partners, including Scottish Government to make changes to plans and/or service delivery often at short-notice. As a result, whilst financial forecasts are in place, there is a need to continue to review these frequently particularly as new expenditure is required and ongoing dialogue over what is funded, and what will be funded locally.

## Best Value

Within the audit plan we set out the intention to follow up on the Council's progress in implementing the Best Value Improvement Plan. This followed the publication of the Best Value Assurance Report (BVAR) by the Accounts Commission.

The Council's BVAR action plan was presented to full Council in March 2020. Therefore, recognising only approved in March and the Covid-19 pandemic we have decided to follow up the action plan, in full, as part of our 2020/21 external audit.

We recognise work of the Council's Recovery Board, spans into certain of the BVAR action plan including financial sustainability, workforce planning and performance management. Where relevant to the 2019/20 audit we have provided commentary within this report.

# Wider scope – significant risks

Within our annual audit plan we identified six significant wider scope risks. In this section we have summarised the risk identified and our conclusions. In addition, beyond these risks additional considerations are set out in pages 27 to 35 across the wider scope and Best value framework.

## Audit Plan wider scope significant risk: Financial Management

### Extracted from our Audit Plan, which was written in March 2020:

For 2019/20 the Council faces significant financial challenges to address the identified budget gap of £27.891 million. In 2018/19, the Council reported an operational overspend of £2.3 million. 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 within budgeting setting. We recognise the financial monitoring and cost management controls being put in place at the Council along with a focus on forecast expenditure as part of the 2019/20 budget, there is a risk that these measures may have adverse implications on the Council's performance in delivering services and ability to deliver longer term, sustainable financial savings.

**Work to respond to the risk:** We reviewed the arrangements in place to identify and support the delivery of in year savings and how these were achieved. We considered the budget setting and monitoring arrangements and how these support the Council deliver its financial targets. This work is aligned to our 'Value for Money' wider scope work in considering the impact if any of budget savings on operational performance.

## External Audit Conclusion

The Council achieved the 2019/20 budget set. Total actual expenditure was £561.3 million, £6 million lower than budgeted expenditure. As a result, Council unearmarked reserves increased in year by £7.5 million. Total unearmarked reserves as at 31 March 2020 were £15.4 million (2.7% of Revenue). This brings useable reserves within the reserves range retained by other Local Authorities.

Staff costs were £11.5 million lower in year than budgeted. This was achieved through in-year cost control for example holding recruitment and proactively managing vacancies. In addition, additional grants and investment income was received, at £10.7million more than forecast.

As a consequence of Covid-19 no service performance outturn monitoring reports were prepared and considered at service level. However, the Corporate Services Committee considered the Council wide revenue and capital outturn report. This was a one off decision, taking into account the global pandemic from March 2020 onwards and also linked to the Covid-19 governance arrangements which were established on a temporary basis.

***The Council delivered on the 2019/20 budget generating underspends which allowed for an increase in general unearmarked reserves in year. As at 31 March 2020 unearmarked reserves represent 2.7% of revenue and will provide additional financial support to the Council in 2020/21 and 21/22 as the financial pressures arising due to Covid-19 emerge.***

## Audit plan wider scope significant risk: Financial Sustainability

### Extracted from our Audit Plan, which was written in March 2020:

A sustainable highland is the Council's change programme. The programme identified savings of £20.5 million are required to deliver the 2019/20 financial position. In prior years the Council has struggled to deliver forecast savings resulting in utilising funds from reserves. A key focus for the Council is delivering savings in year and future years in order to support longer term financial sustainability.

**Work to respond to the risk:** We reviewed the Council's financial plans and progress made against the plans. We considered the work performed by Officers in identifying and evaluating potential options to address the budget gap, including the extent to which these represent sustainable savings and are aligned to the Council's priorities and commitments.

### External Audit Conclusion

As at 31 March 2020 the Council delivered planned savings as set out in its forecast. Looking forward, as at 30 September 2020 the Council is projecting an overspend of £8.7 million compared with budget for the 2020/21 financial year. This is due to the impact of Covid-19.

Over the medium term the Council has estimated a significant budget gap, considering different scenarios. Due to ongoing uncertainty around funding, the ongoing Covid-19 pandemic which is resulting in different costs and activity, there is a recognised risk that the Council may no longer be financially sustainable.

The Council Recovery Programme has 11 key areas of activity:

- Restoring political governance
- Supporting the Recovery of the Highland Economy
- Leadership, Culture and Performance
- Digital Transformation
- Workforce Planning and Development
- Financial Recover strategy
- Lockdown Agility (Returning to work)
- Community Empowerment
- IT Transformation
- Service Redesign
- Asset Management

Delivery of the recovery programme is reported to the Council recovery board. The Council is working on real time reporting to the Board including use of dashboard style reporting to report on savings delivered and at-risk savings. There are a total of 69 actions across the 11 streams. At as November 2020 50 were reported as ongoing and remaining on track for delivery.

***The Council faces significant future risks to ensure it remains financially sustainable. The impact (now and ongoing) of Covid-19 is uncertain, including expenditure and any associated additional income.***

***2020/21 will be a challenging financial year for the Council. At the point of completing our work (October 2020) it was anticipated that the Council will need to use reserves which were only just built up in 2019/20 alongside delivery of all agreed savings.***

## Audit plan wider scope significant risk: Workforce planning

### Extracted from our Audit Plan, which was written in March 2020:

Workforce costs remain a significant area of expenditure with total costs of £295 million in 2018/19. Over the last two years, the Council has enhanced its workforce planning arrangements. A new workforce planning strategy was developed in 2017 and supported through service workforce plans. The workforce strategy sets out a five-year roadmap to allow the council to maintain and develop the workforce and enhance services provided. During 2018/19, the Council undertook a review of senior level organisational structure. The redesign of the senior-level of the organisation created a Chief Operating Officer role and eight Executive Chief Officer posts, supported by Heads of Services. It is envisaged that the design of services at Heads of Service and below will evolve over the coming years.

**Work to respond to the risk:** We assessed how the Council's workforce strategy remained aligned to the financial strategy. We considered how the Council aligns its workforce to areas of service demand, ensuring that resources, including staff spend, are focused on key operational pressures. We considered the new Senior Leadership Structure and how this being embedded to support effective leadership, management and community engagement.

## External Audit conclusion

Service workforce plans have been used to inform and create a corporate workforce plan. This has been informed by the workforce planning strategy. Key themes outlined are sustainability, flexibility, transition and training and development.

The Council continue to have an ageing workforce and have also identified a need for the future workforce to be greater aligned to the changing demands on services and broader service redesign planned. Previously the Council has had a challenge in attracting individuals to the Highlands, particularly in more remote areas. This continues to be an area of focus by the Council alongside how the Council can better use technology to support a more agile way of working.

Workforce planning is core to the Council's recovery plan. Actions being taken include a PESTLE (Political, Economic, Sociological, Technological, Legal and Environmental) review of the Workforce Planning Strategy to ensure aligned to current relevant challenges and establishing a workforce data project to ensure that the Council has the data required to evaluate workforce requirements and support workforce decisions. The current strategy is being reviewed in the context of Covid-19 as well as the likely impact on the Council arising from the UK leaving the European Union.

***Now the Council has a corporate workforce plan, underpinned by service workforce plans the challenges identified need to be proactively addressed. Covid-19 has allowed the Council to progress quickly with greater use of digital technologies and this will support the Council to become more agile and re-look at staffing needed in the more remote areas of the Council area. With staff costs being such a significant cost to the Council, future delivery of savings and changing service delivery is fundamental to making the Council financially sustainable and to do this the Council need to achieve the workforce plan***

## Audit plan wider scope significant risk: Risk Management

### Extracted from our Audit Plan, which was written in March 2020:

The Council's risk management strategy was revised in March 2018 and a risk management culture continues to be embedded across the Council. Given ongoing corporate governance changes it is key that risks continue to be identified, monitored and managed with sufficient governance oversight of risk established.

**Work to respond to the risk:** We have continued to develop our understanding of the Council's risk management arrangements in place including the extent to which developments in the Council's governance arrangements support effective management of risks. This has been done through review of the Council's overall strategic risk management arrangements including reporting to members.

## External Audit Conclusion

The Council has in place a risk management strategy. This is reviewed annually with the results of the annual review presented to the Audit and Scrutiny Committee. The Council has in place a corporate risk register and this is considered every six months by Audit and Scrutiny.

Whilst the individual service committees do not get oversight of the corporate risk register, risk is embedded within service planning. Reports to service committees do contain risk assessments and cross-refer to recognised risks facing the Council. There would be an opportunity, when reviewing the risk management strategy to make this linkage clearer.

At an Officer level, the corporate risk register is considered routinely at Executive Leadership Team meetings. Alongside this, the register is shared, at least every six months at the wider strategic meeting which includes representation of the various political groups.

Looking forward new and/or emerging risks are facing the Council and these should be captured and monitored in the relevant register and through the best forum of governance. Lastly there is a further opportunity for the Audit and Scrutiny Committee to enhance their review of the risk register by focusing on risks which have changed scores, the strategy and resultant actions to mitigate the risk and assurance over the operation of the risk management strategy.

***Risk management arrangements at the Council could be further embedded throughout the Council. This includes reviewing the oversight of the Council wide risks impacting on the Council and ensuring this is done at the right governance forum and these arrangements are captured in the risk framework.***

*Action plan point - 4*

## Audit plan wider scope significant risk: Partnership working with NHS Highland

### Extracted from our Audit Plan, which was written in March 2020:

It is important that there are effective partnership working with the Council and NHS Highland to ensure efficient and effect delivery of adult and children's health and social care under the Lead Partnership model. The current Integration Scheme (the Highland Partnership) agreement ends on 31 March 2020. It is important that the Council work with NHS Highland to ensure that any future agreement supports a sustainable, efficient and effective model of care and service delivery for the people of the Highlands.

**Work to respond to the risk:** We assessed the progress made by the Council in reviewing and updating the Lead Agency model agreement between the Council and NHS Highland.

### External Audit Conclusion

The partnership agreement was due for review and renewal by 25 June 2020. Although work was ongoing between both parties to review the agreement this work was put on hold due to Covid-19. The Council Chief Executive and NHS Highland Chief Executive have written a joint letter to Scottish Government setting out the expectation that a revised agreement will be agreed by 31 March 2021.

The Council, alongside NHS Highland, recognise the ongoing financial pressure in delivering Adult Social Care services. However, both organisations are facing increased financial difficulties. A project board has been established to identify and deliver efficiencies in integrated care, with both organisations represented and new governance arrangements established.

The Council's Executive Chief Officer for Health and Social care left the Council in April 2020 and an interim arrangement is in place before the newly appointed Executive Director starts in January 2021. The principle model is agreed. However, the challenge is the underlying funding of the model in the context of both the Council and the NHS's future financial sustainability challenge. This is an area we will consider further within our 2020/21 external audit and in particular the effectiveness of the revised governance arrangements and the funding decisions agreed by both parties.

***The Council and NHS Highland continue to seek to work proactively together to ensure the lead agency model is reviewed and any revisions agreed by the extended deadline of 31 March 2021. Given financial pressures on both organisations the determination of the funding the Council will provide to the NHS will be key and how this is then built into the future savings plans of the Council.***

## Audit plan wider scope significant risk: Performance Management

### Extracted from our Audit Plan, which was written in March 2020:

The Council has 27 KPI's designed to enable scrutiny of the delivery of Council services. However, these performance measures were predominately based on prior period performance rather than established targets or benchmarks of performance.

The BVAR highlighted that the Council's performance against national LGBF indicators has deteriorated over a five-year period. For 2017/18, 70 per cent of indicators sit within the bottom two quartiles. The report highlighted the need for the Council to have greater focus on establishing targets, including referencing performance of other parties in which to trigger improvement activity.

**Work to respond to the risk:** Whilst too early to assess how the Council has implemented the BVAR findings in this area, due to the BVAR action plan only being approved by the Council in March 2020 and the impact of Covid-19 we have considered the performance reporting arrangements currently in place.

## External Audit Conclusion

Data is collated from within and external to the Council, to support the Council in measuring its performance. Data available externally typically has a time lag of circa 6 to 12 months of a year. This is out with the control of the Council as comes from external sources and depends on when data is published. Following the BVAR report, improvement actions were agreed on performance management and these are being taken forward by Officers. This includes, as part of service redesign, the development of business intelligence (BI). The intention is this development will support the Executive Leadership Team and Service Management Teams with regular performance review, on a monthly or quarterly basis. This revised approach has been captured in the 2021/22 service planning guidance issued by the performance team.

SPI 2 sets out the requirements to demonstrate best value. In particular the Council should look to report on audit assessments of the Council's performance against best value and how the Council is responding. As part of our audit work we have confirmed Officers have arrangements in place to report against this SPI by the deadline which is 31 March 2021. The BVAR improvement plan will be included alongside this external audit annual report, which was delayed due to a delay in signing the accounts.

*The Council continues to make progress in developing its performance management arrangements. This includes the positive development in business intelligence. Actions were captured in the Council's BVAR improvement plan and we will follow up on the arrangements in place, in greater detail, when following up on the BVAR action plan in our 2020/21 external audit.*

# Wider Scope Commentary

## Financial management and financial sustainability

### Financial Performance 2019/20

The Council reported total comprehensive income in 2019/20 of £131 million (2018/19: Expenditure: £12 million). This was as a result of gains recognised in the remeasurement of the net defined benefit liability of £142 million and a net surplus on the revaluation of property, plant and equipment of £44 million. The net deficit on the provision of services for the year was £5.9 million (2018/19: £5 million). Whilst the council reported a deficit for the year, this reflects the impact of accounting adjustments (particularly pensions accounting entries)

The total revenue budget was £567.3 million, with the Council incurring expenditure of £561.3 million. The £6 million underspend against budget, coupled with other transfers between reserves and statutory adjustments, alongside additional Scottish Government income enabled the Council to increase the non-earmarked portion of the General Fund by £7.5 million to £15.4 million. This represents 2.7% of the Council's revenue budget (2018/19: 1.4%).

### Key financial performance information

	2019/20 £ million	Audit comment
Net underspend against operational budgets	6	Overall service underspend against budget reflecting cost management and delivery of service efficiency savings in year.
Uncommitted general reserves (as a percentage of annual planned expenditure)	15.4 (2.7%)	The Council's unearmarked general reserves increased to 2.7% (2018/19: 1.4%) of annual budgeted expenditure. This reserve represents the Council's contingency to meet unforeseen cost pressures in any given financial year.
Net assets	1,544.2	The Council's net assets increased from £1.2 billion at 31 March 2019 to £1.544 billion as at 31 March 2020. This was primarily due to a decrease in defined benefit pension scheme liabilities of £38.7 million.

	2019/20 £ million
Care and Learning – Underspend	6
Community Services - Overspend	(0.1)
Chief Executive's Office - Underspend	0.3
Development and Infrastructure - Underspend	0.2
Corporate resources - Underspend	1.6
Welfare - Underspend	0.1
Other (NDR reliefs / Joint Board requisitions etc) - Overspend	(2.1)
<b>Total Service Underspend against budget</b>	<b>6</b>

The year end position demonstrates the Council's financial management and cost control arrangements established in 2019/20. The main area of underspend against budget was in relation to staffing costs, where expenditure was £11.5 million below budget. This was primarily achieved through cost control, including recruitment and vacancy management. In addition, funds raised through services, government grants and investment income was £10.7 million greater than budget.

In order to deliver a balanced budget in 2019/20 the Council had identified a budget gap of savings £24.6 million, addressed through increased income generation or efficiency savings. Of this total target over £3 million was not achieved, with the Council required to deliver in year efficiencies to support the outturn position.

### Capital expenditure and capital investment strategy

The Council approved a revised five year capital programme in March 2018 outlining planned £490 million of capital investment. During 2019/20 Council had net capital expenditure of £155 million compared with a budget of £173 million including Housing Revenue Account expenditure of £50.8 million (budget of £54.4 million).

The overall underspend of £17.9 million represented slippage in the programme. The slippage relates to a number of individual programmes where projected 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 main areas of capital investment in the year were:

- £9.7 million in ICT;
- £11.8 million investment in roads and bridges; and,
- £42 million investment in Housing stock.

Capital expenditure is funded through a mixture of capital borrowing, capital funding and receipts to support strategic investment.

In recent years the Council has underspent on its capital budget. Where planned capital spend has not been incurred the planned spend is deferred into the following year. The Capital Plan is designed to ensure the Council's estate remains fit for purpose and suitable to deliver the Council Services efficiently and effectively. Therefore it is important that the plan is delivered minimising the delay in capital investment in the Council's estate. Recent performance would indicate that the Council's capital budgets are unrealistic or achievable. It is important that capital plans reflect the Council's true level of planned capital activity in year and set achievable aspiration for the year. This should incorporate any carry forward from previous years.

*Action plan point - 5*

## *2020/21 budget and recovery plans*

For 2020/21 the Council are currently projecting an overspend against budget of £8.7 million (at January 2020). This is due to:

- £26 million overspend in services due to lost revenue / additional costs incurred as a result of Covid-19
- Covid-19 has adversely impacted on the services' planned savings activity in year and therefore planned budgeted savings for 2020/21 will not be fully achieved
- Shortfall in Council tax income of £2.4 million primarily due to the impact of Covid-19 on council tax collection as well as the slower than expected rate of growth in the council tax base (rateable properties)

This is partially offset through additional £12 million government income of which £7.7 million is in relation to Covid 19 support, there is still a shortfall against budget.

Management controls have been implemented to limit spend to items that directly relate to the COVID-19 response or the provision of essential services. Budget holders have been informed that budgets are suspended and will only be released to services to meet essential spending requirements. It is anticipated that this enhanced control over expenditure will provide an opportunity for savings to be achieved.

An initial assessment of action to mitigate the emerging budget gap highlighted the potential use of general funding reserves where some or all non-earmarked reserves could be used to balance the Council's budget.

Currently, the Council's budget includes the planned use of earmarked reserves balances of £5.5 million. Whilst the use of reserves is expected, it is important that there is transparent reporting and understanding of the level of reserves held to ensure that any decisions made are not purely short term in nature and support the longer-term financial resilience and sustainability of the Council.

The Scottish Government, in conjunction with COSLA, is exploring different funding flexibilities to local authorities to help them manage the impact of Covid-19 on their revenue positions in 2020/21 and 2021/22. Officers are considering what the impact of these arrangements will be and how suitable they would be for the Council. We will consider this as part of Wider Scope audit work in 2020/21.

With the economic impact of Covid-19 uncertain there is an increased risk on the outturn position in terms of both revenue and cost base. The Council must continue to maintain scrutiny of the underlying financial performance over the coming months and consider the impact both in the immediate to longer term implications of how any overspend is met by the Council.

## Council Group – Highlife Highland and Eden Court

The Council works with several organisations to support service delivery. Two of these organisations: Highlife Highland and Eden Court Highlands may need to seek financial support from the Council to meet cost pressures and loss of revenue associated with the impact Covid-19. Highlife highland is a wholly owned subsidiary of the Council and consolidated into the Group financial statements. Eden Court Highlands is a Registered Charity with no share capital and the Council commission services from but are not consolidated as part of the Councils' Group.

As a result of the COVID-19 pandemic, both organisations face uncertainty as to when they can resume operations and how this will be executed. Eden Court Highlands is projecting a loss of 80% of its total income up until the end of January 2021 but due to additional government funding is planning breakeven. Within High Life Highland, despite a projected loss of £10 million in income, pro-active measures have been taken by the Board to mitigate losses and the latest forecasts show a £1.5 million deficit in the financial year (September 2020). In addition, both entities are admitted bodies in the Highland Council Pension Fund and the Council has provided guarantees over future pension contributions for these entities.

It is recognised that Highland Council retains a degree of risk if either of these organisations were to fail. The going concern of these organisations will be needed to prevent greater financial on the Council. The Council have considered the medium to longer term viability of these organisations and are satisfied that there is no current concerns that the bodies will not continue to meet the obligations as they fall due. However, the Council should continue to monitor this position closely and assess any additional risk to the Council.

### Management structure

Following the approval of the restructuring of the Council's senior management team in 2018/19, the Council has sought to embed the new structure including the recruitment of the eight permanent chief officer roles. Whilst most posts have been successfully filled, two posts at the time of our audit remain interim appointments – Education and Learning and Transformation and the Economy.

In addition, one permanent appointment, the executive chief officer for Health and Social Care left the Council within six months of their initial appointment. Between April 2020 and to date this role is being filled on an interim basis. The new Chief Officer, permanently recruited in October 2020 starts employment with the Council in January 2021.

One temporary appointment included a consultant for the position of Executive Chief Officer, Education during the year. The use of a consultant has been reviewed by internal audit with future lessons learned on how the Council's processes to recruit to senior posts could be better articulated.

Overall, the level of turnover across senior officer positions within the Council, including interim appointments to Executive Chief Officer roles creates a risk of instability across senior leadership. Given the financial and operational challenges facing the council, it is important that there is a stable, effective leadership team in place creating senior capacity to support the organisation in the future, and embed the changes in culture planned.

*Action plan follow up - 9*



# Governance and transparency

## Governance Structure

The large (74 members) and political make-up of the council (Independent group alongside other parties and non-aligned members) can at times, present a challenge to effective decision-making, in particular balancing council-wide decisions aligned to council priorities alongside the needs of the local communities that elected members represent.

The Council undertook a self-assessment of its governance arrangements in 2018/19 and 2019/20 recognising the opportunity to enhance scrutiny, governance, and oversight. This has seen an increase in the number of strategic committees from three to six. This was in response to concerns that the previous committee remit was too large, and the Council could instead benefit from having in place a larger number of committees with more focused remits. The Council has reduced membership requirements from 25 to 18 members to ensure there is adequate resource and capacity to operate the increased number of committees effectively.

Alongside the six strategic committees there were two new committees created in year – Gaelic Committee and the Tourism Committee. In addition, a Resources Sub-Committee established, to provide additional scrutiny over the Council budget.

Running alongside is the newly created Recovery Board which reports to Council (see commentary on page 21) and the strategic working group overseeing the redesign programme.

As part of our 2020/21 external audit we will look to understand the remit of the respective governance committees and the strategic working groups. It is important that governance and decision making is clear within the council structure and that the arrangements are effective, minimising duplication and ensure that the focus does not become overly operational in nature, and decisions rest at Officer level.

## Effectiveness – Political discussions

From our review of committee webcasts and papers during the year we note that there is an increasing trend where it is taking longer to get through Council business. In more recent examples full council has spanned two days. This may just be due to working remotely and members getting familiar with the teams platform, and how to run effective meetings. Alternatively, based on our review there are instances where the discussions have started to become more operational in nature, and for Officers, rather than discussion remaining at the strategic level. Care should be taken to ensure effective decision making can still take place and that the governance principles established pre Covid-19 remain in place.

*Action plan point - 6*

## Openness and transparency and effective governance in response to Covid-19

A decision was taken to postpone all council and committee meetings during March 2020 and April 2020 due to Covid-19. This was a decision mirrored by many public organisations and reflective of the fact that the Council, at that point in time, did not have an effective digital platform to host council meetings. The decision to suspend meetings for this eight-week period was taken in consultation with the Leader of the Council, Convener and committee chairs.

### Gold command structures

The Chief Executive established an officer gold COVID-19 group which included the Executive Chief Officers (ECOs) and other key staff. This group focused on agreeing strategic priorities as the pandemic evolved.

A member gold COVID-19 group was also established consisting of the Chief Executive, the Convener, the leaders of the administration groups and the official opposition group, the Budget Leader and the ECO for Performance and Governance.

Decisions in this early period, when committees were suspended, were taken under emergency powers. These have been published online to support transparency and were retrospectively approved when full Council we reconvened.

In the period of May and June the strategic committees of the Council were held remotely using teams and these meetings were recorded. The intention was for these meetings to deal with urgent business. This included the Council's corporate resources committee.



### Recovery Board

The member gold group set up the recovery board. The board consists of 15 members including the Leader of the Council. The Board's purpose is to provide strategic oversight and co-ordinate the Council's recovery plan. Recommendations from this Board are reported to full Council for endorsement. Once this Board was established, the Gold structure (Officer and Member groups) stood down.

The gold, silver, bronze command arrangements and the temporary suspension of meetings is like most Council's. As the pandemic is ongoing, the Council should continue to review their governance structures to ensure they remain flexible to meet changing external circumstances and continue to be transparent. This can include lessons learned from the early arrangements established.

*Action plan point - 7*

## Partner organisations (Page 32)

Several partner organisations support the Council in delivering services. Two of these entities: Highlife Highland and Eden Court may require financial support from the Council in the current year due to the adverse impact of Covid-19 on revenue streams. The Council have considered the medium to longer term viability of these organisations and are satisfied that there are no current concerns that the bodies will not continue to meet their obligations as they fall due. However, it is important, given the ongoing uncertainty surrounding covid-19, that Officers and Elected Members continue to maintain an oversight of these bodies and any potential obligation should it crystallise. This is important in ensuring the continuity of services being delivered on the Council's behalf by these entities as well as ensuring the financial position of the Council is maintained.

*Action plan point - 8*

# Value for money

## Duty to secure best value

It is the duty of Highland Council to secure Best Value. The Act specifically outlines the following requirements:

- It is the duty of a local authority to make arrangements which secure best value.
- Best value is continuous improvement in the performance of the authority's functions.
- In securing best value, the local authority shall maintain an appropriate balance among: the quality of its performance of its functions; the cost to the authority of that performance; and, the cost to persons of any service provided by it for them on a wholly or partly rechargeable basis.
- In maintaining that balance, the local authority shall have regard to: efficiency; effectiveness; economy; and the need to meet the equal opportunity requirements.
- The local authority shall discharge its duties under this section in a way which contributes to the achievement of sustainable development.
- In measuring the improvement of the performance of a local authority's functions, regard shall be had to the extent to which the outcomes of that performance have improved.



## Best Value Assurance Report

A Best Value review was undertaken by Audit Scotland and Grant Thornton during 2019 and the Best Value Assurance Report (BVAR) issued in January 2020. The review found that the Council's pace of change has been inconsistent and slower in areas such as improving performance management and ensuring longer term financial sustainability. There is however recognition that the pace of change has significantly increased with the appointment of the Chief Executive in October 2018. The BVAR highlights the persistent challenge faced by the Council in demonstrating that it is financially sustainable, as well as its ability to build its level of reserves to meet unplanned costs. The report also reflects on the management restructure of the Council and the need for a period of stability to deliver the Council's change and improvement strategy.

A BVAR Improvement Plan has been created and presented to the Council for approval in March 2020. Some actions are already in place and being implemented to address known/historic issues in relation to best value. In particular, within the *Financial Management* section of this report we have highlighted how the Council has increased its unearmarked General Fund position through financial management in year to provide greater financial resilience. In addition, within the *Value for Money* section of this report we have highlighted that the Council has refreshed its corporate performance monitoring arrangements to enhance monitoring and scrutiny. However, it is too early to conclude on whether these represent the level of sustained transformation at the Council and whether the Council can demonstrate whether it is achieving all aspects of Best Value through self-evaluation and continuous improvement. In particular we note with the impact of Covid-19 is having adverse impact on the Council's ability to plan in a meaningful way given the constantly changing landscape. Given the Council's focus on the response to the global pandemic and subsequent recovery plans, we will undertake our full BVAR follow up in 2020/21.

We will undertake a full follow up of the BVAR recommendations as part of our 2020/21 external audit reporting on the status of the improvement plan in our Annual Report to Members and the Controller of Audit.

# Value for money

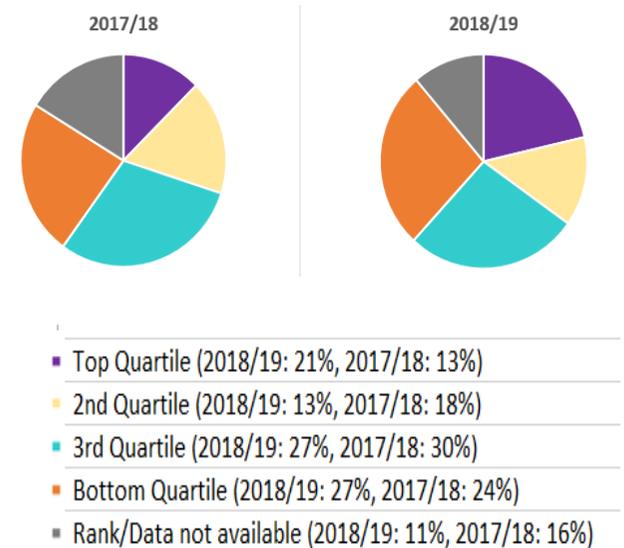
## The Local Government Benchmarking Framework (LGBF)

The Local Government Benchmarking Framework (LGBF) allows councils to compare their performance to the Scottish average for a variety of indicators. The council reports annually on performance against the national LGBF performance indicators in the annual Statutory Performance Indicators (SPI) report.

The BVAR report included an assessment of the Council's performance against national LGBF indicators and highlighted its deterioration over a five-year period. This was based on performance in 2017/18 where 54% of indicators fell within the bottom two quartiles, with an additional 16% unable to be ranked. Indicators within the bottom two quartiles included areas that have been Council priorities for several years such as education. For 2018/19, the Council had a total of 89 indicators which are nationally benchmarked, 10 of which data was not available in order to rank. Of the available data, Highland Council is in the top quartile for 19 indicators (21%). This is an improvement on the performance reported in 2017/18 in which only 13% were ranked in the top quartile. However, in line with 2017/18 reporting, 54% of indicators remained within the bottom two quartiles in 2018/19 as represented in the chart below.

While overall performance is improving in some areas, the Council still has considerable areas for attention to enhance performance. The Council has identified reasons for performance within the bottom quartile and some improvement actions to address these causes.

More analytical use of the data is needed by Council services to understand the factors that link performance and resources, and to identify opportunities where self-assessment, redesign, and benchmarking can support learning and improvement activity. This will provide greater clarity on the impact of Council budget decisions and is now a requirement for Service Plan development within the Council.



## 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. The Accounts Commission published an updated direction in December 2018. This requires the Council to report on SPI 1: *Improving local services and local outcomes*, and SPI 2: *Demonstrating best value*, with effect for financial year ended 31 March 2020.

Under SPI 1, the Council is required to report on:

- Performance in improving local public services, provided by both (i) the council itself and (ii) by the council in conjunction with its partners and communities.
- Progress against the desired outcomes agreed with its partners and communities.

The SPI guidance anticipates that these indicators will be reported assessing the Council's performance over time as well as compared to other authorities using the Local Government Benchmarking Framework.

In reporting against SPI 2: *Demonstrating best value* the guidance requires authorities to report on:

- The council's assessment of how it is performing against its duty of Best Value, and how it plans to improve against this assessment.
- Audit assessments of its performance against its Best Value duty, and how it has responded to these assessments.
- In particular, how it (in conjunction with its partners as appropriate) has engaged with and responded to its diverse communities.

The Council publishes a range of performance information through the Council's website. This includes: financial reports; Council Tax Fact sheet, providing a summary on how Council tax payers' money is used; Highpoints Magazine, council priorities and business plans and performance reports.

We are satisfied that the Council has sufficient arrangements in place to fulfil its responsibilities in accordance with SPI 1 and SPI 2.

# Appendices

- Audit adjustments
- Action plan and recommendations
- Follow up of prior year recommendations
- Audit fees and independence
- Fraud arrangements
- Communication of audit matters

# Audit adjustments

## Corrected misstatements

During our audit we identified nine misstatements to the Council financial statements and one to the Group only accounts which were corrected by Officers:

Item		Dr (£'000)	(Cr) (£'000)	Description
1	CIES – IAS 19 Past Service Costs (taken to Pension Reserve)		(5,876)	<i>Being adjustment within the IAS 19 pension valuation to reflect the Actuarial present value of promised retirement benefits to reflect the proposed remedy to the “McCloud ruling”, a court judgement that pension schemes were unlawful on the grounds of age discrimination that impacts on future liabilities of LGPS schemes (Take through Pension Reserve)</i>
	IAS 19 - Pension Liability	5,876		
2	Cash & cash equivalents	4,252		<i>Being adjustment raised by client to reflect creditor payment instructed on 31 March 2020 but not clearing bank until 1 April 2020.</i>
	Creditors		(4,252)	
3	Short term debtors	1,465		<i>Being adjustment to include capital grant relating to March 2020 which was excluded in error from the debtor balance as at 31 March 2020.</i>
	Capital grants in advance		(1,465)	
4	Short term debtors	160		<i>Adjustment to recognise capital grants relating to 2019/20 within the financial statements for the year ended 31 March 2020.</i>
	Capital grants		(160)	
5	CIES – IAS 19 Past Service Costs	2,906		<i>Being adjustment to recognise the actuarial estimation of the impact of GMP indexation on defined benefit pension obligations (Taken through Pension Reserve).</i>
	IAS Pension liability		(2,906)	
6	Assets under construction	8,221		<i>Being adjustment to reclassify Council house development land from Surplus assets to Assets under construction</i>
	Surplus property		(8,221)	
7	PPE – Other land and buildings		(4,205)	<i>Being journal required to write off Portree Hostels now demolished and not appropriately impaired through revaluation.</i>
	CIES – Impairment (taken to CAA)	2,396		
	Revaluation Reserve	1,809		
8	HRA – Loss on Disposal	3,249		<i>Reclassification to recognise loss in disposal rather than impairment</i>
	HRA Depreciation, impairment & write off		(3,249)	

Item	Dr (£'000)	(Cr) (£'000)	Description	
9	CIES – Depreciation, revaluation & impairment – taken to Capital Adjustment Account		(12,347)	<i>Being adjustment to reflect impact of revaluation adjustments to the financial statements</i>
	Capital adjustment account (through MIRS)	944		
	Revaluation reserve (through OCI)	146,262		
	Assets under construction	29,964		
	PPE – Other land and Buildings		(126,693)	
	PPE – Council Dwellings		(29,959)	
	PPE – surplus assets		(8,221)	

### Overall Impact on the Financial Statements

	CIES	Current Assets	Non-Current Assets	Balance Sheet Current Liabilities	Non-current Liabilities	Reserves
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Per draft financial statements</b>	<b>(267,598)</b>	<b>160,399</b>	<b>2,938,615</b>	<b>(357,053)</b>	<b>(1,200,712)</b>	<b>(1,541,249)</b>
Impact of prior period restatement on opening balances (see prior period adjustments)			97,878			(97,878)
<b>Restated prior period balance</b>	<b>(267,598)</b>	<b>160,399</b>	<b>3,036,493</b>	<b>(357,053)</b>	<b>(1,200,712)</b>	<b>(1,639,127)</b>
Adjusted misstatements (adjusted misstatements)	135,993	5,877	(139,114)	(5,717)	2,961	135,993
<b>Final accounts</b>	<b>(131,605)</b>	<b>166,276</b>	<b>2,897,379</b>	<b>(362,770)</b>	<b>(1,197,751)</b>	<b>(1,503,134)</b>

### Group accounts

Item	Dr (£'000)	(Cr) (£'000)	Description
1	Investment Property	30,950	<i>Being adjustment to separately recognise Investment Property from Property, Plant and Equipment on the face of Balance Sheet as a separate category of assets in accordance with the Code. Note this is a disclosure only adjustment as the assets are appropriately valued as Investment Property</i>
	Property, plant and equipment		

## Prior year adjustments - Council

During the course of our audit work we also identified a number of adjustments to the prior year financial statements. These are detailed in Note 3 to the Council financial statements and Note 9 to the Group Accounts and summarised below. We note there is no overall impact on the Council's General Fund:

### Adjustments to opening prior year balance sheet as at 1 April 2018

	Dr (£'000)	(Cr) (£'000)	Description
Property, plant and equipment	43,554		<i>Being revaluation adjustment to opening comparative balance sheet as at 1 April 2018 reflecting the net increase in PPE balances at that date. Note all revaluation movements restated have been taken to opening reserves position.</i>
Revaluation reserve		(43,554)	

### Adjustments to prior period financial statements 2018/19

	Dr (£'000)	(Cr) (£'000)	Description
Property, plant and equipment	97,878		<i>Being prior year adjustment to restate the valuation of property, plant and equipment as at 31 March 2019 and associated adjustments to annual depreciation and revaluation movements through CIES, OCI and reserves. We note this is cumulative adjustments to those shown above in 1 April 2018 .</i>
Revaluation of non-current assets – Opening B/S adjustment (above)		(43,554)	
2018/19 Depreciation charge		(2,748)	
2018/19 Impairments		(17,263)	
Surplus on revaluation of PPE – 2018/19		(34,313)	

Our audit testing has also identified that Council Dwellings under construction have been incorrectly been included within Council Dwellings and therefore should be reclassified as Assets Under Construction. This does not impact the carrying value of PPE. The following reclassifications have been made between Council Dwellings and Assets under construction. 31 March 2018: £ 1.5 million, 31 March 2019: £7 million as part of the prior year adjustment correction.

## Prior year adjustments - Group

In addition to the Council prior period adjustment which are reflected through to the consolidated Group accounts, our audit also identified a misstatement in relation to the Council's Group balance sheet. The Group financial statements includes the results of the Nairn Common Good Fund and Inverness Common Good Fund. These funds both hold Investment Property. Within the unaudited accounts, Investment Property was included within the Group Property, Plant and Equipment. In accordance with the Code, these assets should be disclosed as a separate category of assets. As these are material to the financial statements, the prior year comparators have been restated as detailed below. We note that this is a disclosure impact only with no impact on the Council's Group revaluation position.

### Adjustments to opening prior year balance sheet as at 1 April 2018

	Dr (£'000)	(Cr) (£'000)	Description
Investment Property	29,556		<i>Being separate recognition of Investment Property from Property, plant and equipment in the Group Opening comparator balance sheet as at 1 April 2018.</i>
Property, Plant and Equipment		(29,556)	

### Adjustments to prior period financial statements 2018/19

	Dr (£'000)	(Cr) (£'000)	Description
Investment Property – opening balance sheet adjustment	29,556		<i>Being adjustment to recognise opening restatement of Investment property and addition and impairment movements in the prior year.</i>
Property, Plant and Equipment – opening Balance		(29,556)	
PPE – Revaluation and addition movements		(467)	
Investment property – revaluation and addition movements	467		

## Uncorrected misstatements

During our audit we identified a number of misstatements to the financial statements. Officers have not adjusted for these misstatements on the basis they are not material to the financial statements. We are satisfied that these misstatements are not individually or cumulatively material to the user of the accounts either quantitatively or qualitatively.

Item		Dr (£'000)	(Cr) (£'000)	Description	Item		Dr (£'000)	(Cr) (£'000)	Description
1	Creditors		(5,121)	<i>Being adjustment to recognise maximum factual and extrapolated errors in identified in expenditure cut-off testing. Actual errors identified of £2 million and extrapolated error of £3.1 million.</i>	5	CIES – Impairment of PPE	309		<i>Being correction of error in revaluation of property due to overstated floor measurements. Note correction would be through the revaluation reserve.</i>
	CIES Expenditure	5,121				PPE - OLB		(309)	
2	CIES – Service Income	398		<i>Being extrapolated projected overstatement of central government debtors based on errors identified in audit sample testing.</i>	6	Depreciation (Capital adjustment account)	309		<i>Being incorrect recognition of depreciation / revaluation movements in year.</i>
	Short term debtors		(398)			Revaluation gains (revaluation reserve)		(309)	
3	CIES - Expenditure	1,131		<i>Adjustment to correct balance sheet position due to misstatement of PPP/Service concession models due incorrect application of indexation.</i>	7	Cash and Cash equivalents		(4,252)	<i>Being adjustment to restate creditors and cash and cash equivalents to reflect the underlying ledger position as at 31 March 2020 (timing of clearance of payments)</i>
	Closing PFI Lease Liability		(1,131)			Creditors	4,252		
4	Debtors – Non-current	250		<i>Being correction of recognition of soft loan issued incorrectly recognised as a capital addition within property, plant and equipment.</i>					
	Surplus assets		(250)						

## Disclosure misstatements – Corrected

During the course of our audit work we identified a number of disclosure adjustments required to the draft financial statements. The following are those adjustments that have been amended in the signed financial statements.

Item	Description	Adjusted
10	Interests in associates and joint ventures	The Council only financial statements do not provide sufficient detail around the recognition and measurement of the Council's associates and joint ventures in the Council and Group accounts. While we are satisfied that these interests are appropriately accounted, there is an opportunity to enhance the Council's accounting policies around these.
1	Material valuation uncertainty	The Council has updated the Council only and Group accounts to reflect the impact of the material valuation uncertainty in relation to the valuation of land and buildings and Investment Property.
2	Accounting policies - REFCUS	The Council has updated the accounting policies to detail how Revenue Expenditure Funded by Capital Under Statute is accounted for in the financial statements.
3	Accounting policies – fair value measurement	The Council has updated its accounting policies to describe fair value measurement in the financial statements in line with the requirements of the Code.
4	IFRS 16	The Council has updated the accounts to reflect the CIPFA / LASAAC deferral of adoption of IFRS 16 until 1 April 2022.
5	Prior year adjustment	Note 3 (Council Only) and Note 9 (Group) accounts have been added to the financial statements to disclose the impact of the prior year adjustment in accordance with the Code.
6	Critical judgements	The Council has updated the critical judgements note in the financial statements to include judgements around the recognition of PPP / Service concession arrangements as meeting the definition of Service concession arrangements in line with IFRIC 12 and the Code
7	Cash flow statement	The cash flow statement has been updated in the current year to separately disclose
8	EFA	Presentational adjustments were required to the EFA in the current year to ensure consistent with Net Expenditure in the CIES.
9	Related party disclosures	The Council has updated the related party disclosure
11	Group accounts	The Notes to the Group accounts have been updated to comply with the requirements of the Code by disclosing detailed notes where the balance / value in the consolidated accounts is materially different to the Council only accounts. This includes: <ul style="list-style-type: none"> <li>- Additional disclosure on Investment Properties</li> <li>- Additional Group disclosure on IAS 19 Defined benefit pension obligations</li> <li>- Disclosure on Financing and Investment Income and Expenditure at the Group Level</li> </ul>
12	Disclosure notes to the accounts – Debtors	The debtors notes to the accounts required updating to explain to the reader the allocation of impairment charge in year.
13	Remuneration report	Remuneration report updated to provide greater detail on individual emoluments paid to officers in the prior year but whom no longer are in post.
14	Disclosures - McCloud	The Council has updated disclosure notes in the financial statements around the inclusion of McCloud remedy within the financial statements.
15	HRA Disclosure	The HRA Statement has been updated to excluded impairment of debtors of £1.934 million. This was correctly reflected in the CIES statement and was only a disclosure error in HRA.
16	Events after the reporting period	The note has been updated to reflect events since the balance sheet date and the
17	Movement in Reserves	The Group Movement in reserve statement has been updated to reflect the Council's share of total comprehensive income and expenditure in the year, excluding transactions with group bodies. The prior period disclosures have been also amended accordingly.
18	Charitable, Education and Trust funds	The Charitable Education and Trust Funds disclosures were updated to report the Highland Council Charitable Trusts Investments and Funds at Market Value rather than Cost, as reflected in the Charities accounts. This does not impact on the council of Group financial statements.

## Disclosure misstatements – Uncorrected

During the course of our audit work we identified a number of disclosure adjustments required to the draft financial statements. The following are those adjustments that the Council has not amended on the grounds that they are not material to the financial statements. Officers have proposed that they will revisit these proposals in preparation of the 2020/21 financial statements. Audit are satisfied the misstatements are not individually or cumulatively material to the user of the accounts.

Item	Description	Misstatement
1	IFRS 15	The Council's accounting policies on revenue recognition do not cover the full disclosure requirements required by IFRS 15, including the five step approach to considering revenue from contracts with customers. We are satisfied that the Council's revenue is recognised in accordance with the Code and IFRS 15 and do not consider the disclosure misstatement to be material to the accounts.
2	Interests in associates and joint ventures	The Council only financial statements do not provide sufficient detail around the recognition and measurement of the Council's associates and joint ventures in the Council and Group accounts. While we are satisfied that these interests are appropriately accounted, there is an opportunity to enhance the Council's accounting policies around these.
3	Critical judgements	The Council draft accounts disclosed critical judgments around future local government funding. Following audit recommendations, Officers added critical judgements around the accounting treatment of PPP/ Service concession arrangements on the basis that the assets and liabilities are recognised in accordance with the Code as qualifying as service concession arrangements. The current disclosure could be enhanced to provide the reader a greater understanding around the critical judgement made by Officers in preparing the accounts and the impact on the accounts. In addition, we do not consider local government funding uncertainty as a Critical Judgements in the accounts.
4	Assumptions made about future and other Major sources of Estimation uncertainty	The Council's unaudited financial statements included the following areas of significant risk of material adjustment in the forthcoming financial year: property, plant and equipment; LGPS pensions liability; debtor provisions; and Council tax provisions. From review of the disclosure, we do not agree with the Council's conclusion that debtors or Council tax provision as major sources of estimation uncertainty as given their current carrying value we do not consider these balances to be of significant risk of material misstatement in 2020/21. Furthermore, there is an opportunity to enhance the disclosure in the accounts around material valuation uncertainty through providing greater detail around the sensitivity of these estimates and the impact on the financial statements.
5	Financial Instruments disclosure	The Council's Financial instruments disclosure should detail the current carrying value of financial assets and financial liabilities as well as their fair value and how this fair value is arrived at. The Council does not have an accurate measure of the fair value of PFI liabilities and therefore has used carrying value as an approximate. Similarly, while the majority of the Council's financial assets are call accounts and debtors, the fair value for long term debtors is currently reported at amortised cost (carrying value). While we do not consider this disclosure to be material to the user of the financial statements, the disclosure should report on the fair value of financial assets and liabilities in accordance with the code. The disclosure should also include detailed around the nature and extent of the financial risks to the Council and how these are managed.
6	Cash flow statement	The code requires specific disclosure requirements within the Council's cash flow statement and supporting notes. This includes separating the movement in debtors from the movement on the impairment of debtors. Similarly, while the current year cash flow statement has been restructured to separately show the proceeds from the sale of PPE and Net Book Value of the sale, the prior year comparators just disclose the gain/loss on disposal. Note the net movement in prior year is immaterial (£0.715 million and gross movements below PM) and therefore satisfied no restatement is required.

Item	Description	Misstatement
7	Segmental reporting	The Council Report Segmental Income there is an opportunity to enhance the reconciliation between Segmental Reporting information and the EFA / CIES statements to provide the reader of the accounts a greater understanding around the reconciliation between internal reporting and the outturn position. We are satisfied that the Council's financial statement disclosures are free from material misstatement but recommend the Council review these to further enhance the reader of the accounts understanding of financial performance.
8	HRA Disclosures	The net expenditure from HRA services reported in the HRA statement in 2018/19 does not reconcile to the CIES statement in the prior year. This was due to the inclusion of impairment of debtors of £1.875 million in cost of services element of the HRA statement rather than shown in the finance and investment line within the accounts. We are satisfied that this prior year disclosure error is not material to the financial statements and does not impact on the CIES disclosures.

# Action plan and recommendations

We have set out below, based on our audit work undertaken in 2019/20, the significant recommendation arising from our audit procedures.

## Recommendation

## Agreed Officers response

### 1. Property, plant and equipment valuation (Page 12)

Officers should ensure that a more robust valuation processes is established to consider the extensive portfolio of assets held to ensure they are valued with sufficient frequency to ensure they are not materially misstated in the accounts. This exercise should consider those assets not subject to formal revaluation in year to ensure there is no indication of material movement in carrying value.

Furthermore, to ensure there is appropriate review and scrutiny of the Council's valuation process, the annual valuation should be reported through a formal revaluation report, summarising the key assumptions made in the valuation and scope and limitations of the valuers work. Given the significance of the carrying value of property, plant and equipment and the level of estimation and judgement around the valuation, it is critical that Officers ensure they have robust processes in place for the effective review, scrutiny and challenge of the Council's valuation to ensure that assets continue to be valued in accordance with the Code and RICS guidance.

**Officer response:** for assets not included in the formal valuation desktop estimations of changes in value will be requested, checked for material changes and if required these will be used to update the reported values. The valuation process will be initiated with a formal instruction from Finance Service and the Internal Valuer will supply a formal valuation report in return. The Council will review its structures and process across its property and valuation teams to drive improvements in the asset valuation process.

**Action owner:** Head of Corporate Finance and Head of Development and Regeneration. ECO Housing and Property

**Timescale for implementation:** 09.04.21 and 30.9.21

### 2. Accounts preparation (Pages 15, 16 & 19)

Our audit testing identified a number of quantitative and qualitative misstatements to the financial statements. While we recognise 2019/20 had unique challenges, including the impact of Covid-19 on financial reporting arrangements, it is important that the Council has sufficient resources to support the preparation of the accounts, including internal review and scrutiny prior to audit inspection. In particular, the Council should review arrangements to ensure completeness and accuracy of income and expenditure transactions around the year end, confirming that the thresholds applied by Officers is suitable to ensure financial statements are materially correct. The Council should have sufficient review of the financial statements, including accounting policies and disclosures, to ensure that the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom have been met. This review should incorporate the Management Commentary contained within the financial statements to provide the reader of the accounts a clear understand of the Council's financial performance during the year.

**Officer response:** The Council will look to amend year end processes and realign resources to facilitate increased checks of income and expenditure for completeness and accuracy and for review of the accounts prior to submission to The Auditor

**Action owner:** Head of Corporate Finance and Commercialism

**Timescale for implementation:** 31.03.21

## Recommendation

### 3. Objection to the financial statements – Insurance Fund Administration (Page 17)

There is an opportunity to enhance the transparency around the application of the Fund, including greater evaluation and reporting of the internal insurance risk being held by the Council through reducing the level of Insurance cover. Good practice recommends regular actuarial assessment of the Insurance Fund to quantify the risk being managed by the Council and therefore better inform Officers and Councillors around the level of Insurance Fund that the Council should maintain.

## Agreed Officers response

**Officer response:** The Council will look to increase reporting of the insurance fund to the Resources Committee and give consideration to conducting an actuarial assessment of the fund.

**Action owner:** Head of Corporate Finance and Commercialism

**Timescale for implementation:** 30.06.21

### 4. Risk management (Page 24)

There is an opportunity to re-review the risk management strategy (framework for the Council). This includes setting out which management groups review risk, when and for what purpose and the same for groups with political representation and ultimately reporting at Committee level. This will better demonstrate the link between service committees and their responsibilities on risk and the Audit and Scrutiny Committee. Lastly, as a result of Covid-19 and Brexit there is an opportunity to refresh the Council wide risks, and Council response to manage or mitigate risk.

**Officer response:** The Council's Risk Management Strategy will be reviewed to ensure links are demonstrated by June 2021. COVID risks are managed on a continuous basis through the Officer GOLD group. Brexit risk is under continuous review by the Brexit Tactical Group feeding into regular reporting to ELT and Audit & Scrutiny. Quarterly and six-monthly reporting will be sustained during the COVID crisis.

**Action owner:** Corporate Audit & Performance Manager

**Timescale for implementation:** June 2021

### 5. Capital plan (Page 28)

Recent performance would indicate that the Council's capital budgets are unrealistic or unachievable having underspent against budget by £17 million in the current year. The Council's infrastructure is important in supporting the efficient and effective delivery of services. The Council must balance the cost of financing capital projects against the revenue implications of running with ageing or unsuitable infrastructure. It is important that capital plans reflect the Council's true level of planned capital activity in year and set achievable aspiration for the year. This should incorporate any carry forward from previous years.

**Officer response:** The Council has reprofiled its capital plan which was presented to Members in January 2021. Work is ongoing through the officer Strategic Asset Management Group (which comprises the ECOs for Housing and Property, Finance and Resources and Infrastructure and Environment) to develop the Council's capital strategy which will help focus on capital programme deliverability and affordability as well as taking a long-term view on the requirement for investment in the Council's assets.

**Action owner:** Strategic Asset Management Group

**Timescale for implementation:** 30.9.21

## Recommendation

## Agreed Officer response

### 6. Political discussions (Page 31)

The level of discussion and debate, particularly at full Council, can be operational rather than strategic and this has resulted in meetings taking much longer than planned, to get through the agenda. Officers and Elected members should continue to work together, to ensure the papers and subsequent discussion and debate support a strategic focus.

**Officer response:** Council and Committee Agendas are being reviewed to ensure a strategic focus and reports will be adjusted to remove operational detail. Guidance to be provided to Committee Chairs to assist in the management of meetings in addressing where members raise operational matters in the course of discussion. A Training session is being arranged with the Standards Commission which will also cover the distinction between strategic and operational.

**Action owner:** ECO Performance & Governance  
**Timescale for implementation:** July 2021

### 7. Recovery Board (Page 32)

The gold, silver, bronze command arrangements and the temporary suspension of meetings is like most Council's. As the pandemic is ongoing, the Council should continue to review their governance structures to ensure they remain flexible to meet changing external circumstances and continue to be transparent. This can include lessons learned from the early arrangements established.

**Officer response:** Council agreed on 7 January that wherever possible decisions would be taken through the Council's standard formal governance arrangements and there is a full schedule of Committee, Council and Board meetings planned throughout the coming months to provide for this and there is scope to arrange urgent meetings under the current Standing Orders to provide for flexibility. This is facilitated by the successful transition to online meeting platforms that were not available at the start of the first lockdown period. Should very urgent action be required as a consequence of the emergency situation that can't wait for committee approval then this will be reported to Members within a week and published on the Council's website for full transparency. However, it is not envisaged that this will happen often, if at all. The situation will be kept under regular review.

**Action owner:** ECO Performance and Governance  
**Timescale for implementation:** January 2021

## Recommendation

## Agreed Officer response

### 8. Partner organisations (Page 32)

A number of partner organisations support the Council in delivering services. It is important, given the ongoing uncertainty surrounding covid-19, that Officers and Elected Members continue to maintain an oversight of these bodies and any potential obligation should it crystallise. This is important in ensuring the continuity of services being delivered on the Council's behalf by these entities as well as ensuring the financial position of the Council is maintained.

**Officer response:** Financial risks associated with partner organisations will be considered as part of the 2021/22 budget setting process and will continue to be reported on as part of regular budget monitoring as has happened in the current financial year.

**Action owner:** Head of Corporate Finance

**Timescale for implementation:** Ongoing

# Follow up of 2018/19 recommendations

We set out below our follow up of our 2018/19 recommendations and these are reflected below for information.

## Recommendation

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### 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.

#### Initial Officer response

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

Follow up – Superseded See Action Plan Point 1

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### 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.

#### Initial Officer response

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

Follow up – Closed

Financial reporting arrangements have been revised to ensure a consistent approach adopted over financial monitoring information.

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## Recommendation

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### 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.

#### Initial Officer response

The 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.

#### Follow up – Ongoing

The Council faces significant future risks to ensure it remains financially sustainable. The impact (now and ongoing) of Covid-19 is uncertain, including expenditure and any associated additional income.

2020/21 will be a challenging financial year for the Council. At the point of completing our work (October 2020) it was anticipated that the Council will need to use reserves which were only just built up in 2019/20 alongside delivery of all agreed savings.

**Action owner:** Executive Chief Officer- Resources and Finance

**Timescale for implementation:** Ongoing

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### 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.

#### Initial Officer 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.

#### Follow up – Complete

The Council's 2019/20 financial performance enabled the Council to grow the unearmarked general reserves position from 1.4% of annual revenue budget to 2.7%. We note that 2020/21 will be a more challenging financial year however the reserves should support the Council in managing any service overspend.

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## Recommendation

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### 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.

#### Initial Officer 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

#### Follow up – Complete

A key element of the Council's Recovery Programme is the workforce planning and development. To deliver a sustainable operating model it is critical that the Council maximises the use of its workforce resources ensuring that work plans are aligned to key council priorities and remain agile to support transformational change required to support the Council's recovery. The Council has in place both Officer and Member oversight to ensure workforce planning plays a key role in the Council's recovery activity and transformation..

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### 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.

#### Initial Officer 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

#### Follow up – Complete

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## Recommendation

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### 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.

#### Initial Officer response

Following Member engagement on SMART indicators and targets the new Corporate Plan (CP) approved in May 2019 (targets in September 2019) was reported to Council in October 2020 focusing on a new approach to the annual performance report shifting from action based reporting to KPI reporting against targets. 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 benchmark targets and trends for 2019/20 to Council in March 2021 through the Local & National SPI annual report which will also pick up on the new Audit Direction around Best Value.

#### Follow up – Closed

The Council continues to look to develop its performance monitoring arrangements and has looked to develop corporate performance during the year. The Council publishes a range of performance information through the Council's website. This includes: financial reports; Council Tax Fact sheet, providing a summary on how Council tax payers money is used; Highpoints Magazine, council priorities and business plans and performance reports.

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### 8. Capital Expenditure (2017/18 Outstanding Recommendation)

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.

#### Follow up – Superseded 2019/20 Action Plan Point - 5

The Council £17.9 million of slippage as at 31 March 2010. 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. The Capital programme has revenue consequences through the impact of loans charges and cost of borrowing. In addition, where there is delays in the investment in infrastructure this can also lead to additional costs in maintaining and operating from ageing infrastructure. It is therefore important that the Council continue to look to support the delivery of the capital programme.

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## Recommendation

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### 9. Strategic Leadership and Tone From the Top (2017/18 Outstanding Recommendation)

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.

#### Follow up

Following the restructuring of the Council's senior management team in 2018/19, the Council has sought to embed these new structures across the organisation as well as recruit appropriate individuals to fill the executive chief officer roles that support the Chief Executive as part of the Council's senior leadership team. While the Council has recruited to five of the eight posts, it has faced challenges in making permanent recruitment across Education and Learning; Health and Social Care and Transformation and Economy. As at November 2020, each of these posts are currently filled on an interim basis. One temporary appointment included a consultant for the position of Executive Chief Officer, Education during the year which included consultancy fees. Given the financial and operational challenges facing the council, it is critical that there is a stable and effective leadership team in place with the capacity and capability to support the organisation through challenging times while maintaining a focus on delivering strategic objectives and statutory services.

**Updated comment:** The ECO Team has 6 permanent appointments and 2 interim. The whole team, under the Chief Executive's leadership, works together very effectively and has a strong corporate strategic focus. The reorganisation of the Council has introduced significant and wide ranging changes to the Council's Service and management structure that would ordinarily have taken some time to work through and fully establish. The advent of a national pandemic has impacted on this as the focus has, unavoidably and appropriately, moved to resilience and response ahead of internal re-structuring. Nevertheless, the effectiveness of the whole senior team has meant that service delivery, financial management, emergency response and COVID recovery are all being taken forward successfully. The ability to put interim posts in place has greatly assisted this in delivering capacity, capability and responsiveness in an agile way. The intention is still to complete the senior management and service restructure at the earliest opportunity and it is anticipated this will be concluded by the middle of 2021 at the latest.

**Action owner:** The Chief Executive

**Timescale for implementation:** July 2021

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# Audit fees and independence

## External Audit Fee

Service	Fees £
External Auditor Remuneration (Agreed fee in plan)	249,500
Agreed additional year end fee (prior year adjustment and valuation matters)	12,600
Pooled costs	24,140
Contribution to Audit Scotland costs	14,910
Contribution to Performance Audit and Best Value	132,200
<b>2019/20 Fee</b>	<b>433,350</b>

## Fees for other services

Service	Fees £
We confirm there are no non-audit fees for the 2019/20 audit	Nil
Audit of Highland Council Charitable Trusts	1,000
Audit of Highland Charities Trust	1,000

Highland Charitable Trusts and Highland Charities Trusts are not consolidated into the Group financial statements on the basis the financial results of these entities are not material to the Group accounts. The audit fees for the charities above are therefore not disclosed in the Council Group financial statements and instead disclosed in the individual charity's accounts.

## 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](mailto: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.

## 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 Financial Reporting Council'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 Financial Reporting Council'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.

# Fraud arrangements

The term fraud refers to intentional acts of one or more individuals amongst management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is 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 relations to management override of controls.
- Leading a discussion with those charged of governance (for the Council this is assumed to be the Audit and Scrutiny Committee) on their view of fraud. Typically we do this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- 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.

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 management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

## 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 he 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 Highland Council we will report to the Auditor General as required by Audit Scotland.

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance including establishing and maintaining internal controls over the reliability of financial reporting effectiveness and efficiency of operations and compliance with applicable laws and regulations.

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 work with the Highland Council to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on a quarterly basis.

# Communication of audit matters

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 below.

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 <b>Confirmed, no matters to report.</b>	•	•
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	•	•
Significant matters in relation to going concern <b>None identified although commentary included on financial sustainability.</b>	•	•
Views about the qualitative aspects of Highland Council's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures <b>Included within the report.</b>		•
Significant findings from the audit <b>Included within the report</b>		•
Significant matters and issues arising during the audit and written representations that have been sought <b>Included in this report and letter of representation obtained at date of signing.</b>		•
Significant difficulties encountered during the audit. <b>Valuation and prior year adjustments covered within our report explaining the delay to our audit.</b>		•
Significant deficiencies in internal control identified during the audit <b>None identified. We have raised opportunities to enhance the processes in place at the Council around the financial statements production.</b>		•
Significant matters arising in connection with related parties <b>None identified.</b>		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements. <b>None identified.</b>		•
Non-compliance with laws and regulations <b>None identified</b>		•
Unadjusted misstatements and material disclosure omissions <b>Reported in Appendix 1 of this report.</b>		•
Expected modifications to the auditor's report, or emphasis of matter. <b>Emphasis of matter in relation to the material uncertainty in respect of the valuation of property, plant and equipment (Council) and Investment Property (Group).</b>		•



The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit reporting process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the entity or all weaknesses in your internal controls.

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