

The Highland Council

**Report to Members and the Controller of Audit
on the 2009/10 Audit**

October 2010



 **AUDIT SCOTLAND**

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Key Messages

We have given an unqualified opinion on the financial statements of The Highland Council. The accounts were certified by the target date of 30 September. They are now available for publication and are an essential means by which the council accounts for its stewardship of public money.

Overall the council's spending was in line with the budget set. Unplanned costs relating to social work, single status and equal pay were offset by savings elsewhere.

Uncommitted general fund balances at year end were 2.3% of the council's revenue budget, below the target level of 3%. A high level of earmarking provides some protection to the council's overall reserve position in future years, and the total level of cash backed reserves has remained broadly consistent since 2006/07 despite increasing pressure on its finances. Reserve levels provide some scope to manage the overall financial position in the short term, but limited opportunity to manage any significant reductions in income and recurring expenditure pressures.

We were satisfied with disclosures made in the annual corporate governance assurance statement and the adequacy of the process put in place by the council to obtain assurances on systems of control. We assessed key financial systems as having a satisfactory level of control for our purposes. Some significant governance concerns were identified in relation to the Caithness Heat and Power project, which is currently subject to further review at the request of the Accounts Commission.

A pathfinder BV2 audit was concluded in April 2010. We found that the council was demonstrating that it was improving well and was well placed to deliver future improvements.

Outlook

The financial challenges facing the Scottish public sector are well documented. There remains uncertainty about what the financial implications for the Highland Council will be and the settlement for local government is not likely to be finally known until January 2011. The council has shown a good understanding of the financial challenges it faces and has made good early progress in addressing these. Its most recent assessment is that aggregate savings of £76 million (12.5% of the revenue budget) will be required by 2012/13. Savings of £23 million have already been agreed, with potential further savings of £42 million set out in the budget consultation document – leaving a 'gap' of at least £11 million still to be closed. Decisions on future budgets have yet to be made.

In establishing its financial plans the council has made an allowance for a range of inflationary and other cost pressures and considered the extent to which new developments, priorities and responsibilities can be funded. Moving forward it is important that the council has a clear understanding of what its spending priorities are, developing these in partnership with other public sector organisations where appropriate. The



immediate challenge is to balance the 2011/12 budget – particularly given the extent to which cuts are frontloaded - but this needs to be achieved in a manner that best supports the council's overall objectives and priorities. Real terms grant reductions are expected to continue until 2015/16 on current projections, and the council will continue to face tough decisions about spending and priorities.

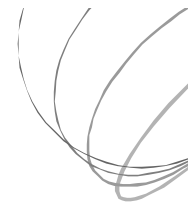
Reducing spending on staff will need to be a key component of the way in which the council responds to the challenges it face. The speed at which spending reductions are required may mean that some pragmatic solutions need to be adopted in the short term. This will need to be balanced with the need to ensure that the council has the right people in the right place to take forward its strategic objectives and priorities, and that any up-front costs represent best value for money. The council's workforce management planning framework will support this work. Improved vacancy management and formal redeployment measures will be useful tools in addressing this area.

The council has made significant progress in developing its approach to asset management, but needs to do more in key areas. This is essential to help achieve objectives and priorities, while getting best value from reducing resources. The wider economic situation also has serious implications for the management of the council's property portfolio, making it difficult to capitalise on surplus assets or maximise rental income. While the council was assessed as 'conforming' in the annual procurement capability assessment, there is scope to do more to deliver savings from this area.

Effectively managing the council's performance will remain a key challenge as council budgets are reduced. It is unlikely that the council will be able to maintain or improve current performance levels across all of its existing services, and it will need to make difficult decisions about what areas are seen as priorities and in which areas will service levels need to be reduced. Crucially, the council will need to use its performance information to understand and manage the effect of spending decisions.

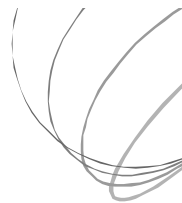
In June 2010, we submitted our final shared risk assessment and assurance and improvement plan (AIP) to the council. This document was produced by the local area network of scrutiny bodies and describes the work planned on corporate activities over the next three years. The local area network is led by Audit Scotland and we shall keep the council up-to-date with any changes to the AIP.

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



Introduction

1. This report is the summary of our findings arising from the 2009/10 audit of The Highland Council (the council) and other relevant work carried out by Audit Scotland. A number of detailed reports have already been issued in the course of the year in which we make recommendations for improvements (see Appendix A). We do not repeat all of the findings in this report. Instead we focus on the financial statements and any significant findings that have arisen from our review of the management of strategic risks.
2. The report uses the headings of the corporate assessment framework, which we and the other scrutiny bodies used as the structure for the recent shared risk assessment and assurance and improvement plan (AIP) [<http://www.audit-scotland.gov.uk/work/scrutiny/docs/Highland.pdf>]. Where relevant, we comment on issues identified in the AIP for investigation or monitoring by the local auditor throughout the report.
3. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest to the council are:
 - Improving public sector efficiency.
 - Overview of local government in Scotland 2009.
 - Protecting and improving Scotland's environment.
 - Scotland's public finances – preparing for the future.
 - Making an impact – overview of best value audits 2004 -09.
 - Roles and working relationships: are you getting it right?
4. All of these reports have been sent to the council for consideration and we do not consider them further in this report. They are available on our website www.audit-scotland.gov.uk.
5. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and have agreed to take the specific steps set out in the column headed *Planned Management Action*. We do not expect all risks to be eliminated or even minimised. What we are expecting to see is that the council understands its risks and has in place mechanisms to manage them. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to be duly assured that the proposed action has been implemented, and is effective.



6. This report is addressed to Members and the Controller of Audit. It will be published on our website after consideration by the council. The Controller of Audit may use the information in this report for his annual overview of local authority audits to the Accounts Commission later this year. The overview report is published and it is also presented to the Local Government and Communities Committee of the Scottish Parliament.



Financial statements

Introduction

7. In this section we summarise key outcomes from our audit of the council's financial statements for 2009/10, comment on the significant accounting issues faced, and provide an outlook on future financial reporting issues.

Audit Opinion

8. We have given an unqualified opinion that the financial statements of The Highland Council for 2009/10 give a true and fair view of the financial position and expenditure and income of the council and its group for the year. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
9. We were satisfied with disclosures made in the annual corporate governance assurance statement and the adequacy of the process put in place by the council to obtain assurances on systems of control.
10. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. Working papers to support the 2009/10 accounts were satisfactory and responses to queries and questions raised during the audit by finance staff were prompt and comprehensive.
11. The accounts were certified by the target date of 30 September 2010 and are now available for presentation to members and publication. The financial statements are an essential means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

Accounting issues

12. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom – a Statement of Recommended Practice (the SORP). With effect from 2010/11, local government will move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS). Because local government has already adopted some aspects of IFRS, we expect the transition to be fairly smooth but there are still significant issues to be addressed.
13. This year councils have to account for PFI projects on an IFRS basis. The Highland Council has two PFI projects in place and a total value of £148 million was included in the restated opening balance



sheet for 2009/10 in relation to these schools. We noted that these assets had not been revalued in line with the council's accounting policy to revalue assets on a five yearly basis. As a result of this audit finding a revaluation was carried out resulting in an increase of £10 million on the value of the schools. After accounting for depreciation in the year the closing value of the PPP projects was £155.5 million.

14. The council have provided a comprehensive financial commentary in the Explanatory Foreword to the financial statements. However it could be improved through clearer explanation of how the figures in the accounts relate back to the budget set for the year, particularly in relation to the movements on reserves and balances. This would make it easier for elected member and the public to follow and make the accounts more transparent.
15. The impact of the economic climate is referred to at the end of the Explanatory Foreword. The commentary could have been enhanced with more detail, in particular giving a wider range of specific examples of where and how the economic climate and the reduction in available funding has impacted significantly on the accounts. Looking ahead, the Foreword provides a valuable opportunity to explain the implications of reduced funding and set out how the council has managed this.

Key risk area 1

16. We were satisfied that the council prepared the accounts in accordance with the 2009 SORP. The council has adjusted the financial statements to reflect audit findings. As is normal practice, immaterial unadjusted errors have been reported to the Director of Finance. Details of significant accounting issues arising in the course of our audit are summarised below.
17. **Internal Recharges.** During audit testing we found that internal recharges of £69.846 million had not been eliminated. Departments providing services internally included both the expenditure and income related to services charged to other council departments whilst the receiving department also showed the expenditure. As a result gross income and expenditure on the face of the I&E were overstated. This had no impact on the net deficit for the year or on the general fund. The I&E was amended to remove the internal recharges and officers advised that adjustments will be made to the final accounts procedures to ensure that internal recharges are eliminated in future accounts.
18. **Grant income.** The gross income and expenditure figure for Council Housing on the face of the I&E were both understated by £11.56 million as the council had netted off grants in the year against expenditure incurred. This had no impact on the net deficit for the year. Grants should be shown as income and the I&E was amended to accurately reflect the gross income and expenditure amounts in 2009/10. Officers advised that adjustments will be made to the final accounts procedures to ensure government grants received are correctly reflected in future accounts.



19. **Cashflow Statement (CFS):** The rents received figure of £63.5 million in the unaudited CFS included non-cash entries of £27.3 million for rent debited to void properties and rent not received from tenants but instead as housing benefit. These elements were also reflected in the Other operating cash expenditure and Housing benefits paid lines as non-cash expenditure. Although these entries had no impact on the net decrease in cash in the year, the inclusion on non-cash entries is incorrect. This impacted on the CFS alone and there was no impact on the deficit for the year or the general fund. The CFS was amended to correctly eliminate all non-cash entries for 2009/10 and officers advised that adjustments will be made to the final accounts procedures to ensure that non-cash elements are excluded from the CFS in future years.

Key risk area 2

Audit testing

20. As part of our work, we took assurance from a number of the council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes:

- | | |
|--------------------------|-----------------------|
| ▪ Payroll | ▪ Creditors payments |
| ▪ Housing rents | ▪ Council tax |
| ▪ Main accounting system | ▪ Non-domestic rates |
| ▪ Debtors and income | ▪ Budgetary control |
| ▪ Cash & bank | ▪ Pensions |
| ▪ Benefits payments | ▪ Capital accounting. |

21. In our 2009/10 annual audit plan we planned to place reliance on the controls work done by internal audit on accounts payable, accounts receivable and payroll administration.

Group accounts

22. The diversity of service delivery vehicles used by local councils means that consolidated group accounts are required to give a true and fair view of a council's income and expenditure. The council have interests in four subsidiaries and a total of four associates and joint ventures. They have, with the exception of Caithness Heat and Power (CHaP), been included in group accounts in accordance with the SORP. Audit assurances were obtained through review of board minutes, internal audit reports and audited accounts. We confirmed that:

- all bodies within the group received unqualified audit opinions from their external auditors



- in accordance with recommended accounting practice, key policies for component bodies such as pension costs and the valuation of fixed assets at market value, have been aligned with the council
- Caithness Heat and Power (CHaP) is, since August 2008, a subsidiary of the council and was set up to deliver an innovative heating and power system for houses in Wick. The project failed to deliver and experienced a range of problems (further details at paragraphs 99 to 102). The council has included a provision of £10.6 million in relation to liabilities for this company but CHaP had not been consolidated into the group statements. Officers advised that the latest accounts for the company were not yet available. In such circumstances, accounting standards (FRS2) allow a company to be omitted from the group accounts providing the exclusion of the company is not material to the overall group accounts. On the basis of recent management reports on the financial position and as a significant provision had already been included in the single entity accounts we accepted that CHaP met the FRS2 conditions. The council will need to keep the position under review for future years.

Key risk area 3

Trust funds

23. Local authorities with registered charitable bodies are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial statements is required for each trust fund. However the Office of the Scottish Charities Regulator (OSCR) has deferred the date of full implementation until 2010/11. This means that reliance can be placed on the existing disclosures for trust funds in the council's financial statements for 2009/10, supplemented by appropriate working papers.
24. The council have commissioned a piece of work from the Scottish Community Foundation to provide options for them on the closure and amalgamation of trusts which will facilitate compliance with OSCR requirements in 2010/11.

Common good fund

25. In December 2007, Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued a guidance note for practitioners. The guidance required the common good fund to be disclosed within the financial statements and a separate common good asset register to be in place by March 2009. The council complied with this guidance by the required date.



Legality

26. Through our planned audit work we consider the legality of the council's financial transactions. In addition the Depute Chief Executive & Director of Finance confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with relevant legislation and regulations.
27. We noted that the Head of Legal Services has been absent for a prolonged period. The council is ensuring that it provides appropriate cover for the contribution of this role to ensuring legal compliance.

Financial reporting outlook

Compliance with International Financial Reporting Standards (IFRS)

28. Along with the majority of Scottish Local Authorities, the council engaged CIPFA/PWC to provide technical advice and support through the IFRS transition process. Although there are no formal deadlines in advance of 30 June 2011 when the 2010/11 accounts are due, the early production of a restated opening balance sheet and shadow accounts is accepted good practice. In line with this good practice the council has provided us with IFRS restated opening balance sheet for 2009/10 and we are currently reviewing this with a view to reporting our findings in the near future. We understand that restated 2009/10 accounts will be ready in November 2010 with the skeleton accounts, including disclosures for 2010/11 being scheduled for early 2011. Work required in respect of the changes to lease arrangements is complete and component accounting is progressing on target.

Key risk area 4

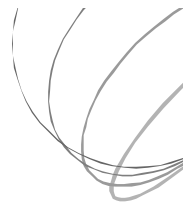
Pension funds

29. The Scottish Government is consulting on the requirement for a separate pension fund audit from 2010/11. This is a significant change from the current approach, where the pension fund accounts are audited as part of the administering council's audit. Audit Scotland has already started to separate the internal and external planning for the pension fund from the administering authority and we shall further refine our audit approach following the outcome of the consultation.

Key risk area 5

Carbon trading

30. From April 2010 a new and complex system for charging for carbon emissions was introduced. The council is required to purchase and account for carbon credits to cover all of its non-transport related energy usage. Incentives and penalties will be built into the system to encourage a reduction in carbon emissions.



31. In 2008/09 we reported that the council have a Carbon Management Plan 2009-2012 which presents the scope, timescales, targets and actions over this period. The Plan recognises that the achievement of targets will require a total investment of £3.615m (based on all the projects being approved) and identifies potential cost savings of £6.05m associated with these projects. Each action requiring capital investment is now subject to a business case and option appraisal to assess the viability and affordability of the actions and the knock on effect on carbon emission levels.

32. The first year of the charge for carbon allowances will be 2011/12, with cost estimated at £0.5 million.



Use of resources

Financial results

33. In 2009/10, the council spent over £838 million on the provision of public services, £757.7 million on revenue services and £80.6m on capital projects. The council's net operating expenditure in 2009/10 was £569.3 million. This was met by central government and local taxation together totalling £570.8 million, resulting in a surplus of £1.5 million, 0.3% of the net expenditure for the year.
34. As the council is required to set its council tax on a different accounting basis this deficit is subject to further adjustments. The main adjustments are to ensure that capital investment is accounted for as it is financed rather than when fixed assets are consumed, and that retirement benefits are charged as amounts become payable to pension funds and pensioners rather than as future benefits are earned. The impact of these adjustments in 2009/10 is to reduce the surplus by £4.1 million, meaning general fund balances of £2.6 million were used during the year. A further £4.1 million was appropriated from the general fund to other cash backed reserves, including £3.7 million to the capital reserve, meaning that the general fund reduced by £6.7 million during the year.
35. While the general fund movement is a key measure in managing the council's annual budget, the income and expenditure position indicates the underlying level of resources the council has consumed or built up during the year. The effect of this will ultimately impact on future revenue and capital budgets as assets are maintained and replaced and pension commitments met.
36. The budget set for 2009/10 was based on a Band D council tax level of £1,163 with planned contributions of around £3 million from earmarked council balances. Overall, therefore, the council's total spending was in line with the budget set. Unplanned costs of £3.4 million relating to equal pay and single status and an overspend of £1.7 million on social work were offset by savings in other general fund services.
37. The council made significant savings (£2.6 million) on a prudent budget for interest and loan costs. As the public sector enters a period of significant financial constraint it is likely that interest budgets are likely to be under significant pressure, reducing the scope to use these areas to help manage the overall financial position of the council.

Financial position

38. Exhibit 1 shows the balance in the council's funds at 31 March 2010 compared to the previous year. Funds include a capital fund which may be used to defray capital expenditure or repay loan principal, and a repair and renewal fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets. At 31 March 2010, the council had total funds of £63.6 million, a decrease of £2.3 million on the previous year.

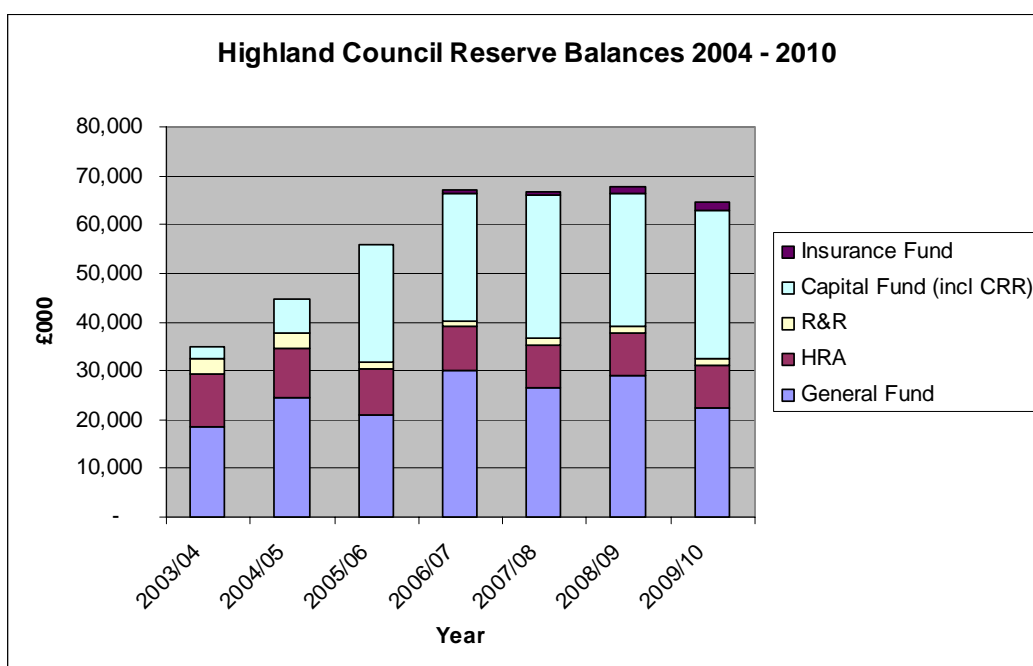


Exhibit 1
Reserves

| Description | 31 March 2010 £ Million | 31 March 2009 £ Million |
|-------------------------|----------------------------|----------------------------|
| General Fund | 22.3 | 28.9 |
| Housing Revenue Account | 8.8 | 8.8 |
| Repair and Renewal Fund | 1.4 | 1.3 |
| Insurance Fund | 1.5 | 1.1 |
| Capital Fund | 29.6 | 25.8 |
| | 63.6 | 65.9 |

39. The general fund decreased by £6.7 million during the year to a balance of £22.3 million which equates to 3.9% of the council's net operating expenditure. Of this balance £8.9 million has been earmarked for specific purposes leaving an unallocated balance of £13.3 million, which is 2.3% of the council's revenue budget. This has fallen below the council's aim to keep a sum of up to 3% of the revenue budget as a contingency in non earmarked balances, although the high level of earmarking provides some protection to the council's overall reserve position for future years.

Exhibit 2
The Highland Council cash backed reserves





40. The council has maintained a broadly consistent level of total reserves since 2006/07 (exhibit 2). This follows an earlier build up of capital funds. General fund reserve levels have fallen from a peak of £30 million in 2006/07. The council has seen increasing pressure while it has managed its overall financial position during this period. Reserve levels provide some scope to manage the financial position in the short term, were this required, but the council has limited opportunity to use its balances to manage any significant reductions in income and recurring expenditure pressures.
41. Exhibit 3 provides some information about the council's financial position compared to other Scottish mainland councils.

Exhibit 3

Financial position indicators

| Ratio | Description | The Highland Council | | All mainland Councils |
|--|---|----------------------|---------|-----------------------|
| | | 2008/09 | 2009/10 | 2009/10 |
| Working capital (Current assets as a ratio of current liabilities) | This is an indicator of the council's ability to pay its current liabilities in the short term. | 40% | 56% | 33% - 191% |
| Useable reserves as a percentage of general revenue expenditure | This shows the proportion of revenue expenditure that could be met from reserves. | 11.5% | 11.3% | 3.7% - 19.6% |
| Long term borrowing compared to tax revenue | This ratio illustrates the proportion of a council's tax related income that would be needed to pay off long term debt. | 266% | 280% | 48% - 295% |
| Long term assets as a percentage of long term borrowing | This gives an indication of the ability to borrow to replace or repair assets. | 319% | 322% | 200% - 755% |

42. These ratios indicate the liquidity and financing position of the council. In making comparisons between councils, there are a number of factors which affect the indicators. These include the council's group structure, asset management arrangements (e.g. housing stock transfers) and financial strategies. We have compiled this information for the first time this year and it establishes a starting point to enable the council's financial stability to be monitored in the future. The council should consider whether the ratios indicate any areas for further consideration within the context of its financial strategies.

Group balances and going concern

43. The overall effect of inclusion of all of the council's subsidiaries, associates and joint ventures on the group balance sheet is to reduce net assets by £316 million, mainly because of pension liabilities of the associate bodies.



44. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Northern Police, Highland & Islands Fire and Rescue, Highland & Western Isles Valuation and Highlands and Islands Transport Partnership) had an excess of liabilities over assets at 31 March 2010 due to the accrual of pension liabilities. In total these deficits amounted to £537 million (2008/09 £329 million), with the council's share being £359 million (2008/09 £219 million). All group bodies' accounts have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax.

Capital performance 2009/10

45. The council's prudential indicators for 2009/10 were set in February 2009. Net capital expenditure in 2009/10 totalled £80.6 million, a drop of £11.5 million from 2008/09 and £1.1 million less than budget. The reason for the shortfall is mainly due to slippage in the capital programme, the most significant slippage occurring in relation to care homes and schools.

Exhibit 4

Sources of finance for gross capital expenditure 2005/10

| | 2005/06 Actual £M | 2006/07 Actual £M | 2007/08 Actual £M | 2008/09 Actual £M | 2009/10 Actual £M |
|--------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Borrowing | 27.3 | 28.8 | 30.4 | 52.7 | 41.5 |
| Fixed Asset Disposal | 14 | 14.9 | 13.1 | 8.1 | 5.4 |
| Government Grants/Other | 19.9 | 20.7 | 20.9 | 31.3 | 33.7 |
| Total | 61.2 | 64.4 | 64.4 | 92.1 | 80.6 |

46. The trend in capital investment and sources of funds is reflected in exhibit 4 which shows a consistent and significant decline in the funds received through the sale of fixed assets reflecting the decline in the sale of council houses and the ongoing drop in the property market. Government finance has increased mainly due to extra funds received as part of the concordat agreements and specific funding for various capital initiatives. The proportion funded by debt has increased slightly over the medium term.

Treasury management

47. The current economic climate means that interest rates on investments are low – the council received £2.2m in investment income this year compared to £3.8 million last year. Borrowing rates are also low,



but the council has a significant proportion of its debt at fixed rates and its average cost of external borrowing over the year was 4.89%. The council has taken advantage of the drop in interest rates to reschedule £60.3 million of debt. This has resulted in estimated annual interest savings of £1.3 million.

Pension funds

48. The council is responsible for the management and administration the Highland Council Pension Fund. The Pension Fund's investments are all managed externally. The value of the investment assets are illustrated in exhibit 5.

Exhibit 5

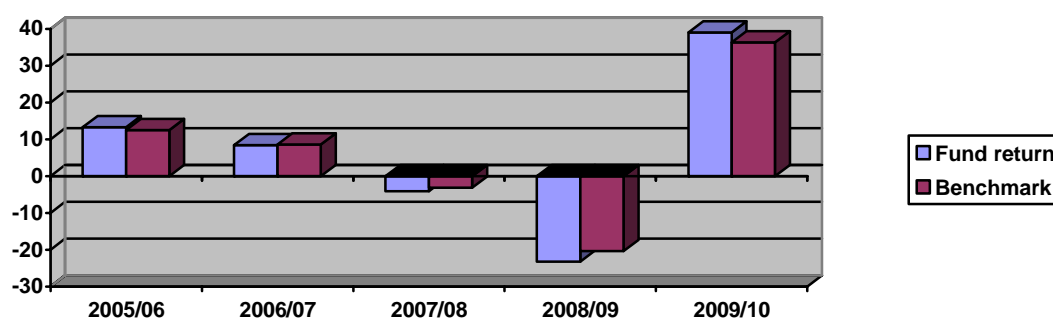
Pension Fund Investments

| | 31/03/07 | 31/03/08 | 31/03/09 | 31/03/10 |
|-----------------------------------|----------|----------|----------|----------|
| | £m | £m | £m | £m |
| The Highland Council Pension Fund | 825.4 | 801.7 | 627.7 | 886.9 |

49. By the end of 2009/10, indications were that the worst of the global financial and economic crisis had passed. Low interest rates supported a rally in markets. All major asset classes rose significantly and improved manufacturing, economic and consumer confidence data suggested the world economy was recovering, although concerns remain over the sustainability of the recovery. This has resulted in the total investment value of the pension fund increasing during 2009/10. However the dynamic nature of the current market does not lend itself to a reliable long term estimate of asset values.

Exhibit 6

The Highland Council Pension Fund – fund and benchmark return 2005/06 – 2009/10



50. Exhibit 6 shows the performance of the fund over the last five years. In 2009/10, the fund's return on investments was 39.0% compared to a benchmark of 36.3%, following slight underperformance in the preceding three years.

51. The long term impact of these fluctuations will be monitored on an ongoing basis by the council. The effect on the asset values of the pension fund and the future outlook for employers' contributions was



assessed at the triennial valuation of the pension fund as at April 2009. The result was an increase in employers' contribution for 2009/10 to 275% and for the years 2010/11 and 2011/12 to 290%.

52. In establishing contribution rates the actuary is required to have regard to the existing and prospective liabilities of the fund and to the desirability of maintaining as constant a rate as possible. Actuarial figures included in the accounts are based on data provided by the council during the year which is projected by the actuary using a number of assumptions and rates, for example, demographic assumptions, estimated investment returns, estimated liabilities, price and salary increases, to calculate the required contribution rates to meet future liabilities. We are not aware of the council undertaking any confirmation that the assumptions applied are appropriate to local circumstances. We would highlight that actuarial reports are only advisory and the council should confirm it is satisfied with the assumptions/rates used in these reports.

Key risk area 6

Outlook

Financial planning

53. The financial challenges facing the Scottish public sector are well documented, with public bodies facing deep and prolonged cuts in funding. In June 2010 the new UK Government set out an Emergency Budget, planning for a period of significant fiscal consolidation. It immediately implemented £6 billion of UK budget reductions. The Scottish Government agreed that it would defer its share of these 2010/11 cuts (estimated as £332 million) until 2011/12, and will have to implement these alongside continuing reductions in the Scottish budget.
54. There remains uncertainty about what the financial implications for the Highland Council will be. The UK government published its comprehensive spending review on 20 October and the Scottish Government will publish the results of its own review in late November. A key issue will be the extent to which some priority services, particularly health, may be protected from budget reductions. The settlement for local government is not expected to be finally known until January 2011. Negotiations are continuing and the Scottish Government is consulting on an end to the council tax freeze.
55. While recognising this uncertainty, all Scottish councils have been working with the Centre for Public Policy and the Regions (CPPR) to estimate the potential impact on the government funding they receive. This provides a basis for financial planning and understanding the level of savings that they will require to make to balance future budgets. Current projections are that a 14% real terms reduction will be experienced over 2011/14, heavily weighted toward 2011/12 reflecting the deferral of 2010/11 cuts. In cash terms this is equivalent to annual reductions in grant of 4%, 1.7% and 1.7% respectively.



56. The council has shown a good understanding of the financial challenges it faces and has made good early progress in addressing these. In setting its 2010/11 budget the council agreed to freeze its council tax, identifying in-year savings of £12 million to meet known spending pressures and planned growth. The most recent corporate budgetary control report anticipates an overspend of £1.9 million for the year, although the council is making continuing effort to curtail spending and ensure planned saving levels are delivered.
57. The council undertook extensive public consultation on a range of specific savings options in the first part of 2010/11 and continues to develop its plans. Its most recent assessment is that aggregate savings of £76 million will be required by 2012/13. This is equivalent to 12.5% of the net revenue budget for 2010/11. Savings of £23 million have already been agreed, with potential further savings of £42 million set out in the budget consultation document – leaving a ‘gap’ of at least £11 million still to be closed. Decisions on future budgets have yet to be made, and options remain under discussion amongst elected members and senior officers.
58. As well as addressing the anticipated reduction in funding, councils also have to manage a range of cost pressures and consider the extent to which they can fund new developments, priorities and responsibilities. In establishing its financial plans, the council has made an allowance for these factors. This means that savings targets need to be greater than would be required to simply offset the anticipated reduction of grant.
59. Moving forward it is important that the council has a clear understanding of what its spending priorities are, developing these in partnership with other public sector organisations where appropriate. The immediate challenge is to balance the 2011/12 budget – particularly given the extent to which cuts are frontloaded - but this needs to be achieved in a manner that best supports the council’s overall objectives and priorities. Real terms grant reductions are expected to continue until 2015/16 on current projections, and the council will continue to face tough decisions about spending and priorities.

Managing People

60. The significant reduction in funding in the years ahead will clearly have implications for the council’s workforce. Reducing spending on staff will need to be a key component of the way in which the council responds to the challenges it face. The speed at which spending reductions are required may mean that some pragmatic solutions need to be adopted in the short term. This will need to be balanced with the need to ensure that the council has the right people in the right place to take forward its strategic objectives and priorities, and that any up-front costs represent best value for money.
61. The council has established a framework for a co-ordinated, corporate approach to workforce planning and staff development through its workforce management plan. The plan covers the period



2008-11 and was initially approved by Resources Committee in August 2008. Progress against the plan's objectives was reported to the August 2009 Resources Committee and highlighted that 75% of the actions were either completed or progressing on target. The remaining 25% were delayed or had been reassigned new target dates, mainly as a result of the reallocation of resources to implement the new pay and grading structure. This approach provides a sound basis for the management of future staffing requirements.

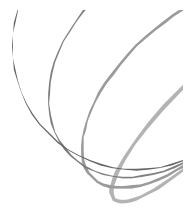
62. Increasing budget pressures and changes to service delivery have resulted in the vacancy management process being reviewed and revised. Improved governance and scrutiny arrangements in relation to recruitment decisions have been implemented. These include a recruitment freeze for all posts, with the exception of those now classified as 'exempt', tighter control on agency, temporary and fixed term contract workers, reviewing overtime, the use of supply and relief staff and tighter controls on acting up arrangements. A process is being introduced for redeploying staff where a potential redundancy situation is identified.
63. In August 2010 the principal local government employer negotiating body imposed a pay deal with non-teaching staff for the three years from 2010 – 2013. This has meant a rise of 0.65% in the first year and a pay freeze for the next two years. The council expects this to contribute three-year savings of almost £10 million.
64. In March 2010, the council conducted their fifth Employee Survey and the results were reported to the Resource Committee in June. A series of employee survey events were then held throughout Highland where members of the Senior Management Team reported the results to staff and asked for their views on how things could be improved. The results of the survey and staff views from the events meetings were used to develop the following three corporate improvement actions:
 - Communication and management change – to continue to increase the effectiveness of organisational communications with the emphasis being on face-to-face meetings between staff and managers and ensure all change and corporate improvement programmes provide appropriate and timely communication and training
 - Training and career development – to complete the roll out of personal development plans by March 2011 and provide appropriate training and development opportunities, including induction training for all staff
 - Pay and terms and conditions and working arrangements – to complete the job evaluation appeals by March 2011 and ensure effective support and communications are in place for all changes to working arrangements. Use ICT and new ways of working to make more effective use of resources.



65. These actions will be monitored through the council's new Performance Management System which is expected to be in place from 1 November 2010 as well as through the Chief Executive's Quarterly Performance Review.
66. Services have also been identifying service specific improvements and these are currently being reported to the relevant strategic committees. Progress on specific actions will be monitored and reported through the Service Quarterly Performance Reviews.

Asset Management

67. The pressure to get the best out of the council's asset base and the money that is invested in it is greater than ever in the current financial circumstances. Effective management of council assets is essential to help the council achieve its objectives and priorities, while getting best value from its reducing resources. The wider economic situation also has serious implications for the management of the council's property portfolio, making it difficult to capitalise on surplus assets or maximise rental income.
68. The council recognises the benefits of introducing a corporate approach to asset management and has included it as one of the nine projects in its corporate improvement programme (see paragraph 133 below). Its aim is to make more productive use of property assets, reduce the number of owned and leased buildings and reduce the cost of maintaining those buildings. In February 2009 a Project Board was formed to oversee the Council's *Asset Management Project*. To date 20 properties have been identified as having immediate potential for disposal to contribute towards the council's projected savings targets. The asset management team are also exploring opportunities for sharing and property rationalisation with other public sector bodies. Initial meetings have been held with NHS Highland and Highlands & Islands Enterprise to consider the potential for such opportunities across the Highlands. In 2009/10 the council generated capital receipts of £0.6 million from the sale of surplus general fund assets; the largest sale was the salmon factory at Dingwall Business Park. Capital receipts from the sale of council houses amounted to £4.1 million.
69. During 2009/10 the council asked CIPFA to undertake a high level review of its asset management structures and processes based on similar work carried out at other local authorities. The purpose of the Review was to get a 'position statement' of where the council was in its progress with implementation of corporate asset management and to give some indication of areas for potential improvement. CIPFA carried this review out against the backdrop of the latest Scottish guidance and more recent best practice guidance published by the Royal Institution of Chartered Surveyors (RICS).
70. The review found that the council's asset management approaches have significantly improved and highlighted some good examples of progress with deliverables particularly through the *Asset Management Project* which focuses on the opportunities for efficiencies from rationalising the estate. A number of areas of good practice were highlighted including:



- a new Capital Bidding process, which should improve the ways in which the council prioritises a reducing capital resource
- efficiencies delivered through corporate challenge of the estate
- working with other public sector bodies and other partners in the use of property assets on an ad-hoc basis
- reviewing office accommodation with a view to make efficiencies and improving the office estate.

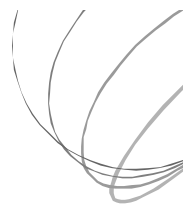
71. The review also highlighted a number of areas for improvement including:

- development of a coherent corporate vision or strategy for asset management
- further integration between financial planning and asset planning in both capital and revenue terms and consistency in the way maintenance budgets are managed and prioritised
- developing coordination at a strategic level with other public bodies and partners
- fully identifying the true cost of owning property.

72. In order to address the findings of Best Value 2 and the CIPFA review, a “Target Operating Model” has been developed and approved by Members to increase the pace of change in the council’s CIP work stream relating to asset management. The target operating model sets out a challenging programme aimed at addressing key areas for improvement, including:

- managing property as a corporate resource that supports service delivery
- linking property to the council's corporate plans, objectives and investment strategy
- developing the council's Property Strategy and aligning it with those of partners in order to improve collaborative working arrangements and explore shared accommodation opportunities
- managing the allocation of capital and revenue funds corporately and investing against objectives recorded in the councils corporate/service plans and commitments identified in the Single Outcome Agreement
- improving the coverage and quality of the council’s data on property condition, suitability, utilisation and running costs in order to identify the true cost of owning property, support strategic asset management planning and influence investment decisions.

73. The adoption of the target operating model represents significant change for the council, both in terms of culture and practice. It is therefore intended to implement the model in four phases under an ‘Action



Framework' incorporating 31 individual recommendations and sub-actions necessary to deliver the target operating model by December 2011.

Procurement

74. Improved procurement practices are an important source of savings. The Public Procurement Reform Programme aims to drive continuous improvement in public sector procurement and to deliver value for money and increased efficiency through improved structures, capability and processes. In 2009, the Scottish Government promoted the use of an annual procurement capability assessment (PCA) to assess procurement performance in all public sector bodies and as a basis for the sharing of best practice and continuous improvement. Results are summarised as non-conformance, conformance, improved performance and superior performance.
75. The Highland Council is a conforming council with an overall score of 35%. This was the fourth highest assessment achieved by a Scottish council, but there is scope to do more to deliver savings from this area. The areas of noticeably stronger performance included leadership and processes (42%) and people (45%). The weaker area of performance compared to the overall score, and the only area on non conformance, was in connection with contract and supplies (19%).
76. The council's current Procurement Strategy which was due to expire in 2011 has been delivered ahead of schedule. The Resources Committee has now approved a new Procurement Strategy for the period up to 2015. The new strategy is aligned to the Single Outcome Agreement and the council's Corporate Improvement Programme.

Key risk area 7

ICT

77. In early 2010, the council entered into a new 5-year support contract with Fujitsu Services for the provision of Information and Communications Technology (ICT). Progress on the implementation of the ICT Strategy and transformation programme which is implemented as part of the contract is reported to Resources Committee.

Housing information system (ICT controls)

78. The Housing Information System has been in use by the council since 1999. Day to day support of the system is carried out by a section of the Business Support team in Housing & Property Services who also develop and distribute management reports for the system. We carried out a review of the ICT controls in place for this system during 2009/10. These controls range from managing user access to assurances over the correct processing of the data on the system to provide accurate and complete management information.



79. Our overall conclusion is that the system is well supported by a team of knowledgeable Business Support staff. There are, however, some risks associated with access to the system and the accounting for the transactions transferred to the council's financial management system (Oracle Financials). We reported these risks to the council during the year and work is currently underway to complete the actions needed to mitigate the risks identified.

Electronic personnel system

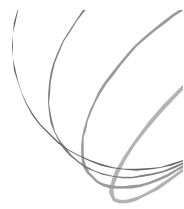
80. The council implemented the ResourceLink system for payroll processing in 2003. Since then, various projects have been started to implement the personnel management elements of the system. These projects have failed to deliver the expected functions and the system remained a payroll processing application first and foremost.
81. In 2007/08, we identified a number of risks concerning the system, ranging from data protection risk to user access management risk. The Human Resources project of the Corporate Improvement Programme, includes within its remit the delivery of a fully integrated personnel and payroll application. Together with the supplier of the ResourceLink system and the ICT service provider, a new project was scoped which is tasked with delivering an updated version of the payroll and personnel system. This includes a newly created database holding both existing and newly collected data, and a new user interface which provides users a fresh and flexible tool to manage staff information. The risks in our 2007/08 report have been taken on board by the project team and we will be monitoring the progress on this area in the coming year.

Data sharing partnership

82. The council is the lead member of the Highland Data Sharing partnership. The purpose of the partnership is to facilitate data sharing between local authorities and police boards in a local health board area.
83. Developments are under way, both locally and at a national level, to implement electronic data sharing solutions between Social Work, Education, Health and Police systems. A central hub, the Multi Agency Store managed by NHS National Services, will be the linch-pin to accomplish this.
84. Changing from a paper based data sharing arrangement to a full electronic process will require updating of the procedures in place for practitioners. In particular, data owners (which can be either of the data sharing partners) should give consideration to removal of shared information where sharing is no longer appropriate.

Shared services

85. Shared services is one of the ways open to local authorities for reducing spending and sustaining essential public services. The council already has in place a number of joint working and shared service arrangements with other councils and public sector partners including Pathfinder (delivering



broadband services to remote areas) and the Business Gateway. In August 2010 Members agreed that Highland Council should engage with councils and other public sector partners within the Highlands & Islands and North East of Scotland to identify further opportunities for developing shared services. Officers will shortly be reporting back to Members on a number of proposals for their consideration.

Other significant financial issues

86. Eleven new schools were built under the council's Public Private Partnership (PPP) programme in recent years. The rates costs associated with the project were underestimated and this has resulted in the council now being liable for almost £10m more than expected in rates over the next 27 years. The council have engaged an adviser to review this aspect of the project and will report back to members on the result of this review including any basis for legal proceedings.



Governance and accountability

Introduction

87. Corporate governance is about direction and control of organisations. Councils are large complex organisations and so good governance is critically important. The council has assessed its own arrangements against the CIPFA/SOLACE guidance: *Delivering Good Governance in Local Government*. The assessment has identified a number of areas for improvement and the council is working to address these.

Scrutiny

88. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account and support the modernisation agenda. The Audit & Scrutiny Committee's remit includes overseeing risk management, dealing with matters referred to the committee by the council for scrutiny purposes and considering the plans and work of internal and external audit. Last year we reported that the committee is well attended and in overall terms its remit and working practices are in accordance with the good practice principles. This remains the case this year and we are pleased to note that practices have been further improved through the recent introduction of a process for ensuring that local government national reports published by Audit Scotland will now be considered by the relevant service committee and actions arising will be scrutinised by the Audit & Scrutiny Committee.

89. The scrutiny focus of the committee this year has been in relation to the processes and outcomes relating to efficiency savings and budget reductions. This study is nearing completion and will shortly be discussed by the Members responsible for its preparation prior to being presented to the wider Audit & Scrutiny Committee.

Roles and relationships

90. The Accounts Commission recommends that councils give priority to the continuous professional development of its Members. The council has continued to develop and offer a comprehensive range of training to Members since 2007. Two thirds of all Members now have personal development plans and work is ongoing in developing plans with the remaining Members. The challenge for officers is to provide training appropriate to Members' varying training needs within the current financial constraints. Some Members have already requested and been given access to the staff e-learning database and plans are in place to update the learning offered and encourage other members to use this resource.



Partnership Working

91. The council and its partners promote a strong ethos and commitment for working together for the benefit of the Highland area. Community planning structures are well developed at strategic and local levels with appropriate political, official and community representation on each. The community plan is the keystone of the council's strategic planning framework and the single outcome agreement (SOA) is supported by all partners. The SOA is viewed as a stepping stone to deliver the priorities set out in the community plan.
92. Effective partnership working has resulted in consistent progress in delivering complex cross cutting strategic local outcomes with partners and good service performance overall. The Best Value 2 (BV2) audit found that there is a need to strengthen the communication links between the strategic and local partnerships and to complete the review of partnership arrangements to deliver the SOA. This has been incorporated into the council's BV2 action plan.
93. Our Assurance and Improvement Plan issued in June 2010 highlighted that partnership working is particularly strong and effective in relation to child protection services but there is scope for improvement to develop partnership working further in adult services and community learning and development. Progress on this area will be monitored through the new shared risk assessment, a collaborative process adopted by scrutiny bodies.

Community engagement

94. The Highland Council and its community planning partners have adopted the national standards for community engagement and remain consistently strong in this area. The council works with local communities in a number of ways. As well as ward forums there are special interest forums such as those for community care users and carers, the environment, local access, the economy and young people. Engagement on issues for young people is particularly strong including 'Highland Youth Voice', a paid Youth Convener post, active pupil and parent councils and senior pupil interactive consultations. The council also works with community councils and representatives of equalities groups. Capacity building for engagement is supported through tenant participation approaches and through the EU Leader programme in rural communities. The council has added to its range of engagement approaches by setting up a citizens' panel.

Public performance reporting

95. The council continues to engage with the local community and encourages public involvement in how resources are allocated and spent at a local level. The Ward Forum arrangements are a key part of this process. To further enhance engagement and to contribute to the difficult budgetary decisions that will have to be made within the current financial climate the council encouraged the public to put forward suggestions and comments on services and savings through an internet blog. The suggestions/comments are being used to inform budget decisions.



96. Highland Council produces an annual performance report which is published on the council's website and circulated as an insert in the local press. In addition each household receives a report on performance outcomes alongside their council tax bills.

Governance and internal control

97. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data which would result in a material misstatement in the accounts.
98. Internal audit plays a key role in governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control systems. We reviewed the effectiveness of the internal audit function and are satisfied that internal audit meets appropriate professional standards.
99. During our audit of the annual accounts we confirmed that disclosures made in the annual governance statement and the process for obtaining assurances on systems of control are satisfactory. The council have recognised the need to further improve and enhance their corporate governance framework by concluding on the outstanding issues from 2009/10 which includes completing a review of the Whistle Blowing Policy, delivering Community Planning Briefings for Members and completing the review of the Employee Code of Conduct. Key areas of work in 2010/11 also include delivery of the Corporate Improvement Programme (see paragraphs 134 to 136) to achieve efficiencies and service improvement, delivering the improvement plan from the Best Value 2 audit and rolling out the public sector improvement framework.

Caithness Heat and Power

100. In our report on the 2008/09 audit we highlighted that a range of governance, financial and technical problems had been experienced in relation to a district heating project initiated by the council and progressed by Caithness Heat and Power (CHaP), a company established by the council to deliver the project. The Head of Internal Audit and Risk Management reviewed the governance of the project from its inception through to the time at which the council took control of the company. The result of this review was reported at a special council meeting in January 2010.
101. In June 2010 the controller of audit reported to the Accounts Commission on 'the serious and wide ranging deficiencies in the council's dealings with CHaP and to highlight matters for councils to consider in future when approving projects of this nature'. The report highlighted fundamental failings in project initiation, and in risk management, significant weaknesses in governance of the project and that the council had failed to comply with 'following the public pound' principles. Having considered the report, the Commission directed the controller of audit to carry out further investigations. Once this



audit work has been completed the controller will produce a further statutory report, which will be considered by the Commission in due course.

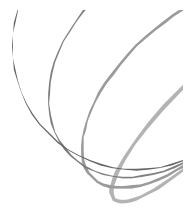
102. The council has responded to the serious concerns raised in these reports and officers are implementing a remedial action plan. Good progress has been made in implementing planned actions, with most of these now concluded. Key actions include:

- Revision of policies & procedures – standing orders, scheme of delegation, financial regulations, risk management strategy and supporting guidance have been reviewed and revised. New requirements include a senior officer sponsor for each council company, documentation of individual's responsibilities/ roles in relation to the monitoring of council companies, introduction of formal gateway reviews for all innovative projects and strengthened requirements for business cases, option appraisals and risk assessments for all capital projects. The council has also introduced a requirement to maintain specific risk registers for all major projects.
- Clarifying the remit of the Joint Ventures Board as the mechanism for oversight by senior officers of projects of this nature.
- Introducing an annual process for Directors and Corporate Managers to provide assurance on the appropriateness of arrangements to govern projects and companies within each service. This is underpinned by a review across all other projects of the extent to which the risks highlighted in the CHaP project are being managed.
- Member and Officer training – A comprehensive programme of training for all council managers and elected members on the issues experienced in the CHaP project is nearing completion. Reminder letters were also issued to all managers on their responsibilities in relation to relevant procedural requirements and guidance.
- Considering legal recovery action where appropriate – a review has been undertaken of possibility of any legal redress and the results of this will be reported to members shortly.
- Considering disciplinary action where appropriate – an independent review was commissioned and the report from this considered. The action recommended is to be taken.

103. The range of activity undertaken has strengthened internal control over projects of this nature and raised awareness, improving overall governance arrangements. We will continue to keep the effectiveness of revised arrangements under review as part of our continuing audit work.

Prevention and detection of fraud and irregularities

104. At the corporate level, the council has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. These arrangements include: an anti-fraud and



corruption policy and response plan; a whistle blowing policy; codes of conduct for elected members and staff; and defined remits for relevant regulatory committees.

105. The Standards Commission found that three elected members, who had their conduct referred to it, could not reasonably be found to have breached their code of conduct.

NFI in Scotland

106. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. The NFI has generated significant outcomes for Scottish public bodies (£21 million during the 2008/09 NFI cycle and £58 million cumulatively up to end March 2010). If fraud or overpayments are not identified in a body, and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.

107. The most recent data matching exercise collected data from participants in October 2008 and the national findings were published by Audit Scotland in May 2010. Last year we commented on the delays in investigating NFI matches in a number of areas within the council. The majority of the work has however now been completed and the position to date has highlighted ten fraud cases and 151 errors together totalling £87,425. The council are seeking recovery of £81,526 from 124 data matches.

108. Despite the delay in following-up the high risk matches (mainly due to pay modernisation and the workload arising from this) the council has now substantially completed this work. We are satisfied that the council's arrangements for investigating the data matches are now well established.

109. Instructions for the 2010/11 NFI exercise were issued by Audit Scotland in June 2010 and participants should be preparing to provide the requested data by early October. The national report published in May 2010 included a self-appraisal checklist that all participants were recommended to use prior to NFI 2010/11. The council have used this checklist and identified areas where they can further improve the planning and follow-up processes for dealing with NFI matches.

Housing Benefit

110. Audit Scotland took over the inspection responsibilities of the Benefit Fraud Inspectorate in Scotland in April 2008. Our specialist team are carrying out a programme of risk assessments of benefits services in all councils over a two year period.

111. The risks to The Highland Council's benefits service were initially assessed in June 2008. At that time the benefits service had recently restructured and had implemented an electronic workflow management system. Our 2008 risk assessment identified a number of risks to continuous

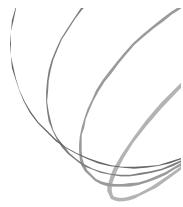


improvement and the council prepared an action plan to address the issues raised. In May 2010 we carried out a further assessment and assessed the council's progress in implementing the earlier action plan.

112. We found significant action had been taken in the intervening period to address the risks identified. Work done by internal audit and the Department for Work and Pension's Performance Development Team had confirmed that the benefits service had focused on both the speed and accuracy of processing benefit claims through its period of extensive change. The main risk from the 2010 assessment was in relation to benefits overpayments which are increasing year on year whilst the amount being recovered is decreasing. The benefits service plans to introduce an IT system to help improve recovery levels and produce better performance reports.

Outlook

113. Governance and accountability issues are likely to be prominent as the council's operating environment and economic position becomes more difficult and the development of working in partnership with others increases.
114. We recognise the challenges posed by the SOAs. The Accounts Commission acknowledges that SOAs are still at an early stage of development. At this stage in the evolution of this new approach to planning, we are interested in the processes rather than just the outcomes. Partnership working is critical to the council's success and this has been recognised by the council who have included its partners from the beginning of the SOA process. We are developing our approach to the audit of partnerships and will increasingly be looking at the contribution of partners as well as the council's own contribution to the delivery of outcomes.



Performance management and improvement

Introduction

115. We believe that an effective council has a clear and ambitious vision for what it wants to achieve for its locality and communities to secure high quality services and effective outcomes for local people. The vision is backed up by clear plans and strategies to secure improvement, with resources aligned to support their delivery. An effective council has a performance management culture which is embedded throughout the organisation. The assurance and improvement plan concluded that the council did not have any significant weaknesses in this area. This assessment was informed by the outcome of the Best Value 2 report (see below) and the resultant improvement plan. This section provides a high level overview of performance management in Highland Council.

Best value 2

116. Best value 2 (BV2) is the next phase of Best Value audit. Its approach has moved on significantly from the first phase, which provided a baseline for how Scottish councils are performing. BV2 audits are more proportionate and risk based being founded on a shared risk assessment process involving other inspectorates. They are more focused on impact and outcomes and designed to provide a more rounded view of partnership working in a local area, and the difference it is making. BV2 forms an important part of the wider scrutiny arrangements for councils in Scotland.

117. Highland Council was chosen as one of five 'pathfinder' sites where various aspects of its proposed approach to BV2 were tested and the results of the work carried out was used to provide judgements on the council's:

- pace of change and direction of travel
- prospects for delivering future improvements.

118. The BV2 review concluded that the council is demonstrating that it is improving well and is well placed to deliver future improvements. Areas of strength and good practice were highlighted in terms of effective partnership working and community engagement.

119. Eight areas for improvement were identified and these focussed on:

- co-ordinating and prioritising the range of performance improvement activities
- demonstrating value for money more consistently and openly



- improve performance in parts of some services, for example in adult social work and the management of council housing rent arrears
- improved management and political arrangements to progress the equalities agenda further
- concluding improvements to staffing arrangements
- increasing the pace of change in two Corporate Improvement Programme work streams (customer engagement and asset management)
- strengthening the communication links between the strategic and local partnerships and complete the review of partnership arrangements
- taking forward the improvement actions for the Caithness Heat and Power project.

120. A BV Improvement Plan to address the areas has been developed and was agreed by the council in June 2010. Across the seven areas for improvement in the plan there are 28 separate actions. Progress is currently monitored through the Chief Executive's Quarterly Performance Review (QPR). As at end September 2010, six actions were completed, 19 were progressing well and on target and three were slightly delayed with new dates agreed for completion in 2009-10.

Vision and Strategic Direction

121. The council has a clear vision for the Highlands which is shared by partners and clearly articulated in the SOA and the council's strategic plans. There is strong, clear and consistent strategic leadership which identifies the key priorities for the area. Political and management arrangements provide clear mechanisms and arrangements for local priorities to feed into corporate priorities and for those priorities to translate to local activity.
122. The council has a set of key documents that reflects its aims and objectives, such as the community plan, single outcome agreement (SOA) and corporate plan. These documents cascade down into service plans. The community plan is at the centre of the council's planning framework.

Performance management

123. The council's performance management framework is sound and is integrated with service planning and delivery. A comprehensive and robust approach to reporting service performance is in place through the Quarterly Performance Reviews which hold Directors and services to account.
124. The council's performance management framework is continuing to develop and the acquisition of an electronic system for recording and reporting of performance which is due to be in place November 2010 should further improve the arrangements in this area.



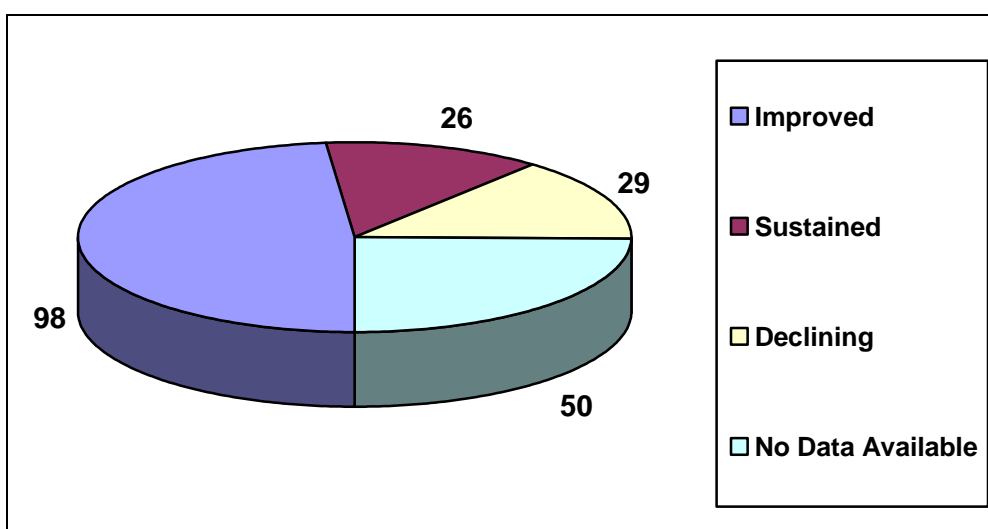
125. The council has a good awareness of the areas where it needs to improve and the pace of improvement has increased since a change in the political leadership and senior management team in 2007. However the recent BV2 report comments that its improvement agenda could be more effective and secure increased impact if its approach was better coordinated and prioritised.
126. The council and its partners are responding to the need to continually improve their approach and have established an SOA Performance Management Group of officers from across the partnership who are responsible for coordinating the performance information. There have been delays in getting the new electronic performance and risk management system in place. A revised implementation date of November 2010 has been set. The new system will be used by both the council and its partners.

Overview of performance in 2009/10

127. Exhibit 6 summarises progress in 2009/10 against the 15 national outcome targets within the SOA where 203 separate indicators are identified. Data is unavailable for 50 of these indicators. Where data has been reported 81% of indicators show an improvement.

Exhibit 6

Achievement of Highland Council's targets 2009/10



128. During the year there have been some notable areas of improvement within each of the national outcome areas, for example the percentage of non-householder planning applications dealt with within two months has increased to 59.9% from a baseline of 47.4% in 2006/7 (NO1) and the percentage of residents who rate their community positively has reached 96.5%, an increase of 4.5% from the previous year (NO10).



129. The areas where performance is declining presents the greatest challenge to the council and its partners. The most notable areas of decline relate to primary school achievements in reading, writing and maths (NO4 and NO5), staff sickness (both at the council and within its partner health body) (NO15), and a decline in the business start-up rate (NO2), through the impact of the recession.

Statutory performance indicators (SPI)

130. The Accounts Commission has significantly reduced the range of statutory performance information that all councils must report. This reflects the developing scrutiny arrangements, single outcome agreements and the development of the Best Value audit regime. The council's SPI information is published on its website and incorporated in the Statement of Accounts. In addition to the 25 specified SPIs for 2009/10 the council is also required to publish local indicators which:

- demonstrate the council is securing best value
- assist stakeholders and other interested parties to compare performance both over time and between councils as appropriate.

131. The council has identified 47 cost based local indicators which covers a wide range of activities including the average cost per kilowatt hour of fuel, management and maintenance costs per council house per annum and the cost of museums per visit/usage. Data on these indicators has been collected for 2009/10 as a baseline for reporting trends and comparisons in subsequent years. Within the council, key local indicators and SPIs are included within each service's Quality Performance Reviews.

132. Each year we review the work carried out by Internal Audit on the reliability of the council's arrangements to prepare SPIs. There were no concerns raised about the reliability of these arrangements nor any concerns on specific indicators in 2009/10.

Equality and Diversity

133. The Highland Council is aiming to ensure that all of its activities comply with best practice in the field of equality and diversity and our BV2 work confirmed that the council had implemented sound processes and structures to progress the equalities agenda. A draft single equality scheme has been developed in preparation for a new integrated equality duty on the public sector in April 2011. Equality issues are explicit in service plans and policies are monitored and screened for relevance on a quarterly basis. The management team receive regular performance and feedback on equalities. However, it is recognised that equality and diversity needs to be more embedded as this is not routinely considered as a priority, nor actively championed by members as effectively as sustainable development. The Equalities Officer Working Group is focusing on improving the council's performance on equality issues.



Change management and efficiency

134. The council's Corporate Improvement Programme (CIP) seeks to coordinate and prioritise continuous improvement activities across the council. The CIP was set up in the latter part of 2008, building on the experiences of the Business Improvement Team's work as well as incorporating the results of the Diagnostic Pathway reviews carried out. The Programme and its constituent projects are tasked with delivering wide-ranging, sustainable efficiencies across the council's services for the financial years 2010/11 to 2012/13. Initially, eight projects were identified and in the course of 2009 a ninth project was added:

- Information management
- Procurement
- Asset management
- Mobile and flexible working
- Customer Engagement & Assessment
- Human resources
- Transport
- Business Support
- Income Generation – added in 2009.

135. We carried out a review of the management of the CIP and found that the Programme is well managed, with clear lines of accountability and provides the council with a robust framework for delivering change and efficiencies. As with any Programme or project, the CIP is affected at times by scarcity of resources (for example a lack of suitable staffing of project teams or conflicting priorities with other business deliverables) but such issues are identified timeously and managed.

136. Recently, a new monitoring process was put in place to monitor the expected (target) financial savings that the CIP is tasked with delivering. Savings are now reported consistently across the CIP, comparing savings targets set at the start of each project with the actual savings identified in the budget. Delivery against these savings will be monitored through the council's regular revenue outturn monitoring process, carried out by the Resources Committee and reported through the council's financial statements.

Key risk area 8

Risk Management

137. Risk is the threat that an event, action or inaction will adversely affect an organisation's ability to achieve its objectives. Risk management is the process of identifying, evaluating and controlling risks. Risk management supports decision making and contributes to performance.



138. The council generally has a sound approach to managing risk. The Audit and Scrutiny Committee receives reports on corporate risks twice a year. An inclusive approach to risk management is promoted through the risk management group. Individual services maintain their own registers and risk updates are provided through the Quarterly Performance Review and reported to the relevant committees. The introduction of the electronic performance and risk management system in November 2010 will improve the analysis and speed of retrieval of key performance data and risks. Improvements made in response to concerns about the CHaP project will strengthen risk management of individual projects.

Outlook

139. Effectively managing the council's performance will remain a key challenge as council budgets are reduced. It is unlikely that the council will be able to maintain or improve current performance levels across all of its existing services, and it will need to make difficult decisions about what areas are seen as priorities and in which areas service levels will need to be reduced. Crucially, the council will need to use its performance information to understand and manage the effect of spending decisions.

140. The long term and complex nature of many of the outcome targets established through the SOA process also poses many challenges for performance management. In responding to short term and more structural funding difficulties, the council and its partners will need to be clear how they will continue to contribute to shared objectives and priorities – maximising impact from the funds available.



Appendix A

External audit reports and audit opinions issued for 2009/10

| Title of report or opinion | Date of issue | Date presented to Audit Committee |
|--|----------------------|--|
| Annual Audit Plan | 26/2/10 | 15/4/10 |
| Review of Housing Information Systems | 10/6/10 | 19/8/10 |
| Shared Risk Assessment/ Assurance and Improvement Plan | 15/6/10 | 19/8/10 |
| Review of Corporate Improvement Programme | 15/6/10 | 19/8/10 |
| Internal controls assurance report | 28/6/10 | 19/8/10 |



Appendix B: Action Plan

Key Risk Areas and Planned Management Action

| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|--------------|---------------|---|---|---------------------|--------------|
| 1. | 14 & 15 | <p>Explanatory Foreword</p> <p>The Foreword would be improved through clearer explanation of how the figures in the accounts relate back to the budget set for the year. It also provides a valuable opportunity to explain the implications of reduced funding.</p> <p>Risk: The accounts are not transparent and therefore difficult for readers to follow.</p> | <p>There is a statement provided within the explanatory foreword which presents performance against budget in the same way as the monthly monitoring reports. Complexity will always be an issue when budgets are increased or decreased due to use or not of earmarked funds.</p> <p>Agree to review the position but with no commitment to change the current presentation.</p> | Head of Accounting | 30 June 2011 |
| 2. | 17 - 19 | <p>Accounting procedures</p> <p>Final accounts procedures need to be improved to address the main accounting issues identified in this year's audit.</p> <p>Risk: Potential misstatement of the financial position of the council.</p> | <p>The issues raised this year whilst affecting the presentation of the figures had been accepted in previous audits and in no way resulted in a misstatement of the Councils financial position</p> <p>Agreed to review the treatment of recharges and specific grant funding.</p> | Head of Accounting | 30 June 2011 |
| 3. | 22. | <p>Group Accounts</p> <p>The council should keep the need to include CHaP within the group accounts under review.</p> <p>Risk: The omission of CHaP from the group accounts gives rise to material misstatement of the group financial performance and position.</p> | Agreed. | Head of Accounting | Ongoing |



| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|--------------|---------------|---|--|---------------------------|-------------------------|
| 4. | 28. | <p>IFRS</p> <p>The introduction of IFRS is a significant change to local government accounting and will need to be effectively managed.</p> <p><i>Risk: Insufficient attention is paid to the introduction of IFRS, meaning that the council is unable to prepare compliant accounts in time.</i></p> | The Accountancy Team will continue to manage the move to IFRS effectively. | Head of Accounting | Ongoing to 30 June 2011 |
| 5. | 29. | <p>Pension Funds Audit</p> <p>The Scottish Government may decide, following consultation to introduce a separate audit requirement for the Pension Fund from 2010/11.</p> <p><i>Risk: The arrangements to support this change may not be in place.</i></p> | Separate Annual Reports and Accounts for the Pension Fund are already prepared in addition to the Pension Fund Accounts included as part of the Highland Council's Annual Accounts. This should be sufficient for the needs of a separate audit requirement for the Pension Fund. | Head of Corporate Finance | 30 June 2011 |
| 6. | 52 | <p>Actuarial assumptions</p> <p>The council does not consider and confirm whether actuarial assumptions are appropriate to local circumstances.</p> <p><i>Risk: Future contribution rate are not based on the local experience and circumstances of the council.</i></p> | <p>Actuaries request and are provided fund specific information on which to base their FRS 17 estimates.</p> <p>The Pensions team in the Highland Council will in future conduct a high level check of the FRS 17 reports for assurance where possible that the reports are broadly consistent with the fund specific data provided.</p> <p>However it will not be possible to conduct a detailed review all of the actuarial assumptions and consequent outcomes.</p> | Head of Accounting | 31 May 2011 |



| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|--------------|---------------|---|--|--|--|
| 7. | 76. | <p>Procurement</p> <p>While the council was assessed a 'conforming' in the annual procurement capability assessment, there is scope to do more to deliver savings from this area.</p> <p>Risk: Procurement approaches do not deliver best value for money.</p> | Ensure the delivery of the Procurement Strategy to 2014/15. | Depute Chief Executive / Director of Finance | 31 March 2015 |
| 8. | 136. | <p>Delivering savings</p> <p>Moving forward it is important that the council has a clear understanding of what its spending priorities are, developing these in partnership with other public sector organisations where appropriate.</p> <p>Effectively managing performance will remain a key challenge as budgets are reduced. Crucially, the council will need to use its performance information to understand and manage the effect of spending decisions.</p> <p>A new monitoring process has been implemented to monitor delivery of planned savings. The value of savings required is extremely challenging.</p> <p>Risks: The council is unable to meet expenditure commitments from available income.</p> <p>Available funding is not effectively directed to priorities.</p> | The Council has initiated a significant public budget consultation exercise to gauge public views on ways to address budget challenges and to assist in service prioritisation. In addition, the Council has in place robust budgeting procedures including rolling scrutiny meetings with Services to ensure suitable steps are being taken to identify and take forward options to address savings requirements. The Council is promoting a strong efficiency agenda across Services, has a Corporate Improvement Programme running with nine initiatives to generate operational savings and is actively participating in the Government's Shared Services agenda across a number of initiatives. | Depute Chief Executive & Director of Finance / Head of Corporate Finance | Budget for 2011/12 to be agreed by Council in Feb 2011 |