Moray Council

DRAFT 2017/18 Annual Audit Report

AUDIT SCOTLAND

Prepared for the Members of Moray Council and the Controller of Audit

26 September 2018

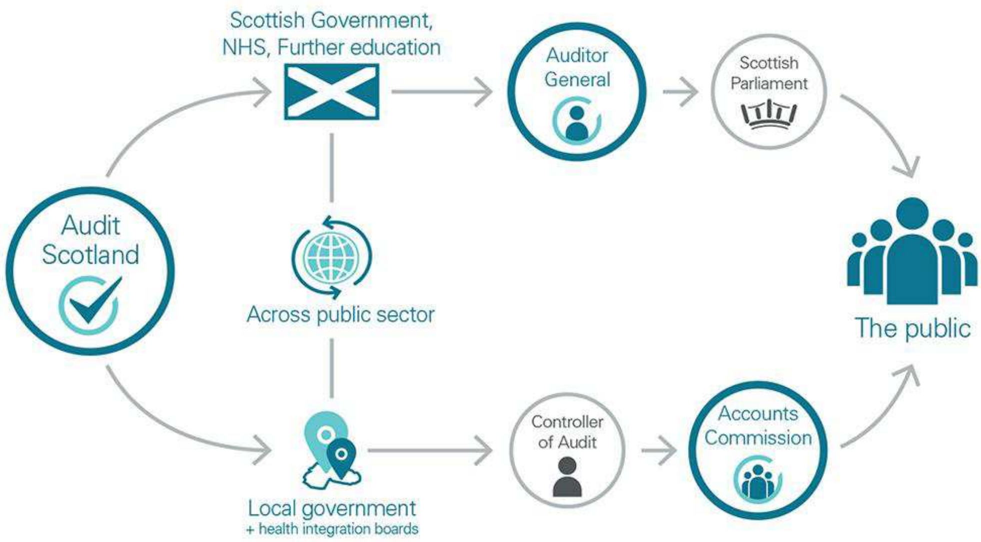
Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- the Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance

- the Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Key messages

2017/18 annual accounts

1 Our audit opinions were all unqualified.

2 There were two material adjustments to the unaudited accounts. The pension liability and pension reserve has been reduced by £18 million and investments of £11 million have been reclassified as cash equivalents.

3 20 of the Council's 31 charitable trusts have not disbursed any funds in the last five years and it is unclear how they meet the public benefit requirement.

Financial management & financial sustainability

4 The 2017/18 budget included £7.9 million of uncommitted reserves and savings of £3.4 million. Savings were delivered, and the actual use of reserves was lower than planned at £4.1 million.

5 The Council has a good track record of delivering savings, but its immediate financial position is extremely challenging. The Council has relied on general fund reserves to balance its budget for the last three years and this can't continue indefinitely.

6 The Council reports a small underspend against its 2018/19 budget to date, but there are significant budget pressures. Medium term financial pressures are also significant, and the Council has yet to agree a transformation programme and medium and long term financial plans to deliver financial sustainability.

Governance and transparency

7 The Council has a clear vision for the people of Moray, but corporate plan outcome measures and supporting plans are still being developed.

8 Cross-party and cross-member working will be required to achieve a sustainable financial position for the Council and management capacity is required to support transformational change.

9 The Council has achieved Cyber Essentials accreditation, but business continuity planning is out of date or non-existent.

Value for money

10 Revised performance management and reporting arrangements are being developed and there has been a gradual decline in the Council's performance relative to other councils since 2012/13.

11 Education Scotland has significant concerns in Education and Children's Services including leadership, outcomes for children, weak inspection outcomes and recruitment and stability.

Introduction

1. This report summarises the findings arising from the 2017/18 audit of Moray Council (the Council).

2. The scope of the audit was set out in our Annual Audit Plan presented to the March 2018 meeting of the Audit & Scrutiny Committee. This report comprises the findings from:

- an audit of the annual accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the *Code of Audit Practice 2016* as illustrated in Exhibit 1.

Exhibit 1
Audit dimensions

Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2017/18 have been:

- an audit of the key controls operating within the main financial systems and review of governance arrangements
- audit work covering the arrangements for securing Best Value relating to financial management, financial sustainability and vision and leadership
- an audit of the 2017/18 annual accounts of the Council and the 31 section 106 charities it administers, including the issue of independent auditor's reports setting out our opinions.

4. The Council has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices.

5. The Council is also responsible for compliance with legislation, and putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.

6. Our responsibilities as independent auditor appointed by the Accounts Commission are established by the Local Government in Scotland Act 1973, the *Code of Audit Practice (2016)* and supplementary guidance, and International Standards on Auditing in the United Kingdom (UK).

7. As public sector auditors we give independent opinions on the annual accounts. We also review and provide conclusions on the effectiveness of the Council's performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability. We also report on the Council's best value arrangements and in doing this we aim to support improvement and accountability.

8. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016*.

9. This report raises matters from the audit of the annual accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

10. Our annual audit report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.

11. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and the 2017/18 audit fee of £231,050, as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

Adding value through the audit

12. Our aim is to add value to Moray Council by providing insight into, and offering foresight on, financial sustainability, risk and performance by identifying areas of improvement and recommending and encouraging good practice. In so doing, we aim to help the council promote improved standards of governance, better management and decision making and more effective use of resources.

13. This report is addressed to both the Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk.

14. We would like to thank all management and staff who have been involved in our work for their co-operation and assistance during the audit.

Part 1

Audit of 2017/18 annual accounts

Main judgements

Our audit opinions were all unqualified.

There were two material adjustments to the unaudited accounts. The pension liability and pension reserve has been reduced by £18.1 million and investments of £11 million have been reclassified as cash and cash equivalents.

20 of the 31 charitable trusts have not disbursed any funds in the last five years. It is unclear how they meet the public benefit requirement.

One property incorrectly classified as an investment has been identified. The asset is not held for either its service potential or for investment returns. The Council will review its treatment during 2018/19.

Audit opinions on the annual accounts

15. The annual accounts for the Council and its group for the year ended 31 March 2018 were approved by the Council on 26 September 2018. We reported, within our independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- the audited part of the remuneration report, management commentary and the annual governance statement were all consistent with the financial statements and properly prepared in accordance with the guidance.

The Council and its group annual accounts are the principal means of accounting for the stewardship of resources and performance in the use of resources.

16. Additionally, we have nothing to report in respect of misstatements in the other information presented with the financial statements, the adequacy of accounting records or the information and explanations we received.

Audit opinions on section 106 charities

17. A separate independent auditor's report is required for The Moray Council – Connected Charity Trust Funds' annual accounts as Moray Council elected members are sole trustees of the 31 charitable trusts. We received the charities' accounts in advance of the agreed timetable and after completing our audit we reported in our independent auditor's report that:

- the financial statements give a true and fair view of the section 106 connected charities' financial position and are properly prepared in accordance with charities' legislation
- the trustees' annual report is consistent with the financial statements and prepared in accordance with proper accounting practices.

Submission of the Council and its group annual accounts for audit

18. We received the unaudited annual accounts on 28 June 2018 in line with the audit timetable set out in our 2017/18 Annual Audit Plan. The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team during the audit.

Risk of material misstatement

19. Appendix 2 provides a description of areas we assessed as being at risk of material misstatement at the planning stage, how we addressed them and our conclusions thereon. These risks influenced our overall audit strategy, the allocation of staff resources to the audit and how the efforts of the audit team were directed.

Materiality

20. Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and was reported in our Annual Audit Plan. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

21. On receipt of the annual accounts we reviewed our planning materiality calculations. Minor changes were made to the materiality levels we reported in our annual audit plan as reported in Exhibit 2. This had no impact on our audit approach.

Exhibit 2
Materiality values

Materiality level	Amount
Overall materiality	£3.7 million
Performance materiality	£1.5 million
Reporting threshold	£0.1 million

Source: Audit Scotland

22. We also set separate materiality levels for the section 106 charities (Exhibit 3):

Exhibit 3
Materiality values

Materiality level	Amount
Overall materiality	£9,500
Performance materiality	£5,700
Reporting threshold	£500

Source: Audit Scotland

Significant findings from the audit in accordance with ISA 260

23. International Standard on Auditing 260 (UK) requires us to communicate significant findings from the audit to those charged with governance. These are summarised in Exhibit 4. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 has been included.

24. The findings include our views about significant qualitative aspects of the Council's accounting practices including:

- Accounting policies
- Accounting estimates and judgements
- Significant financial statements disclosures
- Timing of transactions and the period in which they are recorded
- The impact on the financial statements of any uncertainties
- The effect of any unusual transactions on the financial statements
- Misstatements in the annual accounts
- Disagreement over any accounting treatment or financial statements disclosure

Exhibit 4
Significant findings from the audit of the financial statements

Finding	Resolution
1. Pension Scheme Valuation The Council accounts for its share of North East Scotland Pension Fund in accordance with International Accounting Standard 19 Employee Benefits (IAS19). This relies on valuations of pension fund assets and liabilities by the scheme's actuary (Mercers). The actuary produced the IAS19 report using estimated data for the final part of the year. Asset returns estimated by the actuary for the final part of the year were significantly lower than actual returns. This resulted in pension fund assets reported in the Council's balance sheet being understated by £16.5 million. In reviewing the Council's asset value, the actuaries also identified an error in the original IAS19 report issued to the Council. This resulted in a decrease in the Council's liability of £1.6 million. The asset valuation issue also impacts on the Grampian Valuation Joint Board (GVJB) which is included in the Council's group accounts. A revised IAS19 report was also obtained for GVJB.	The amendments resulted in a decrease in the pensions net liability and pension reserve of £18.1 million. The Council's share of the decrease in the GVJB's pension liability is £0.2 million. There is no impact on the general fund. **This has been corrected in the audited financial statements**

Finding	Resolution
2. Short Term Investments Cash and cash equivalents are investments that mature within 3 months or less of the balance sheet date and that are readily convertible to known amounts of cash with insignificant risk of change in value. Audit testing of the £11 million of short term investments identified that this balance had been incorrectly classified as it met the definition of cash and cash equivalents.	Short term investments had been overstated and cash and cash equivalents had been understated by £11 million in the unaudited accounts. **This has been corrected in the audited financial statements**
3. Dormant charities The Office of Scottish Charity Regulator (OSCR) website states that "in general, if a charity does nothing for a prolonged period, it is unlikely to be providing public benefit and this may result in it failing the charity test". 20 of the Council's 31 section 106 charitable trusts have not disbursed any funds in the last five years and so it is unclear how they meet the public benefit requirement. Section 46 of the Charities and Trustee Investment (Scotland) Act 2005 requires auditors to report to OSCR when the charity test is not met.	Since 2012/13 the Council has reduced the number of its trusts from 127 to 59 (28 of the trusts don't have charitable status). It has also set up a single trust 'The Moray Council Charitable Trust' which was registered with OSCR in August 2016. The plan is to transfer the remaining trusts into this single trust. Little progress has been made, however, due to capacity issues within the Council's legal and democratic service. Recommendation 1 (refer appendix 1, action plan)
4. IJB Debtor At the year end, the Council was owed £0.8 million by the Moray Integration Joint Board (IJB) in relation to resource transfer as cash paid by the NHS on behalf of the IJB had not been received by the Council until after the year end. This debtor had been netted off the creditors balance in error.	Short-term debtors and short-term creditors were understated by £0.8 million. **This has been corrected in the audited financial statements**
5. Provision for compensation payment The unaudited accounts included a provision for compensation payable as a result of the Elgin flood alleviation works. Audit testing identified that the certainty of the cashflow meant that the transaction should have been treated as an accrual.	Provisions were overstated, and short-term creditors were understated by £0.3 million in the unaudited accounts. **This has been corrected in the audited financial statements**
6. HRA Investment Property The unaudited accounts included £2.2 million of land that had been classified as Investment Property within the HRA. Audit enquiries identified that this land should be classified as Surplus Assets as it is not used to provide a service nor held for investment purposes.	Management have not adjusted for this error in the audited financial statements. Recommendation 2 (refer appendix 1, action plan)
7. Classification of long term loan Audit testing of a sample of short term creditors identified that a loan from the Scottish Government had been misclassified as it did not fall due before 31 March 2019.	Short term creditors were overstated, and long-term borrowing was understated by £0.1 million. Management have not adjusted for this error in the audited financial statements. audited financial statements. Recommendation 2 (refer appendix 1, action plan)

Finding	Resolution
8. Classification of income Income generated from the sale of inventory items (low value assets that the Council has not included as non-current assets) has been included in the loss on disposal of non-current assets figure in the unaudited accounts. This should have appeared as service income.	Other Operating Expenditure and Gross Income is understated by £0.1 million. Management have not adjusted for this error in the audited financial statements. Recommendation 2 (refer appendix 1, action plan)
9. Investment income The Charities Statement of Recommended Practice does not permit income from investments to be added to endowment capital except in specific circumstances. The Moray Council - Connected Charity Trust Funds unaudited 2017/18 financial statements had added investment income to endowments funds.	This resulted in an understatement of unrestricted funds and an overstatement of endowments funds of £34,000. Prior year figures were also restated. There is no impact on the total funds of the connected charities. **This has been corrected in the audited financial statements**

How we evaluate misstatements

25. A number of misstatements were identified during the course of the Moray Council audit. These were discussed with relevant officers, and two material adjustments were made to the financial statements, covering the pensions valuation and the classification of investments. The impact of unadjusted misstatements is detailed in Appendix 3.

26. In assessing the misstatements identified in Exhibit 4 we recognised that three of these individually exceeded our performance materiality value of £1.5 million. In two cases (valuation of pension scheme assets and classification of short term investments) the misstatement reflects the full extent of the error identified as the actuary provided a revised valuation of all the Council's share of the pension scheme assets and all of the short-term investments were examined and reclassified. As a result, further audit procedures were not required.

27. The third misstatement relates to the classification of land held by the HRA as Investment Property. In response to this audit finding, we reviewed all of the assets included as Investment Property within the unaudited financial statements and concluded that there were no other assets that did not meet the definition of Investment Property.

28. The remaining misstatements total £1.3 million which is below our performance materiality level and so further audit procedures are not required.

29. There was one misstatement identified during the audit of The Moray Council - Connected Charity Trust Funds' annual accounts. The amount of misclassification has been identified in full and adjusted in the audited financial statements.

30. It is our responsibility to request that all errors are corrected although the final decision lies with those charged with governance taking into account advice from senior officers and materiality. Management do not propose to adjust for the items detailed in Appendix 3.

Objections

31. The Local Authority Accounts (Scotland) Regulations 2014 require a local authority to publish a public notice on its website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The Council complied with the regulations. There were no objections to the accounts.

Follow up of prior year recommendations

32. We have followed up actions reported in our 2016/17 Annual Audit Report and assessed progress with implementation. These are reported in Appendix 1 and identified by the prefix b/f (brought forward).

33. In total, seven actions were agreed in response to our 2016/17 recommendations. Overall, the Council has made good progress in implementing these actions, with five being fully implemented. For those actions not yet implemented, revised responses and timescales have been agreed with management in Appendix 1.

Part 2

Financial management

Main judgements

The 2017/18 general services budget included £7.9 million of uncommitted reserves and savings of £3.4 million. Savings were delivered, and the actual use of reserves was lower than planned at £4.1 million.

Financial management is effective, and the Council has a good track record of delivering planned savings.

A significant element of the £61 million capital programme was Elgin High School funded by borrowing under the Scottish Government's Hub programme.

The Council's 2017/18 general services budget was £200 million and included the use of uncommitted reserves (£7.9 million) and savings (£3.4 million)

34. In February 2017 the Council approved a balanced net revenue budget of £200 million for 2017/18 for general services. This included the use of £7.9 million of uncommitted reserves and required £3.4 million of savings to be achieved.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively

Financial management and reporting is effective

35. Financial monitoring reports (revenue and capital) are included in a comprehensive financial reports monitoring pack and discussed at the Policy & Resources Committee on a quarterly basis. The information presented in the pack is appropriate and sufficiently detailed to support effective scrutiny. In addition, budget monitoring reports are reviewed by budget holders on a monthly basis and reports are provided to the Corporate Management Team on a quarterly basis.

36. Our review of these reports concluded that they provided an overall picture of the budget position at service level. The reports also included a forecast outturn position and good narrative explanations for significant variances against budget. They allowed both members and officers to scrutinise the Council's finances.

The Council used £4.1 million of its general fund balance during 2017/18, £3.8 million less than planned

37. The Council reported an overall underspend against its original 2017/18 general fund revenue budget of £3.8 million. This was due to actual expenditure being less than budgeted by £2.9 million and the receipt of additional income totalling £0.9 million (£0.6 million from council tax receipts and £0.3 million from additional government grants).

38. The revenue budget position was refined during the year and in June 2018, the Council reported an underspend of £1.6 million against its final budgeted expenditure. The key elements making up the £1.6 million underspend are set out below:

- service underspends (£0.5 million)
- contingencies, inflation and other budget pressures underspend (£0.6 million)
- additional savings achieved (£0.5 million)

39. There were significant variations in how different services performed against budget and the more significant under and overspends are summarised in Exhibit 5 below.

Exhibit 5
Summary of significant under / overspends against budget

Area	(Under)/over spend (£m)	Reason for variance
Underspends		
Schools & Curriculum Development	(£1.2)	Due to pupil equity underspend carried forward of £0.6 million and devolved school management budget underspend carried forward of £0.6m
Corporate Services	(£0.7)	Mainly attributed to staffing underspend of £0.2 million, discretionary housing benefits underspend of £0.1 million and additional income not anticipated of £0.1 million. Other variances have a cumulative effect of an underspend of £0.3 million.
Overspends		
Integrated Children's Services	£1.2	Mainly attributed to an overspend for the purchase of care £1.6 million offset by a number of other small underspends.

Source: Moray Council 2017/18 Revenue Outturn

The Housing Revenue Account had a deficit of £1.5 million that was funded from reserves

40. The budgeted gross expenditure for the HRA in 2017/18 was £18.3 million. This was mostly funded from council house rents and resulted in a rent increase of 4% with the average weekly rent increasing from £54.94 to £57.22.

41. In 2017/18, the Council recorded a deficit on HRA services of £1.5 million. After applying the statutory accounting adjustments and transfers from reserves (£1.5 million), the HRA balance reduced by £45,000. This leaves a cumulative surplus of £1.1 million to be carried forward to future years.

The Council has a good track record of delivering planned savings

42. The Council has a good track record in delivering savings targets over the last four years. Management have advised that all planned savings (£3.4 million) were achieved and that additional savings totalling £0.5 million were also delivered during 2017/18.

The Council invested £61 million in capital projects during 2017/18

43. In February 2017, the Council approved the 2017/18 Capital Plan totalling £43.6 million. Amendments were made to the Capital Plan by the Council and the Policy & Resources Committee throughout the financial year to give a final approved Capital Plan of £66 million (£52.5 million for general services and £13.5 million for HRA). The main changes being the inclusion of Elgin High School (£26.2 million) offset by the decision to defer a number of projects to future years, the largest of which was the new Linkwood High School.

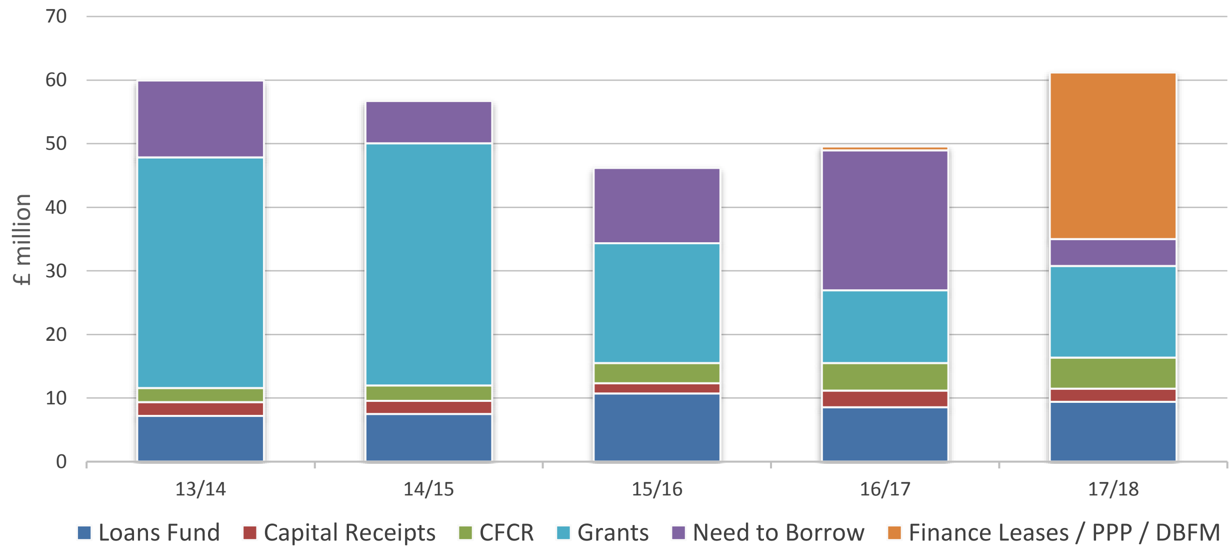
44. The Council invested £61 million in capital projects during 2017/18: 92% of its final approved capital programme. Nearly £7 million was invested in new council houses and £4 million in improving the current housing stock. Within general services, the majority of expenditure was within Education Services including the new Elgin High School.

The Council funded its new Elgin High School through long term borrowing as part of the Hub programme

45. Exhibit 6 sets out how capital expenditure was funded during the year. For 2017/18, the mix of resources used to finance capital expenditure was different to that used in previous years. This was mainly due to the completion of the new Elgin High School which was built under the Scottish Government's Hub programme (NPDO). The 25-year contract for the construction, maintenance and operation of the new school involves a long-term lease of £26 million. Capital grants and contributions were £3 million higher than in 2016/17 and external traditional borrowing was significantly less.

46. In line with the Council's Treasury Management Strategy for 2017/18, short-term borrowing was undertaken during the year to take advantage of low interest rates compared to long-term borrowing. Short-term borrowing increased from £39 million to £51 million.

Exhibit 6
Sources of finance for capital expenditure



Source: Moray Council Accounts 2013/14 to 2017/18

47. As at 31 March 2018, the Council was committed to £152 million of unitary charge payments under PPP/DBFM contracts covering the period to 2033. This has increased from £100 million as at 31 March 2017. The assets used to provide services at the three schools covered by these contracts are valued on the Council's balance sheet at £60 million.

Systems of internal control are effective overall but with areas for improvement in payroll and changes to suppliers' bank account details

48. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the Council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

49. Our findings were included in our 2017/18 Management Report that was presented to the Audit and Scrutiny Committee on 22 August 2018. We concluded that there were some control weaknesses, particularly in relation to payroll and changes to suppliers' bank account details. We revised our audit approach in response to these weaknesses to enable us to obtain sufficient assurance to conclude on the 2017/18 annual accounts.

Part 3

Financial sustainability

Main judgements

The Council's immediate financial position is extremely challenging. It continues to rely on using uncommitted general fund reserves to balance its budget. This has been the case for the last three years and can't continue indefinitely.

The Council reports a small underspend against its 2018/19 budget to date, but there are significant budget pressures.

Medium term financial pressures are also significant, and the Council has yet to agree a transformation programme and medium and long term financial plans to deliver financial sustainability.

The Council's underlying borrowing position is significant but still relatively manageable.

The immediate financial position is extremely challenging, and the Council continues to rely on using uncommitted reserves to balance its budget

50. The Council approved its 2018/19 budget in February 2018. The revenue budget was set at £199 million with an identified funding gap of £11 million. Plans to address this gap include £6.5 million of savings and a further transfer of £4.5 million from uncommitted reserves. Council tax was also increased by 3%. The planned savings for 2018/19 are made up of many small amounts. The more significant savings include:

- £1.2 million reduction in the funding allocated to Moray Integration Joint Board (see paragraph 60 below)
- £0.5 million reduction to roads maintenance budget (non-recurring)
- £0.2 million reduction in borrowing costs
- £0.2 million reduction in management costs.

Financial sustainability looks forward to the medium and long term to consider whether the board is planning effectively to continue to deliver its services or the way in which they should be delivered

The Council reports a small underspend against its 2018/19 budget, but there are significant budget pressures

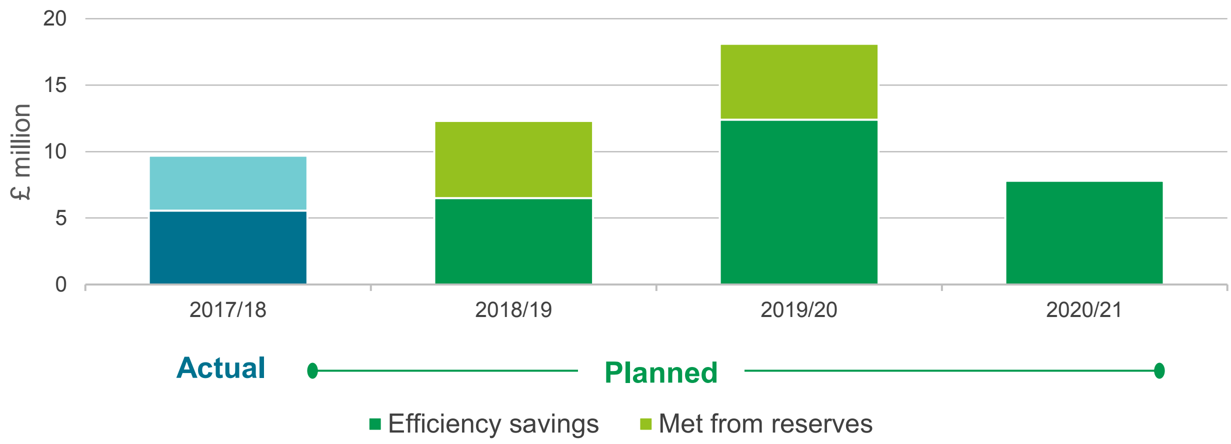
51. The latest budget monitoring report, to 30 June 2018, records that the Council is underspending its general services budget by £0.2 million. The majority of this underspend relates to lower than expected expenditure from devolved school management budgets.

52. Emerging budget pressures are also being identified within 2018/19 budget reports. The most significant of these is within the Moray Integration Joint Board (IJB) which the Council funds in partnership with NHS Grampian. The IJB has a budgeted funding gap of £3.3 million for 2018/19 which it has been unable to close. The most recent IJB budget monitoring report records an overspend against the 2018/19 budget of £1 million as at 30 June 2018. The Council is responsible for 40% of any deficit incurred by the IJB. The effect of these pressures in IJB related services could result in a further financial risk to the Council of £1.7 million in 2018/19. The Council has recognised £1.3 million as a potential additional call on reserves within its financial management reports.

Medium term financial pressures are also significant, and savings plans have yet to be agreed to meet these

53. Current projections indicate that the Council faces significant funding gaps for 2019/20 and 2020/21. Exhibit 7 shows how the Council plans to bridge these gaps.

Exhibit 7
Identified funding gaps 2017/18 – 2020/21



Source: Council's 2017/18 Outturn Report and Corporate and financial Planning 2018/19 Report

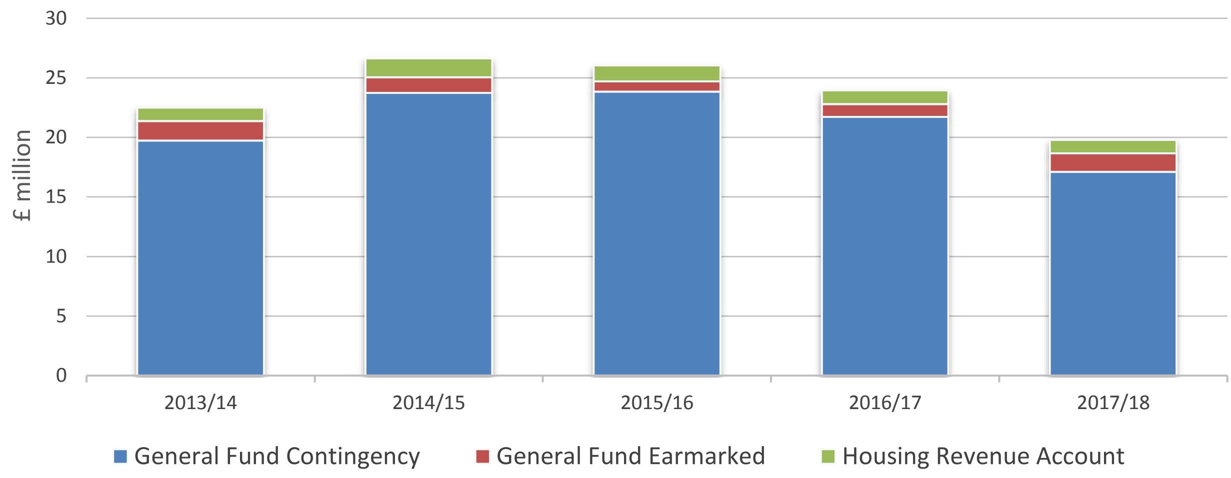
54. Exhibit 7 highlights that significant savings are required to be achieved in 2019/20. Work has begun to identify these savings, but these will take time to develop and implement. The Council has agreed to develop a list of short term savings options for consideration in late September 2018. This is a challenging timescale, particularly given the recent change in administration, but it is essential that it is met if the Council is to set a balanced budget for 2019/20 and beyond.

General fund reserves have been used to support the revenue budget for three years and this can't continue indefinitely

55. During 2017/18, the Council's general fund reserves (including HRA) decreased by £4 million. This was lower than the planned use of reserves, as identified in Part 2 of this report.

56. Exhibit 8 provides an analysis of the general fund (including the HRA balance) over the last five years split between committed and uncommitted reserves. This shows that the general fund reserve reached a peak of £25 million in 2014/15 but has been reducing over the last three years as reserves have been used to maintain financial balance.

Exhibit 8
Analysis of general fund over last five years



Source: Moray Council Accounts 2013/14 to 2017/18

Reserves will be reduced to a minimum level by 31 March 2020

57. The Council considers the level of its general fund reserve when setting the budget each year. The Council's approved reserves strategy is to hold £5 million as unearmarked reserves. At 31 March 2018 the Council's unearmarked reserves were significantly above this level at £17 million. The most recent financial forecast (June 2018) highlights that the Council will reduce the unearmarked reserve to £5 million by 31 March 2020.

58. The Council's usable reserves (£25 million) aren't significantly backed by cash or investments (which total £7 million) on the balance sheet, so the Council would need to borrow to realise these reserves (see paragraph 64).

The Council has yet to agree a medium or long term financial strategy

59. Last year we reported that the Council did not have a medium or long term financial strategy in place. The Council has acknowledged, for a number of years, that its current level of service provision is not financially sustainable and, as we explain above, has balanced its annual revenue budget through the use of reserves.

60. The Council has made savings over recent years but continues to rely on short term one-year savings plans to deliver annual budgets. As part of its '*Modernisation and Improvement Programme*' it has begun to review how it operates but has yet to agree a medium and long term financial plan necessary to deliver sustainable services.

61. Work has begun to achieve transformational change to deliver medium term financial sustainability including:

- digital – investment aimed at enhancing digital service provision to deliver service efficiencies
- property asset management – development of a strategy to achieve rationalisation of property assets aligned to Council priorities

- management arrangements – aligning arrangements to corporate plan and Council priorities
- transforming the economy – including continued development of the Moray Growth Deal through the Moray Economic Partnership
- transforming education – development of a *Moray Schools for the Future* action plan

62. The Council acknowledges, in its latest Corporate Plan, that sustainable service delivery will require extensive and detailed consideration of every aspect of what services the Council can provide, to what scale and quality and how services are delivered. The following 'Reform Matrix' is being used to identify opportunities for inclusion in modernisation and improvement programme:

- transformation (different service)
- redesign of services (same service but leaner/new approach)
- redefine services (stop/reduce/community contribution/provision of service)
- income generation and commercialisation (charges/sponsorship/new services/sale of assets).

63. The Council has recognised that it will need outside help to deliver a robust modernisation and improvement programme and has been in contact with the Improvement Service, and COSLA for support. An external 'not for profit' organisation has also been engaged to provide initial diagnostic work on potential efficiency improvements.

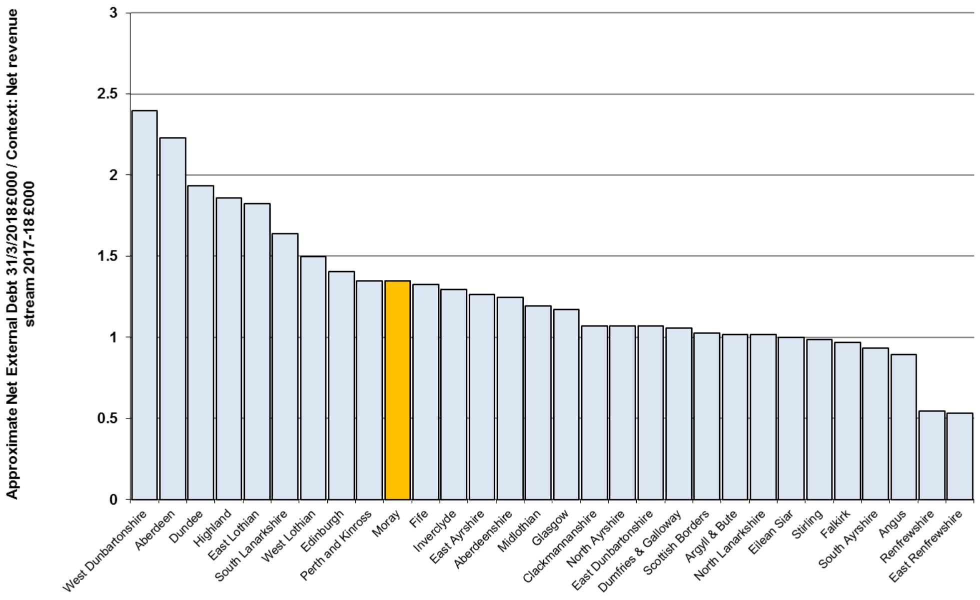
Recommendation 3

The Council needs to agree a medium and long term financial plan for the delivery of sustainable services. In order to achieve this, it needs to build on the existing strands of work and the reform matrix to agree a significant and cross-Council transformation plan.

The Council's underlying borrowing position is significant but still relatively manageable

64. The Council's net borrowing of £261 million is 1.35 times it annual revenue stream of £194 million. This places it above average compared to other councils (Exhibit 9). However, as noted at paragraph 58 if the Council is to realise its usable reserves of £25 million, over time it will need to undertake further borrowing. This would increase its borrowing to 1.5 times its revenue stream, placing it in the upper quartile of councils, but not at a level which appears unsustainable. Although it is acknowledged that sustainability really depends on the Council's ability to service its debt, through interest repayments.

Exhibit 9
Councils' net borrowing relative to its size



Source: Councils' unaudited financial statement 2017/18

Part 4
Governance and transparency

Main Judgements

The Council has a clear vision for the people of Moray, but corporate plan outcome measures and supporting plans are still being developed.

Cross-party and cross-member working will be required to achieve a sustainable financial position for the Council and management capacity is required to support transformational change.

Appropriate governance arrangements are in place that support scrutiny and decision making. The Council is open and transparent in the way it conducts its business.

The Council has achieved Cyber Essentials accreditation, but business continuity planning is out-of-date or non-existent.

Vision is clearer and more ambitious in the current 10-year plan

65. The Moray Community Planning Partnership's 10-year plan (Local Outcomes Improvement Pan (LOIP)) was approved in February 2018 and forms the basis of the Council's Corporate Plan 2023 (covering the period 2018 to 2023). The Corporate Plan sets out the Council's vision which is *'to make life better for everyone in Moray, where there is a positive future for all, within a vibrant economy, with empowered and connected communities'*.

66. This refreshed vision is much clearer and more ambitious than that included in the previous 10-year plan (Moray 2026). The vision is supported by four main priorities for the Council which are in turn linked to the priorities set out in the LOIP:

- ensure caring and healthy communities
- promote economic development and growth and maintain and promote Moray's landscape and biodiversity
- provide a sustainable education service aiming for excellence
- work towards a financially stable Council that provides valued services to our communities.

Corporate plan outcome measures and supporting plans are still being developed

67. Both the LOIP and the Corporate Plan 2023 include outcomes for each of the identified priorities. Our review concluded that these are not sufficiently specific and measurable and did not include clear milestones and targets against which the Council and its partners can measure performance.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making and transparent reporting of financial and performance information.

68. The Corporate Plan 2023 will be supported by a number of other plans including Service Plans, financial and workforce plans, and the performance management framework. A number of the plans are still at the development stage including a number of Service Plans. It is, therefore, too early to say how well these are linked to the LOIP and Corporate Plan 2023.

Recommendation 4

The Council should review its outcome measures and develop clear milestones and targets against which to measure its performance in delivering its priorities. Supporting plans should also be developed which clearly link to the LOIP and Corporate Plan 2023 and which support the Council's need for transformation and redesign of services.

Cross-party and cross-member working will be required to achieve a sustainable financial position

69. We reported last year that members must make difficult decisions about the services the Council can afford to deliver. Since then, the Council has experienced a period of political instability with a number of members leaving the administration, and a new minority administration being formed in June 2018. A significant transformational plan is required to address the financial sustainability issues identified in Part 3 of this report and this needs cross-party and cross-member cooperation to agree key strategic priorities and actions to address this.

70. In our 2017/18 Management Report we recommended that members should consider setting up a cross-party budget working group to discuss and agree budget priorities and actions.

Management capacity is under pressure

71. Since our last Annual Audit Report, there have been a number of changes to key senior staff within the Council. The Corporate Management team consists of the Chief Executive and three Directors. During 2017/18, two of these Directors left the Council (the Director Corporate Services in June 2017, and the Director of Education and Social Care in February 2018).

72. These posts were covered on a temporary basis until both posts were advertised in May 2018. A substantive Director of Corporate Services was appointed in June 2018. A substantive Director of Education and Social Care was not appointed, and this post will continue to be covered on a temporary basis until summer 2019. Education and Social Care are two of the Council's priority areas, and in our Local Scrutiny Plan we raised concerns about the strategic leadership and governance arrangements within Education and Children's Services. It is critical that there continues to be a focus on improving these areas under these interim arrangements.

73. There were also changes to two of the council's statutory posts with a new Head of Financial Services appointed at the end of June 2017, and a new Chief Social Worker in August 2018.

74. Recent changes in the Council's administration have also put additional pressures on the Corporate Management Team with Directors and Heads of Service providing additional briefings to members. The transformational change process that the Council needs will require the Corporate Management Team to have capacity to deliver the redesign and transformation of Council services.

Recommendation 5

Management capacity should be reviewed to ensure that it is sufficient to deliver the transformational change programme required to deliver financial sustainability in addition to 'business as usual'.

There are appropriate governance arrangements to support decision making and accountability

75. The Council is required to establish governance arrangements to ensure that its business is conducted in accordance with law and proper standards, that public money is safeguarded and that the adequacy and effectiveness of these arrangements is monitored.

76. The Council's committee structure is a sound foundation for good governance and accountability. We attended Audit and Scrutiny Committee meetings and reviewed agendas, papers and minutes from meetings of the Policy and Resources Committee, as well as full Council meetings during 2017/18. The papers provided by officers are of a good standard and provide members with a good overview of the issues being covered, together with more detailed information as appropriate. This helps to ensure that issues are debated at committee meetings.

The Council is open and transparent in the way it conducts its business but there is scope to improve the transparency of its financial reporting in the management commentary

77. Transparency means that the general public has access to understandable, relevant and timely information about how the Council is taking decisions and how it is using resources such as money, people and assets. The Council's commitment to transparency includes:

- members of the public can attend meetings of the full Council and other committees and the agendas, papers and minutes of these meetings are available on the Council's website. All meetings are webcast and available to view for 12 months after the meeting
- the Council's website allows the public to access a wide range of information including the register of members' interests, current consultations and surveys and how to make a complaint
- the Council makes its annual accounts available on its website.

78. The management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body. The Council revised its template for the management commentary in the 2017/18 accounts, making it much shorter and including a number of graphics. We reviewed the management commentary and confirmed that it was consistent with the financial statements. We noted, however, that there was scope to improve its content including:

- providing an analysis showing the budget, actual outturn, variance and explanation for variances for each operating segment linked to the Expenditure and Funding Analysis in Note 7
- providing more explanation and highlighting of the linkages between information in the management commentary and in the annual accounts

- strengthening the review of business section so that it is balanced and comprehensive. There is a list of the Council's achievements but no significant reference to the challenges in the year
- considering whether other key performance indicators can be included to allow the development, performance or position of the business to be more easily measured (e.g. see comments above in relation to the HRA variances)
- reviewing whether the graphics, for example those 'about the Council' and the political make-up are material to the management commentary.

Recommendation 2

Accounts preparation processes should be reviewed prior to the preparation of the 2018/19 annual report and accounts. In particular, the content of the management commentary should be reviewed as set out above.

Internal audit has not been externally reviewed

79. We reviewed the internal audit function and noted that an external assessment against the Public Sector Internal Audit Standards (PSIAS) had not been undertaken since the introduction of the PSIAS on 1 April 2013. The PSIAS requires that an external assessment take place at least every five years and so internal audit have not complied with this requirement. We have been advised that an external assessment will be undertaken in September 2018.

80. The Internal Audit Manager recently completed a self-assessment against the PSIAS and reported the results of this review to the Audit and Scrutiny Committee on 22 August 2018. Two standards were assessed as partially conforming. Progress against addressing these areas is due to be made. We will undertake a further review of internal audit as part of our planning for the 2018/19 audit.

Recommendation 6

An external assessment of the internal audit function against the Public Sector Internal Audit Standards should be undertaken as a matter of urgency and the results reported to the Audit and Scrutiny Committee.

There has been good progress following up NFI matches

81. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. In our 2017/18 Management Report we reported that Council had made good progress with the 2016/17 NFI exercise.

Standards of conduct for prevention and detection of fraud and error are satisfactory

82. The Council has a range of established procedures for preventing and detecting fraud and irregularity including a whistleblowing policy, anti-fraud strategy and codes of conduct for members and officers. In 2016/17 we recommended that the requirement to complete registers of interest be extended to senior officers and other key staff so that potential conflicts of interest are identified and appropriately managed. We reported in our 2017/18 Management Report that a register of senior officers' interests has been prepared and is published on the Council's website. Both the members' and senior officers' registers of interest are updated every six months.

The Council has achieved Cyber Essentials accreditation, but business continuity planning is out of date or non-existent

Cyber security

83. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017 which requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate. This actively encourages public sector bodies to seek independent assurance of critical technical controls, which in their view, is achieved by obtaining Cyber Essentials or Cyber Essential Plus accreditation. The Council achieved Cyber Essentials accreditation in September 2018 and work is ongoing to achieve Cyber Essentials Plus accreditation by 31 October 2018.

Business continuity plans

84. The Council's Business Continuity Policy places the onus on individual services to create and maintain their own Business Continuity Plans (BCP). As part of our 2017/18 audit we obtained a copy of the Council's latest assessment of critical functions, dating from 2009, and from this requested copies of continuity plans for Finance (Payments) and ICT services in order to assess the business continuity arrangements in place. At the time of our review, a BCP was not available for ICT Services. A BCP was provided for Payments but this had not been refreshed since 2015. Plans have subsequently been put in place to create a BCP for ICT by 31 March 2019.

Recommendation 7

The Council should review its business continuity planning arrangements to ensure that they are fit for purpose.

The Council does not consider that it is significantly exposed to the risk arising from EU withdrawal

85. There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- workforce - the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour

- funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports

- regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

86. The Council is aware of the potential risks and has reflected on these areas including reference to them within its risk register. Until the impact of Brexit becomes clearer, the Council does not consider that it is significantly exposed to these risks. Its use of EU funding is relatively low.

Part 5

Value for money

Main judgements

Revised performance management and reporting arrangements are being developed. There has been a gradual decline in the Council's performance relative to other councils since 2012/13.

Housing benefits performance has declined due to the loss of key staff.

Education Scotland has significant concerns in Education and Children's services including leadership, outcomes for children, weak inspection outcomes and recruitment and stability.

As part of our Best Value approach we reviewed financial management, financial sustainability, transformation and vision and leadership.

Value for money is concerned with using resources effectively and continually improving services.

87. Best value is assessed over the five-year audit appointment as part of the annual audit work. A Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in this five-year period. The BVAR report for Moray Council is planned towards the end of the five-year programme.

88. The best value audit work carried out this year focussed on the Council's arrangements for demonstrating best value in financial management (see Part 2), financial sustainability and transformation (see Part 3), and vision and leadership (see Part 4). The effectiveness of the Council's best value arrangements in other areas will be assessed and reported throughout our audit appointment.

Revised performance management and reporting arrangements are being developed

89. Last year we reported that the Council's performance management framework was under review to ensure that it was fit for purpose and reflects best practice. A draft revised performance management framework was considered by the Corporate Management Team in June 2018. This is currently being reviewed by the Improvement Service before being submitted to members for approval.

90. Performance measures for the LOIP have yet to be approved and revised measures were due to be considered by the Community Planning Partnership in September 2018 but have been further delayed. As a result, there has been no performance reporting against the LOIP outcomes since its approval in February 2018. Performance against the previous ten-year plan – Moray 2026 – was reported to the Community Planning Partnership in February 2018 as part of the approval of the LOIP.

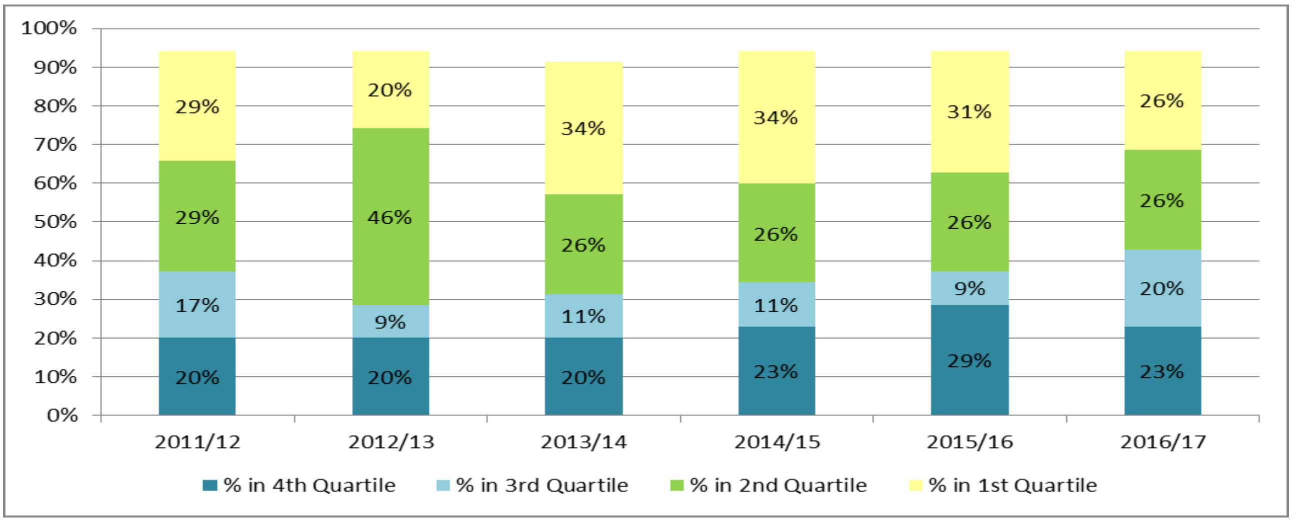
There has been a gradual decline in the Council's performance against the LGBF indicators since 2012/13

91. The Council participates in the Local Government Benchmarking Framework (LGBF). The framework aims to bring together a wide range of information about how all Scottish councils perform in delivering better services to local communities, including the cost of services and how satisfied citizens are with them.

92. The most recent National Benchmarking Overview Report 2016/17 by the Improvement Service was published in February 2018 and covered the 2016/17 reporting period. The national report was submitted to the Audit and Scrutiny Committee in March 2018. Exhibit 10 compares the Council's performance against the LGBF indicators to other Scottish councils over the last six years. This shows a steady decline in the number of Council indicators in the top two quartiles since 2012/13 (from 66% to 52%).

93. In previous years, the Audit and Scrutiny Committee report also identified areas where the Council is performing well and areas where improvement is required, as well as comparing the Council's performance to a Scotland wide benchmark for each performance indicator. We have been advised that this information will be provided to the Audit and Scrutiny Committee meeting in October 2018 following review by the relevant service committee.

Exhibit 10
LGBF relative performance over time, 2011/12 to 2016/17



Source: *Local Government Benchmarking Framework,* Improvement Service 2018

The arrangements for reporting statutory performance indicators (SPIs) are satisfactory, but could be improved

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

95. For 2017/18 two SPIs were prescribed:

- SPI 1: covering a range of information relating to areas of performance such as improving local public services, improving local outcomes, engaging with communities and achieving best value

- SPI 2: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

96. Last year we reviewed the Council's arrangements for the collection, verification and reporting of performance information and noted that there was scope to improve these. During 2017/18, verification procedures were enhanced with the introduction of internal audit sample checks on local SPIs and LGBF indicators.

97. The performance information available to the public via the performance section of the Council's website is not always current, particularly the half yearly updates. Whilst information is available to the public in hard-copy format, for the sake of openness and transparency, the Council should ensure their publication process includes update of the website information as a matter of routine, in order that external interested parties may easily and readily access performance data.

Housing benefits performance has declined due to the loss of key staff

98. In December 2017 we published our risk assessment update report on the audit of housing benefit at the Council. The previous risk assessment, carried out in August 2015, identified one risk to continuous improvement.

99. Since then, there have been some significant changes within the revenues service including the establishment of an income maximisation team, and the transfer of responsibility for processing applications for free school meals and education clothing grants to the benefit service in May 2017.

100. The report recognises that the Council maintained or improved its speed of processing claims performance each year from 2014/15 to 2016/17 but notes that the speed of processing claims performance declined significantly in 2017/18 from an average of 23 days for new claims and 8 days for change events to 29 days and 12 days respectively as at September 2017. This level of performance places the Council in the bottom quartile of all Scottish councils for speed of processing. A number of factors contributed to this decline in performance, most notably the loss of two experienced processors in February and March 2017 and the Benefits Processing Supervisor in July 2017. The recruitment and retention of experienced staff remains a key issue for the Council.

101. The report identified four risks to continuous improvement. The Council have implemented or are in the process of implementing measures to address these risks and performance indicators have been introduced so that members can monitor the performance of the Housing Benefit service.

Education Scotland has significant concerns in Education and Children's Services including leadership, outcomes for children, weak inspection outcomes and recruitment and stability.

102. The 2018/19 Local Scrutiny Plan (LSP), prepared by the Local Area Network (LAN) of scrutiny partners, was finalised in March 2018 and considered by the full Council in June 2018.

103. The LSP reported significant concerns regarding strategic leadership and governance in Education and Children's Services. Outcomes for children and young people are below the national average and the virtual comparator and, in some measures, are showing a decline. Scrutiny outcomes, including inspections, have overall shown a weak picture in recent years, particularly in the primary sector. This has been exacerbated by an acute shortage of teachers, an inability to recruit primary Head Teachers and a lack of long term stability in the central Quality Improvement Team.

104. Since publication of the LSP, Education Scotland has enhanced its monitoring of Education Services. The Area Lead Officer meets regularly with officers to support and challenge progress towards improvement, and the Council is developing, in collaboration with Education Scotland, support for improvement around three key themes. Progress towards improving educational outcomes for children and young people will continue to be monitored closely by Education Scotland.

National performance audit reports

105. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2017/18, Audit Scotland published a number of reports were issued which are of direct interest to the Council. These are outlined in Appendix 4.

106. The Council has a process in place to ensure that findings from national reports are reviewed, and where relevant, presented to the Audit and Scrutiny Committee. This reporting includes an assessment of current arrangements and the identification of actions to be taken to apply good practice examples highlighted in the reports.

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	**Compliance with the charity test** 20 (65%) of the Council's 31 section 106 charitable trusts have not disbursed any funds in the last five years and so it is unclear how they meet the public benefit requirement. **Risk** The charitable trusts do not meet the charity test as they are not providing public benefit.	The Council should progress the transfer of trusts into the new trust set up in August 2016 so that available funds can be used for the public benefit.	Transfer of trusts continues but progress has been slow as it is not a corporate priority and capacity has been directed towards other areas e.g. CAT which align more closely to the Corporate Plan. The public benefit from reorganisation is likely to be limited and the costs of reorganisation are high compared to the value of the trust assets. **Responsible officer:** Head of Legal and Democratic Services **Agreed date:** As time permits
2	**Accounts preparation** We identified a number of errors in how transactions were classified within the unaudited financial statements. In addition, we noted that there was scope to improve the content of the management commentary to make it more transparent. **Risk** There is a risk that the accounts do not give a true and fair view of the Council and its group's financial position and net expenditure.	Accounts preparation processes should be reviewed prior to the preparation of the 2018/19 annual report and accounts.	**Classification of transactions** Year end processes are being reviewed and is part of the accountancy section's team plan along with a debriefing CPD session already arranged. **Responsible officer:** Principal Accountants **Agreed date:** March 2019 **Management Commentary** Audit comments will be reviewed when the Management Commentary is planned with the PPR and Communications Officer **Responsible officer:** Head of Financial Services **Agreed date:** March 2019

No.	Issue/risk	Recommendation	Agreed management action/timing
3	**Financial sustainability** As part of its '*Modernisation and Improvement Programme'* the Council has begun to review how it operates but has yet to agree a transformation plan and medium and long term financial plans which will be essential to the delivery of sustainable services. **Risk** The Council is unable to agree and implement a sustainable model for service delivery before its reserves are exhausted.	The Council needs to agree a medium and long term financial plan for the delivery of sustainable services. In order to achieve this, it needs to build on the existing strands of work and the reform matrix to agree a significant and cross-Council transformation plan.	This will be developed as part of the Council's corporate planning and financial planning process. Latest report to council 26 September 2018 including the latest version of the Modernisation and Improvement Programme plan. Work is ongoing and will be further developed prior to the budget for 2019/20 being set to enable work on the highest priority actions to begin. **Responsible officer:** Corporate Management Team / Head of Financial Services **Agreed date:** February 2019 and thereafter
4	**Performance measures** There is scope to improve the outcome measures included in the LOIP and Corporate Plan 2023 including setting clear milestones and targets against which the Council and its partners can measure performance. A number of supporting plans are still being developed. **Risk** The Council is unable to deliver its priorities without clear supporting plans and indicators against which to measure performance.	The Council should review its outcome measures and develop clear milestones and targets against which to measure its performance in delivering its priorities. Supporting plans should also be developed which clearly link to the LOIP and Corporate Plan 2023 and which support the Council's need for transformation and redesign of services.	Strategic Partnership Lead Officers are finalising the performance measures against the LOIP priorities. If the revised Performance Management Framework recommendations are implemented this would give the structure around monitoring progress against the LOIP and Corporate Plan. **Responsible officer**: Corporate Director (Corporate Services) **Agreed date:** January 2019

No.	Issue/risk	Recommendation	Agreed management action/timing
5	**Management capacity** The transformational change process that the Council needs will require the Corporate Management Team to have the necessary capacity to deliver the redesign and transformation of Council services. **Risk** Lack of management capacity results in the Council being unable to deliver on the redesign and transformation of services necessary to deliver financial sustainability.	Management capacity should be reviewed to ensure that it is sufficient to deliver the transformational change programme required to deliver financial sustainability in addition to ‘business as usual’.	This is recognised in the budget report to council on 26 Sept as an issue which needs to be tackled. Additional resource has been commissioned to initiate the process of transformation and future needs will be reviewed as work proceeds **Responsible officer:** Corporate Management Team **Agreed date:** February 2019
6	**External assessment of Internal Audit** An external assessment of the Council’s internal audit function was not completed within five years of the introduction of the Public Sector Internal Audit Standards as required by these standards. **Risk** Without external assessment, Internal Audit cannot demonstrate that it complies with the Public Sector Internal Audit Standards.	An external assessment of the internal audit function should be undertaken, and the results reported to the Audit and Scrutiny Committee.	This is being progressed at the current time and the outcomes report from the external assessor’s review will be presented to the Audit and Scrutiny Committee as soon as it is available. **Responsible officer:** Internal Audit Manager **Agreed date:** February 2019
7	**Business continuity planning** Audit testing of two services noted that one did not have a BCP and the other’s BCP had not been refreshed since 2015. **Risk** The Council cannot continue ‘business as usual’ in the event of a key systems failure.	The Council should review its business continuity planning arrangements to ensure that they are up to date and fit for purpose.	The Council has no dedicated business continuity staff resource. Where business continuity is assessed as a significant risk this will be considered during review and update of service risk registers. **Responsible officer:** Corporate Management Team **Agreed date:** Phased process through to March 2019

No.	Issue/risk	Recommendation	Agreed management action/timing
Follow up of prior year recommendations			
b/f 1	**Internal recharges** Internal recharges have not been eliminated from the gross income and gross expenditure figures included in the CIES. **Risk:** gross income and gross expenditure are overstated in the annual accounts.	Management should review how they account for internal recharges within the CIES.	**Not completed** Internal recharges were not eliminated from gross income and expenditure totals within the 2017/18 CIES. It is acknowledged that the LASAAC guidance is not clear, but we would expect that these amounts would be eliminated. There is no impact on the net cost of services or deficit on provision of services within the accounts. **Revised action** The Code for 2018/19 will require this elimination and we will comply with the Code. Work is already in progress to put this in place for 2018/19 and to look at 2017/18 for comparator information **Responsible officer:** Principal Accountants **Agreed date:** March 2019
b/f 2	**Financial Sustainability** The current level of service provision is not financially sustainable, and the Council is currently using its reserves to maintain services at previous levels. **Risk:** the Council is unable to agree and implement a sustainable model for service delivery before its reserves are exhausted.	Members need to make difficult decisions about which services (and at what level) the Council can afford to deliver in the future. These decisions need to be made quickly as officers have projected that the Council's reserves will be exhausted by 31 March 2019.	**Not completed** Refer to Part 3 of this report, and action plan recommendation 3 above.
b/f 3	**Revaluations** The wrong social discount factor was used to revalue council dwellings. **Risk:** council dwellings are materially misstated in the annual accounts.	Year end working papers should be reviewed to ensure that the correct discount rate is used to revalue council dwellings.	**Complete** The correct social discount factor was used to revalue council dwelling additions in 2017/18.

No.	Issue/risk	Recommendation	Agreed management action/timing
b/f 4	**Depreciation** Where components are replaced during the year, depreciation is not charged on the replacement component as required by the accounting policy. **Risk:** non-current assets are misstated in the annual accounts.	All non-current asset additions should be depreciated in the year of acquisition as set out in the Council's accounting policy.	**Complete** Replacement components were depreciated in line with the Council's depreciation policy in 2017/18.
b/f 5	**Holiday pay accrual** Errors were identified in the spreadsheet used to calculate the holiday pay accrual. **Risk:** the holiday pay accrual is misstated in the annual accounts.	The spreadsheet should be reviewed to ensure that the holiday pay accrual is complete and accurate	**Complete** The spreadsheet used to calculate the 2017/18 holiday pay accrual had been updated to correct the issues identified in 2016/17.
b/f 6	**Rental income** Rental income invoices are not reviewed to ensure that they are accounted for in the correct financial year. **Risk:** rental income and debtors are overstated in the annual accounts.	Rental invoices should be reviewed to ensure that they have been allocated to the correct financial year.	**Complete** Rental invoices have been reviewed and allocated to the correct financial year.
b/f 7	**Group boundary** The Council has not reviewed its group boundary since the introduction of the new definition of 'control' of group components was introduced in 2015/16. Moray Leisure Limited's non-current assets are not revalued to current cost on consolidation. **Risk:** the group accounts are materially misstated.	The Council should review its group boundary against the new definition of 'control'. A current cost valuation of Moray Leisure Limited's non-current assets to evidence that it is not materially different to the historic cost valuation used to prepare the group accounts.	**Complete** The Council reviewed its group boundary as part of the 2017/18 accounts preparation and demonstrated that Moray Leisure Limited should be accounted for as an associate in the Council's group accounts. A current cost valuation of Moray Leisure Limited's non-current assets was not undertaken but our review of the working papers provided by the component auditor confirmed that they were not material to our audit opinion.

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the *Code of Audit Practice 2016*.

Audit risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
1 Risk of management override of controls ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the accounts.	Detailed testing of journal entries. Review of accounting estimates. Focused testing of accruals and prepayments. Evaluation of significant transactions that are outside the normal course of business	**Results** We did not identify any significant issues within our work on journals or accounting estimates. Our testing of accruals and prepayments did not identify any errors and there were no significant transactions outside the normal course of business. **Conclusion** No issues were identified that would indicate management override of controls.
2 Risk of fraud over income Moray Council receives a significant amount of income in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.	Analytical procedures on income streams. Detailed testing of revenue transactions focusing on the areas of greatest risk. Walkthrough of controls over income transactions and significant grant income. Review of National Fraud Initiative arrangements and results.	**Results** We did not identify any significant issues from our testing of income controls and transactions. Our work on National Fraud Initiative did not identify any issues. **Conclusion** No fraud issues were identified.
3 Risk of fraud over expenditure The Code of Audit Practice expands the ISA assumption on fraud over income to aspects of expenditure. The council incurs significant expenditure in areas such as welfare benefits, and social care payments.	Audit work on the National Fraud Initiative matches. Walkthrough of controls over social care payments. Detailed testing of expenditure including social care payments and housing benefit transactions.	**Results** We did not identify any significant issues in our testing of expenditure controls, although we reported areas where controls could be strengthened. Our testing of transactions and our work on National Fraud Initiative did not identify any issues. **Conclusion** No fraud issues were identified.

Audit risk	Assurance procedure	Results and conclusions
4 Estimation and judgements There is a significant degree of subjectivity in the measurement and valuation of pensions and non-current assets. This subjectivity represents an increased risk of misstatement in the financial statements. The council uses the Beacon Principle methodology to value its council dwellings. Last year we identified that the wrong social discount factor had been used resulting in council dwellings being understated by £0.5 million in the unaudited accounts. The 2017/18 accounts will also reflect the outcome of the triennial valuation of the pension fund, based on revised membership data and financial assumptions.	Assessment of the scope, independence and competence of the professionals engaged. Review of the actuarial valuation including assumptions. Review of the social discount rate used as part of the Beacon Principle methodology. Substantive testing of journals and disclosures in connection with these estimates.	**Results** Refer to Exhibit 4, finding 1 for issues identified with the valuation of pension scheme assets. Our audit procedures did not identify any issues with the valuation of non-current assets. The correct social discount factor was used to revalue council dwelling additions in 2017/18 (refer Appendix 1, b/f 3) We did not identify any issues from our substantive testing of journal entries. **Conclusion** The pension liability was overstated by £18.1 million in the Council's unaudited accounts due to issues with the valuation of pension scheme assets. No other issues were identified with other estimations and judgements used in compiling the accounts.
5 Changes in key finance staff The Principal Accountant responsible for the preparation of the annual accounts plans to retire in April 2018. There is a risk that appropriate arrangements are not put in place to ensure a smooth transition during the accounts preparation and audit processes.	Clarify the arrangements for the preparation of the 2017/18 annual accounts. Confirm arrangements for regular and final clearance meetings during final accounts audit process.	**Results** Responsibility for the preparation of the 2017/18 annual accounts was shared between two Principal Accountants within the finance team. Regular meetings were held with finance staff during the final accounts audit process to agree all adjustments to the accounts. **Conclusion** No issues were identified with the changes in key finance staff.
6 Group boundary The council has not reviewed its group boundary since the introduction of the new definition of 'control' of group components was introduced in 2015/16. There is a risk that the group boundary is not complete and that Moray Leisure Limited is not appropriately consolidated within the group accounts.	Review and assess the group boundary. Review the consolidation process to confirm appropriateness.	**Results** The Council reviewed its group boundary as part of the 2017/18 accounts preparation and concluded that Moray Leisure Limited should be accounted for as an associate within the group accounts. We reviewed the work done by the Council and concluded that it complied with the guidance. **Conclusion** No issues were identified with the Council's review of its group boundary.

Audit risk		Assurance procedure	Results and conclusions
7	**Internal recharges** Internal recharges were not eliminated from the gross income and gross expenditure figures included in the Comprehensive Income and Expenditure Statement (CIES) in 2016/17. Revised guidance will require these internal recharges to be eliminated in 2018/19. Revised guidance for 2017/18 has yet to be issued. There is a risk that gross income and gross expenditure are overstated in the 2017/18 accounts.	Review the 2017/18 CIES and working papers to confirm that the revised LASAAC guidance for 2017/18 has been followed.	**Results** Internal recharges were not eliminated from gross income and expenditure totals within the 2017/18 CIES. It is acknowledged that the LASAAC guidance is not clear, but we would expect that these amounts would be eliminated. There is no impact on the net cost of services or deficit on provision of services within the accounts. **Conclusion** The Code requires internal recharges to be eliminated in 2018/19.
8	**New financial systems** The council introduced new payroll and income management software systems during 2017/18. There is a risk over the completeness and accuracy of the data migrated to the new systems and that they are not operating as intended resulting in misstatements within the annual accounts.	Document the payroll and income management systems. Walkthrough of key controls within these systems. Substantive testing of payroll and income transactions.	**Results** We identified a number of a control weaknesses within the council's new payroll system which were reported in our 2017/18 Management Report. Controls within the new income management system operated satisfactorily. **Conclusion** Controls within the payroll system require improvement.
Risks identified from the auditor's wider responsibility under the Code of Audit Practice			
9	**Financial sustainability** The council does not have a long-term financial plan for revenue resources. The current level of service provision is not financially sustainable, and the council is currently using its reserves to maintain services at previous levels. In addition, the majority of the council's current 10-year Capital Plan is not directly linked to the council's priorities but arises from the need to invest in the council's current asset base to bring it up to, or maintain it at, the approved standard for the asset type. Without long term planning there is a risk that the council is unable to agree and implement a sustainable model for service	Undertake specific audit work on financial planning, progress of transformational change and leadership. This will include review of the 2018/19 budget and progress made with developing a medium term financial plan covering the period to 31 March 2023.	**Results** These have been set out in Part 3 of this report. Refer also to Appendix 1, recommendation 3. **Conclusion** The Council has yet to agree a sustainable financial strategy for the medium to long term. Current projections are that the uncommitted general fund will be reduced to minimum balance in the council's policy by March 2020.

	Audit risk	Assurance procedure	Results and conclusions
	delivery before its reserves are exhausted.		
10	**Financial management** The approved budget for 2017/18 includes £3.4 million of savings and uses £7.6 million of reserves to bridge the funding gap. The latest budget monitoring report to 31 December 2017 forecasts an overspend against budget of £0.9 million at the year-end which will require to be funded from reserves. In addition, the council will have to fund half of any overspend by the Integration Joint Board. As there are limited reserves available, any overspend in 2017/18 is a risk to the council's future financial sustainability.	Review financial monitoring reports and the financial position at the year end. Consider the robustness and completeness of financial monitoring during the year. Review the council's progress in achieving its planned savings.	**Results** The 2017/18 outturn resulted in the use of £4.1 million of reserves instead of the £7.9 million required to balance the original budget. In addition, the Council achieved its savings target of £3.4 million with additional savings of £0.5 million also achieved. **Conclusion** Financial management is effective. However, the Council continues to face significant financial pressures in 2019/20 and beyond.

Appendix 3

Summary of uncorrected misstatements

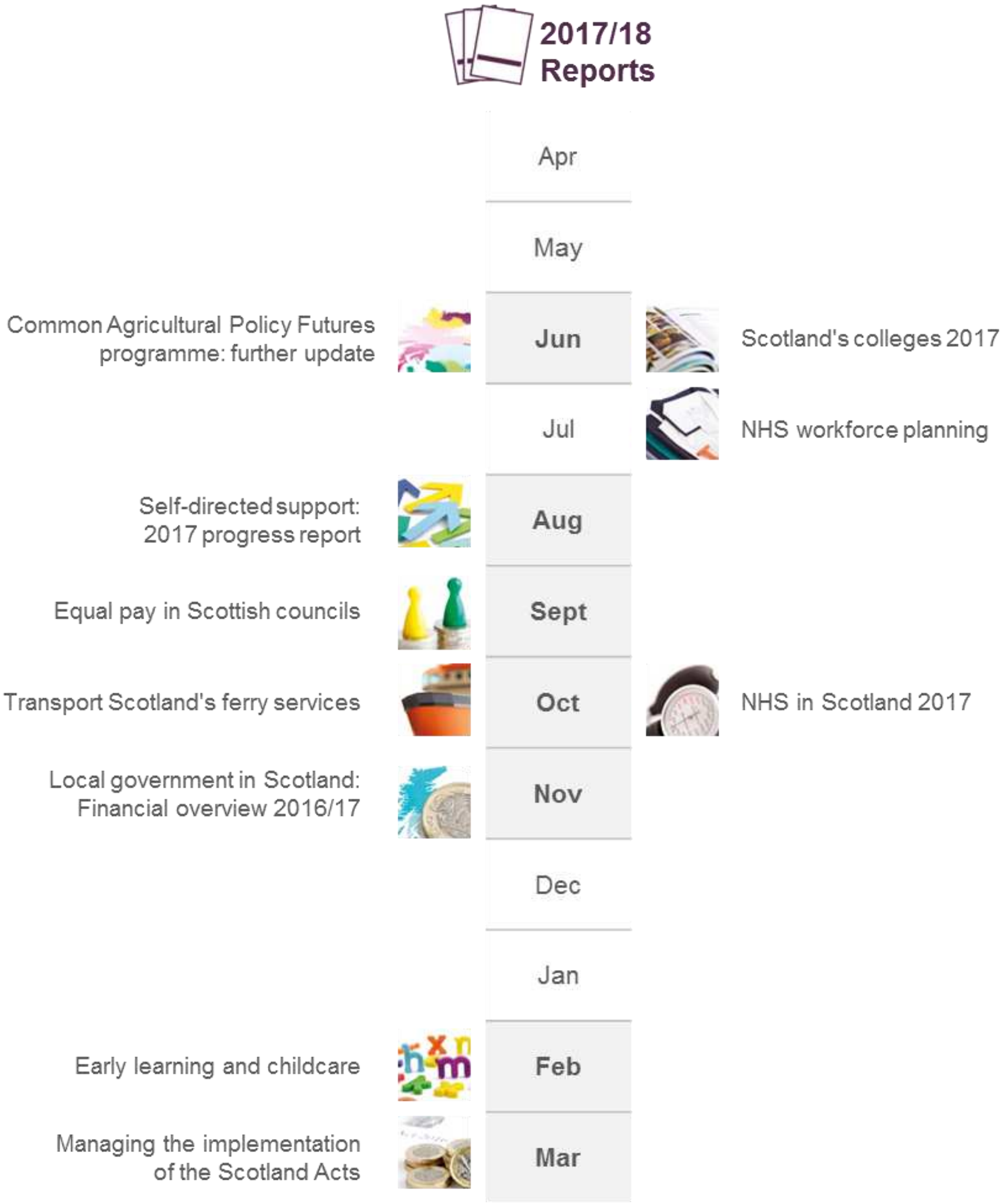
We report all uncorrected misstatements that are individually greater than our reporting threshold of £0.1 million.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements (see in Exhibit 4 findings 6, 7 and 8). Cumulatively these errors are above our performance materiality level. As explained in paragraphs 25 to 30, we have considered the impact of these errors on our audit approach and undertaken additional audit procedures. We are satisfied that these errors do not have a material impact on the financial statements.

Ref.	Account areas	Comprehensive income and expenditure statement		Balance sheet		Movement in Reserves Statement
		Dr £000	Cr £000	Dr £000	Cr £000	
Exhibit 4, finding 6	Surplus Assets			2,150		
	Investment Property				(2,150)	
Exhibit 4, finding 7	Short Term Creditors			150		
	Long Term Borrowing				(150)	
Exhibit 4, finding 8	Other Operating Expenditure	120				
	Gross Income		(120)			
Net impact		**120**	**(120)**	**2,300**	**(2,300)**	

Appendix 4

Summary of national performance reports 2017/18



Local government relevant reports

Principles for a digital future – May 2017

Self-directed support: 2017 progress report – August 2017

Equal pay in Scottish councils – September 2017

Local government in Scotland: Financial overview 2016/17 – November 2017

Moray Council

DRAFT 2017/18 Annual Audit Report

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