

Shetland Islands Council

2022/23 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Members of Shetland Islands Council and the Controller of Audit

November 2023

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Key messages

2022/23 annual accounts

- 1 Audit opinions on the annual accounts of Shetland Islands Council and the section 106 charity administered by the Council are unmodified.
- 2 Significant adjustments of £32 million were made in the audited financial statements reflecting changes in housing and pension valuations.

Financial management and sustainability

- 3 The Council has appropriate and effective financial management and reported an underspend of £2 million in 2022/23.
- 4 Useable reserves have decreased for the first time in eight years, due to reductions in investment valuations.
- 5 Total capital expenditure in 2022/23 was £15 million against an approved budget of £25 million and a wider review of capital planning is required,
- 6 The Council budget for 2023/24 has a budget gap of £3.2 million which is to be funded through general fund reserves.
- 7 The Council has a medium-term financial outlook with a projected cumulative budget gap of £106 million over 3 years.

Other wider code work

- 8 The Council continues to have a clear vision based on challenges facing the Islands. These are contained in “Our Ambition”, the Council’s corporate plan.
- 9 The Council has established a clear reporting framework and performance indicators which align to its Council plan priorities, but annual progress reporting should be more focused and balanced.
- 10 The Council has made progress with the recommendations in the 2022 BVAR. There is evidence of progress in almost all areas, but no area is fully complete yet.
- 11 The Council does not demonstrate full compliance with the Statutory Performance Information (SPI) Direction.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of Shetland Islands Council (the Council). The scope of the audit was set out in an annual audit plan presented to the 15 May 2023 meeting of the Audit Committee. This Annual Audit Report comprises:

- significant matters arising from an audit of Shetland Islands Council's annual accounts
- conclusions on Shetland Islands Council's performance in meeting its Best Value duties
- conclusions on the wider scope areas that frame public audit as set out in the [Code of Audit Practice 2021](#), covering financial management, financial sustainability, vision, leadership, and use of resources to improve outcomes.

2. This report is addressed to Shetland Islands Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

3. We would like to thank elected members, management and staff, particularly those in finance, for their cooperation and assistance in this year and we look forward to working together constructively over the course of the five-year appointment.

Responsibilities and reporting

4. Shetland Islands Council has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices. Shetland Islands Council is also responsible for compliance with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

5. The responsibilities of the independent auditor are established by the Local Government (Scotland) Act 1973 and the [Code of Audit Practice 2021](#), and supplementary guidance and International Standards on Auditing in the UK.

6. This report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation. 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 of its responsibility to address the issues we raise and to maintain adequate systems of control.

Auditor Independence

7. 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 therefore the 2022/23 audit fee of £252,590 as set out in our 2022/23 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

8. We add value to Shetland Islands Council by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, arrangements to ensure the best use of resources and financial sustainability.
- sharing intelligence and good practice identified.

1. Audit of 2022/23 annual accounts

Public bodies are required to prepare annual accounts comprising financial statements and other related reports. These are principal means of accounting for the stewardship public funds.

Main judgements

Audit opinions on the annual accounts of the Council and the section 106 charity administered by the Council are unmodified.

The audit resulted in the value of council dwellings being decreased by £7 million and the pension liability being restated by £25 million.

Audit opinions on the annual accounts are unmodified

9. The unaudited annual accounts were received in line with our agreed audit timetable on 30 June 2023. The Council approved the annual accounts for Shetland Islands Council for the year ended 31 March 2023 on 21 November 2023. As reported in the independent auditor's report, in my opinion as the appointed auditor:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the audited part of the remuneration report was prepared in accordance with the financial reporting framework
- the management commentary and annual governance statement were consistent with the financial statements and properly prepared in accordance with the applicable requirements.

Overall materiality was assessed as £5.8 million

10. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact their opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature. It is ultimately a matter of the auditor's professional judgement.

11. Our initial assessment of materiality was carried out during the risk assessment and planning phase of the audit. This was reviewed on receipt of the unaudited annual accounts and is summarised in [Exhibit 1](#).

Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£5.8 million
Performance materiality	£2.9 million
Reporting threshold	£250,000

12. The overall materiality threshold for the audit of the annual accounts of Shetland Islands Council was set with reference to gross expenditure, which we judged as the figure most relevant to the users of the financial statements.

13. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 50% of overall materiality, reflecting previous year errors, a high level of estimation and several complex systems with a high volume of transactions.

Significant findings and key audit matters

14. Under International Standard on Auditing (UK) 260 we communicate significant findings from the audit to the council, including our view about the qualitative aspects of the body's accounting practices.

15. The Code of Audit Practice also requires all audits to communicate key audit matters within the annual audit report under International Standard on Auditing (UK) 701. These are matters that we judged to be of most significance in our audit of the financial statements.

16. The significant findings are summarised in [Exhibit 2](#).

Exhibit 2

Significant findings and key audit matters from the audit of the annual accounts

Issue	Resolution
<p>1. Carrying value of council dwellings</p> <p>The Code of Practice on Local Authority Accounting (the Code) requires bodies to revalue assets with sufficient regularity to ensure the carrying value does not differ materially from the current value. Council dwellings were last revalued at 31 March 2019, with a full revaluation planned for 2023/24.</p> <p>Desk top exercises were undertaken by the in-house valuer, covering a sample of assets not subject to valuation during the year. These exercises identified that the beacon values for the representative sample had decreased by 9.41% since the last valuation, a reduction of over £7 million on the carrying value of £75.7 million in the unaudited accounts.</p>	<p>The audited financial statements have been updated to reduce the carrying value of council dwellings by £7.4 million. A full revaluation exercise on council dwellings will be undertaken in 2023/24.</p>
<p>2. Valuation of pension asset</p> <p>The 2022/23 unaudited annual accounts included a pension asset of £2.9 million.</p> <p>The pension accounting standard (IAS 19) limits any pension asset to the lower of the surplus and what is described as an asset ceiling. Further guidance on calculating the asset ceiling is provided in IFRIC 14. It refers to the impact of a 'minimum funding requirement' which stipulates a minimum amount of contributions that must be paid over a given period. The existence of a minimum funding requirement limits the ability of a body to reduce future contributions.</p> <p>Where the present value of the minimum funding requirement contributions exceeds the future service cost, IFRIC 14 advises that no asset should be recognised.</p> <p>This is the position with the Council and a pensions asset should have been reduced to zero for the funded pension scheme, with unfunded liabilities remaining as a pensions liability in the balance sheet.</p>	<p>The audited annual financial statements have been amended to reflect a pension asset of zero for the Council's funded obligations, with a pension liability of £22.3 million for its unfunded obligations, for which the IFRIC 14 calculation does not apply.</p>

Our audit identified and addressed the risks of material misstatement

17. [Exhibit 3](#) sets out the significant and non-significant risks of material misstatement to the financial statements we identified in our 2022/23 Annual Audit Plan. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3

Significant and Non-Significant risks of material misstatement in the annual accounts

Audit risk	Assurance procedure	Results and conclusions
Significant risks of misstatement		
<p>1. Risk of material misstatement due to fraud caused by management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively</p>	<ul style="list-style-type: none"> • Assess the design and implementation of controls over journal entry processing. • Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments. • Test journals at the year-end and post-closing entries and focus on significant risk areas. • Consider the need to test journal entries and other adjustments during the period. • Evaluate significant transactions outside the normal course of business. • Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year. • Substantively test income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Test accounting accruals and prepayments focusing on significant risk areas. 	<p>No material misstatements were identified caused by management override of controls.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>2. Estimation in the valuation of council dwellings</p> <p>The Council's housing stock was last revalued in 2019/20. Valuations are based on specialist assumptions including the discount factor to apply for social housing. Changes in these assumptions can result in material changes to valuations.</p> <p>There has been limited adjustment to the valuation of council dwellings since the 2019/20 valuation exercise.</p> <p>There is a risk that the carrying amount in the accounts on 31 March 2023 does not appropriately reflect movements and changes in assumptions since the last revaluation.</p>	<ul style="list-style-type: none"> • Examine management's assessment of fair value of council dwellings not subject to full revaluation in 2022/23. We will critically assess if this is based on expert valuer's opinion and assess the appropriateness of any assumptions • If undertaken, we will review the information provided to the valuer and complete a walkthrough of the valuation process for council dwellings to obtain an understanding of the process, including the methodologies and assumptions applied. • Test the reconciliation between the financial ledger and the property asset register and any valuation report to check asset valuations and useful lives. 	<p>A £7.380 million decrease to the carrying value of council dwellings was agreed.</p> <p>Refer to issue 1 in Exhibit 2</p>
<p>3. Estimation in the valuation of land and buildings.</p> <p>There is a significant degree of subjectivity in the valuation of land and buildings. Valuations are based on specialist assumptions and changes in these can result in material changes to valuations.</p> <p>Other land and buildings are revalued on a five-year rolling basis with a valuation date of 31 March. There is a risk of material movement between the date of valuation and the balance sheet date.</p>	<ul style="list-style-type: none"> • Review the information provided to the external valuer to assess for completeness. • Evaluate the competence, capabilities, and objectivity of the professional valuer. • Complete a walkthrough of the valuation process for OLB to obtain an understanding of the process, including the methodologies and assumptions applied. • Review reports from the valuer to confirm overall asset valuation. • Obtain an understanding of management's involvement in the valuation process for OLB to assess if appropriate oversight has occurred. 	<p>We concluded that land and buildings are not materially misstated.</p>

Audit risk	Assurance procedure	Results and conclusions
	<ul style="list-style-type: none"> • Examine management's assessment of fair value of OLB assets not revalued at 31 March 2023. We will critically assess if this is based on expert valuer's opinion and assess the appropriateness of any assumptions. • Test the reconciliation between the financial ledger and the property asset register and any valuation report. • Check asset valuations and useful lives. 	
<p>4. Presumed risk of fraud over harbour income recognition.</p> <p>Harbour income in 2021/22 amounted to £36 million.</p> <p>There is a rebuttable risk that fraud over income could lead to material misstatement of income.</p>	<ul style="list-style-type: none"> • Analytical review procedures • Reviewing the controls in place around recognition and accounting of harbour income • Examination of monthly/year-end reconciliations • Sample testing of harbour income transactions • Review of any unusual transactions 	<p>We conclude that harbour income is not materially misstated.</p>
<p>Non-significant risks of misstatement</p>		
<p>5. Estimation in the valuation of pension assets and liabilities</p> <p>Actuarial estimates are a complex combination of liabilities over significant future periods based on life expectancy and CPI growth and discounting (based on corporate bond rates).</p> <p>Assets are based on an individual employer body's share of assets at the last triennial valuation. Roll forward adjustments are provided to members data and to asset valuations.</p>	<ul style="list-style-type: none"> • Assess the scope, independence and competence of the professionals engaged in providing estimates for pensions. • Review the appropriateness of actuarial assumptions and results including comparison with other councils and the pension fund as a whole. • Establish officers' arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by the Council. 	<p>Following adjustments of £25.2 million, we conclude that the pension liability is not materially misstated.</p> <p>Refer to issue 2 in Exhibit 2</p>

Audit risk	Assurance procedure	Results and conclusions
<p>There is a risk that small changes in the assumptions used can lead to large changes in the resulting valuations resulting in material misstatement in the annual accounts.</p>		
<p>6. Valuation of long-term investments</p> <p>The 2021/22 Accounts include long term investments of £411 million.</p> <p>Markets have been volatile over recent years and there is a risk that valuations are materially misstated</p>	<ul style="list-style-type: none"> • Evaluate the competence, capabilities, and objectivity of the fund managers. • Review reports from the fund managers to confirm overall asset valuation. • Sample testing of investment valuations. 	<p>We conclude that long-term investments disclosed in the 2022/23 accounts are not materially misstated.</p>
<p>7. Estimation in PFI models</p> <p>The Council has a PFI contract for Anderson High School with a fair value of £40 million at 31 March 2022. The accounts also include amounts due to contractors under this contract totalling £83 million.</p> <p>Unitary charge payments to contractors require to be divided into the service and construction elements using estimation techniques.</p> <p>There is a risk of misstatement in the associated liability if inappropriate assumptions have been made, particularly given recent changes to RPI/CPI and associated indices</p>	<ul style="list-style-type: none"> • Obtain the PFI model and assess for reasonableness, based on whether it has been updated to reflect current unitary charges. • Determine management's processes for updating the model to reflect the future impact of recent changes in RPI/CPI, based on the requirements of the original contract indexation terms. 	<p>We conclude that the PFI liability is not materially misstated.</p>
<p>8. Estimation in the valuation of fishing quotas</p> <p>The 2021/22 Accounts include fishing quotas valued at £43 million.</p>	<ul style="list-style-type: none"> • Evaluate the competence, capabilities, and objectivity of the professional valuer. 	<p>We conclude that fishing quotas are not materially misstated.</p>

Audit risk	Assurance procedure	Results and conclusions
This investment requires annual assessment of its value and is affected by the quantity of Fixed Quota Allocation Units (FQAs) in the market.	<ul style="list-style-type: none"> • Complete a walkthrough of the valuation process for fishing quotas to obtain an understanding of the process, including the methodologies and assumptions applied. • Review reports from the valuer to confirm overall asset valuation. 	

We identified misstatements of £34 million within the unaudited financial statements and the majority was corrected

18. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

19. Total misstatements identified were £34 million which exceeds our performance materiality threshold. We considered whether further audit procedures were required and reviewed the nature and causes of these misstatements, which mainly related to non-current asset valuation adjustments and the reassessment of the IAS19 pension asset. We have concluded that most arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error. We considered whether other misstatements presented material risks of misstatement in the relevant account area and concluded they did not.

20. Other than the corrected material misstatement detailed as significant findings in [Exhibit 2](#), we also identified a misstatement of £1 million due to an under valuation of an investment. The accounts include a Blackrock SAIF investment product, which was valued at the end of December 2022. The valuation report to the 31 March 2023, which was received after the unaudited accounts had been prepared shows that the investment had increased by £971,000. This has not been corrected by management in the audited accounts.

Our audit opinions on the Section 106 charity were unmodified

21. Due to the interaction of section 106 of the Local Government in Scotland Act 1973 with the charities legislation, a separate independent auditor's report is required for the statement of accounts of each registered charity where members of Shetland Islands Council are sole trustees, irrespective of the size of the charity.

22. Our audit opinions on the Section 106 charity were unmodified.

23. At the audit planning stage we identified one significant risk of material misstatement in relation to the charity audit. As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.

24. We undertook audit procedures designed to provide an appropriate level of assurance over the transactions relating to the charity and did not identify any material misstatements due to management override of controls.

25. The unaudited accounts disclosed the trust funds as unrestricted, meaning they could be used at the discretion of trustees to further the objectives of the charity. However, as restrictions do exist on how investment income is allocated to support specific educational purposes, the audited accounts have been amended to recognise the funds are restricted by nature.

Good progress was made on prior year recommendations

26. The Council has made good progress in implementing prior year audit recommendations identified by Deloitte LLP, the previous external auditor. Management actions taken to address the recommendations are set out in [Appendix 1](#).

Good practice

27. ISA540 requires auditors to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable. This includes requesting written representations from management regarding the reasonableness of methods, significant assumptions and the data used in determining the amounts in the estimates.

28. The Council's accounts include a number of complex estimates, including property valuations, pensions liabilities, investments and fishing quota valuations. These valuations are informed by a mix of internal and external advisors. Management has an established process for documenting their assessment of valuations, including their review of methodology and reasonableness of assumptions used by advisors. We consider the documentation of this review process as part of the financial statements closedown process an example of good practice.

2. Financial management

Financial management means having sound budgetary processes, and the ability to understand the financial environment and whether internal controls are operating effectively.

Conclusion

The Council has effective and appropriate financial management.

The Council reported an underspend of £2 million. This was mainly due to additional external funding which was not used in 2022/23.

Useable reserves have decreased for the first time in eight years, due to reductions in investment valuations.

Capital expenditure in 2022/23 was £15 million against an approved budget of £25 million, an underspend of £10 million and a wider review of capital planning should be undertaken.

Controls within the main financial systems were operating effectively while standards for the prevention and detection of fraud remain appropriate.

The Council's budget setting and financial management arrangements operated effectively during 2022/23

29. The 2022/23 budget was approved on 16th February 2022. The Council approved a balanced General Fund budget of £140 million for 2022/23. This incorporated an initial budget gap of £5.1 million which was to be met from reserves to achieve financial balance. The budget already incorporated "sustainable" use of reserves of £25 million (investment returns of £14.4 million and Harbour Account trading income of £10.6 million).

30. The proposed budget also included an assumed 3% increase in Council Tax. However, elected members decided to freeze Council Tax at the same level as 2021/22. So, the approved budget required an unsustainable draw on reserves of £5.5 million.

The 2022/23 outturn was an underspend of £2 million

31. Total General Fund net revenue expenditure for 2022/23 was £146 million against an approved revised budget of £148 million: an underspend of £2 million. The underspend was due to a combination of under and overspends in

services but mainly due to the Council not needing the contingency set aside to manage pay awards uncertainty.

32. The revenue element of the Harbour Account generated a surplus of £11 million, £2 million less than budget, mainly through decreased tanker income and increased cost prices.

33. The more significant under and overspends are summarised in [Exhibit 4](#).

Exhibit 4

Summary of significant under/overspends against budget

Area	£m	Reason for variance
Underspends		
Development services	£2.090 million	Lower than anticipated grant applications due to other schemes being available, a relatively short period in which to apply for funding and the timing of grant claims received from third parties. This particularly affected the Coastal Communities Fund Scheme and the Winter Activities Fund Scheme.
Infrastructure services	£1.233 million	<p>Vacant posts across Environmental and Estates Operations (28 FTE) and Roads (12FTE) mainly due to delays in getting posts reconfigured and advertised or lack of applicants.</p> <p>No spend on planned external contractor surface treatment works due to contractor supply chain issues.</p> <p>Additional income for the sale of Bitumen to Sumburgh Airport and Viking Energy.</p> <p>Underspend offset by overspend in Ferry & Air Operations due to increased staff costs for the pay award, increased costs of marine fuel, use of agency workers to cover vacant posts and increased dry docking costs.</p> <p>Also increased costs of fuel and gritting salt and additional external contractor costs due to severe winter weather periods for Roads Services.</p>
Overspends		
Children's services	£1.009 million	<p>Teachers' pay award higher than budgeted.</p> <p>Higher cleaning employee costs from additional office space.</p> <p>Additional catering staff from increased uptake of school meals.</p>

Area	£m	Reason for variance
		Increased costs of school catering and cleaning supplies.

Source: Shetland Islands Council Draft Revenue and Capital Outturn 2022/23

34. Senior management and members receive regular and accurate financial information on the body's performance against budgets. The body has appropriate budget setting and monitoring arrangements.

An overspend of £0.6 million was reported against the housing revenue budget

35. The Council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set a level which will at least cover the costs of its social housing provision.

36. The revenue element of the Housing Revenue Account generated a surplus of £1 million, which was £0.6 million less than budget. This was mainly due to higher than anticipated expenditure on repairs and maintenance, driven by increased prices for raw materials.

Useable reserves have decreased for the first time in eight years, due to reductions in investment valuations

37. One of the key measures of the financial health of a body is the level of reserves held. The level of usable reserves held by the body decreased from £430 million in 2021/22 to £390 million in 2022/23.

38. The decrease was mainly attributable to a decrease in the earmarked unrealised investment gains. These reduced from £132 million to £96 million. Unrealised investment gains can be very volatile based on investment movements and are not certain. The gain is "unrealised" because the underlying investments have not been sold.

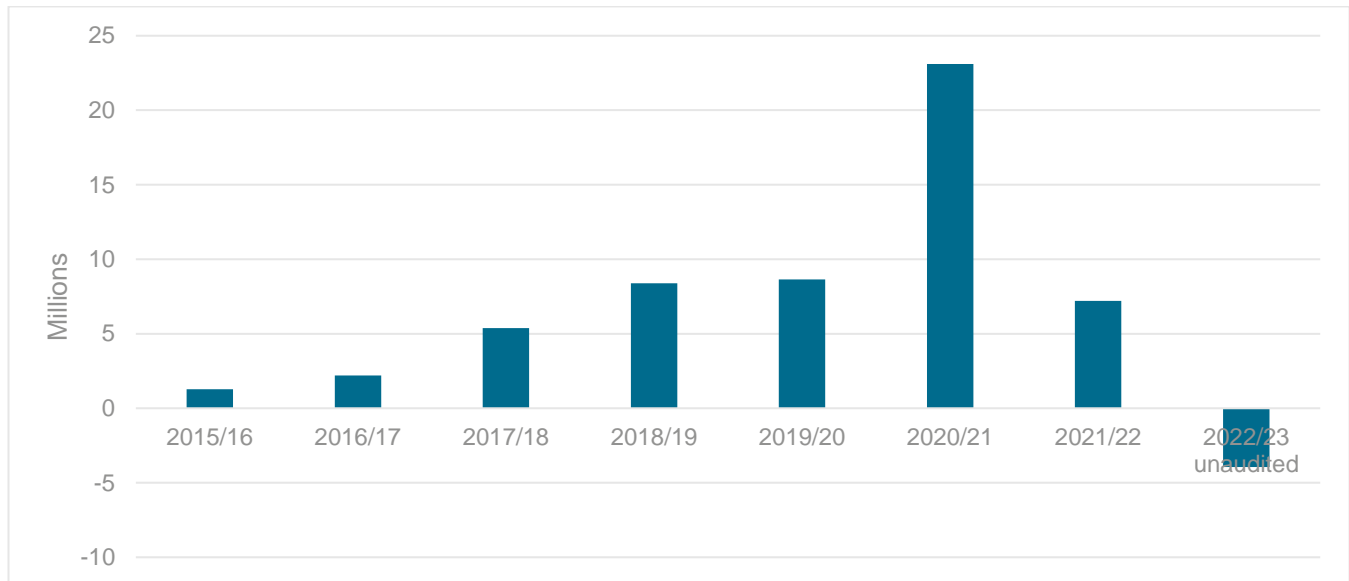
39. The uncommitted general fund balance has reduced by £8.5 million from £23.8 million in 2021/22 to £15.3 million in 2022/23. This represents 11% of the Council's annual budgeted net expenditure.

40. [Exhibit 5](#) provides an analysis of the movement in useable reserves over the last eight years which shows that reserves have decreased during 2022/23, for the first time over these eight years.

Exhibit 5

Movement in useable reserves (excluding unrealised gains) over the last 8 years.

Only in 2022/23 has the total useable reserves of the Council reduced.



Source: Shetland Islands annual accounts

Planned efficiency savings were achieved

41. The 2022/23 budget included planned savings and efficiencies of £3.3 million, which were achieved in the year. £2.4 million of savings were on a recurring basis (73%) with the remainder on a non-recurring basis (27%).

Capital expenditure slippage in 2022/23

42. Total capital expenditure in 2022/23 was £15 million of which £10.7 million related to general services, £0.3 million to the harbour account and £4 million to the housing revenue account. The approved budget was £25 million resulting in an underspend of £10 million. This was mainly caused by a lack of contractors, supply issues and the uncertainty over price rises. Works will continue into 2023/24 and £5.9 million will be carried forward to finance the continuation of those works.

43. The slippage or underspend in the capital programme is a recurring issue for the Council, with underspends noted in 2021/22 and 2020/21. This might indicate that capital plans are optimistic.

44. Planned capital investment for 2023/24 totals £22 million, of which more than 64 percent is allocated for the maintenance of existing assets. £7.7 million has been provisionally included for new developments and potential projects, subject to approval of their respective business cases.

45. In line with recommendations made in our BVAR thematic report, a wider review of capital planning should be undertaken to determine if capital plans are

overly optimistic or whether more agile procedures are required to review projects experiencing slippage (see **recommendation BV6** in [Appendix 1](#)).

Appropriate financial control arrangements are in place in most areas, however deficiencies exist in procurement compliance and the commissioning of consultancy services

46. As required by Audit Scotland’s Code of Audit Practice, as part of our audit we identified and evaluated the key internal controls in the accounting systems. Our objective was to gain assurance that it has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

47. We concluded that the key controls in the main financial systems were generally operating as specified. However, we did identify some scope to improve existing controls, shown in [Exhibit 6](#)

Exhibit 6

We identified some areas where a key control could be strengthened

Audit finding	Additional audit procedures and recommendation
<p>1. Review of Access</p> <p>A periodic review is not carried out on the list of employees with access to the Pay360 Income Management system.</p>	<p>Periodic reviews should be carried out to ensure that access is limited to appropriate users.</p> <p>Recommendation 1 in Appendix 1</p>
<p>2. Daily Reconciliations</p> <p>Automated daily reconciliation reports and exception reports are produced by the Pay360 Income Management system.</p> <p>These reports are reviewed and, if necessary, actioned. However, the review and any actions taken was not being evidenced.</p>	<p>The review of reconciliations and any actions taken should be evidenced.</p> <p>Recommendation 2 in Appendix 1</p>

48. The internal audit function is delivered by Audit Glasgow. We considered internal audit’s annual report, presented to the June 2023 Audit Committee, as part of our review of the Annual Governance Statement included within the 2022/23 annual accounts. This disclosed internal audit’s opinion that limited assurance can be placed upon the adequacy and effectiveness of the governance and control environment which operated during 2022/23 in the Council, due to some 2022/23 audits having unsatisfactory and limited audit opinions and the volume of uncleared audit points from prior years. The Council has developed a procurement project action plan to address the issues identified relating to procurement compliance and the commissioning of consultancy services.

Standards of conduct and arrangements for the prevention and detection of fraud and error were appropriate

49. Shetland Islands Council has a range of established procedures for preventing and detecting fraud and irregularity including a whistleblowing policy, anti-fraud, bribery and corruption policy and codes of conduct for councillors and officers.

National Fraud Initiative

50. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland which aims to prevent and detect fraud. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

51. The Council has made good progress in progressing matches in most areas. Of the 1,851 high level matches, investigation of 1,677 has been completed. Three errors, totalling £3,103, were identified relating to duplicate payments. In addition, 31 Blue Badges were cancelled preventing estimated fraud of £20,150.

3. Financial sustainability

Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Conclusion

There are no short or medium-term issues with the Council's significant reserves, but these have reduced for the first time in eight years and reporting of the reserves projection is being reviewed.

The Council budget for 2023/24 has a budget gap of £3.2 million which will be funded through general fund reserves.

The Council has a medium-term financial outlook with a projected cumulative budget gap of £106 million over 3 years.

There are no short- or medium-term issues with the Council's significant reserves, but these have reduced for the first time in eight years

52. [Exhibit 7](#) sets out the wider scope risks relating to financial sustainability we identified in our 2022/23 audit. It summarises the audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 7

Risks identified from the auditor's wider responsibility under the Code of Audit Practice

Audit risk	Assurance procedure	Results and conclusions
Unsustainable use of reserves to balance the budget.	<ul style="list-style-type: none"> Assess the sustainability of using reserves to balance the budget. Monitoring trends and projections for movements in reserves Review of medium to long-term financial planning. 	<p>Review of financial sustainability was undertaken and reported as part of our Best Value thematic review and in the following paragraphs.</p> <p>The Council has 15 years of reserve left at the current rate of use – and this does not assume ongoing investment returns, so could be considerably longer.</p>

Audit risk	Assurance procedure	Results and conclusions
	<ul style="list-style-type: none"> Monitoring of the estimated future funding gap. 	<p>There are no short- or medium-term issues with the financial sustainability of the Council. However, the Council does need to consider that in 2022/23 total usable reserves, excluding unrealised gains, did reduce for the first time in eight years (by 1% but remain at a level higher than 2020/21). The Council has agreed that it will review how it reports projections of income and expenditure and the reserves balance to make this clearer.</p>

Recommendation 3

The Council should review and update the reporting of income and expenditure projections in the medium-term financial outlook, to ensure they include all reasonable assumptions and elements of the financial position and their impact on projected reserve balances.

The Council has a budget gap of £3.2 million in 2023/24 and this will be met from reserves

53. On 15 March 2023, the Council approved a balanced revenue budget for 2023/24, which reflected budget consultations with the community. The budget for 2023/24 had a gap of £3.2 million. This was after a council tax increase of 4.5 percent, “sustainable” use of reserves (investment returns of £15.4 million and Harbour Account trading income of £18.1 million), £4.2 million of savings and efficiencies and £2.6 million from service reviews. The remaining gap is to be met from general fund reserves. The budget included funding from the Scottish Government of £108 million.

54. The Harbour Account budget assumes similar levels of activity to recent years. The Harbour Account also expects to benefit from additional income from increased charges being applied and from the Shetland Gas Plant, (arising from the increased price of gas). The Council anticipates the Harbour Account will return a total surplus of £18.2 million in 2023/24 through ports and harbour trading activity.

55. The Housing Revenue Account (HRA) budget incorporates an approved increase of housing rent charges of 4.5 percent to generate sufficient revenue to meet day-to-day operating costs and to help finance planned capital investment. There is £9.1 million of planned capital investment in housing stock.

Recent budget reports indicate an overspend of £2.5 million in 2023/24

56. The most recent budget monitoring report projects an overspend of £2.5 million against a revised General Fund budget of £157.5 million. This is due to some vacancy factors, service reviews and 1% savings not yet being achieved.

The Council has a medium-term financial outlook with a projected cumulative budget gap of £106 million over 3 years

57. The Council has prepared a medium-term financial outlook (MTFO) 2022-2027, which is refreshed annually ahead of the budgeting cycle. The latest update was September 2022. The MTFO summarises the key financial planning assumptions and translates the assumptions and financial modelling into three different scenarios:

- An optimistic, upside scenario
- A central, most likely scenario, and
- A pessimistic, downside scenario.

58. Scenario planning and financial modelling indicates that the Council faces a significant challenge in being able to set balanced budgets in the future. The central scenario indicates a potential cumulative budgetary deficit of £106.4 million by 2026/27 (£20.8m 2023/24; £26.2m - 2024/25, £28.9 - 2025/26: £30.5m – 2026/27) should the Council not be proactive in managing and addressing the financial pressures it expects to face in the short- to medium-term. The MTFO is in the process of being updated.

4. Other wider scope audit work

During 2022/23 our other wider scope audit work included a Best Value thematic review of leadership and priorities, and consideration of the Council's performance management and reporting arrangements, governance, and its use of resources to improve outcomes.

Conclusions

The Council continues to have a clear vision based on challenges facing the Islands. These are contained in "Our Ambition", the Council's corporate plan.

The Council has established a clear reporting framework and performance indicators which align to its Council plan priorities, but annual progress reporting should be more focused and balanced.

The Council has made progress with the recommendations in the 2022 BVAR. There is evidence of progress in almost all areas, but no area is fully complete yet.

The Council does not demonstrate full compliance with the SPI Direction.

Best Value audit work is now fully integrated within our annual audit work

59. Councils have a statutory duty to make arrangements to secure continuous improvement in the performance of their functions. Expectations are laid out in the [Best Value Revised Statutory Guidance 2020](#).

60. Over the previous external audit appointment period (2016/17-2021/22), each of the 32 councils in Scotland were the subject of a separate Best Value Assurance Report (BVAR) published by the Accounts Commission. [The Shetland Islands Council BVAR](#) was published in August 2022.

61. Under the [Code of Audit Practice 2021](#), the audit of Best Value in councils is now fully integrated within our annual audit work. Best Value at the Council will be assessed comprehensively over the period of the audit appointment and will include an annual evaluation of the Council's approach to demonstrating improvement in its services and public performance reporting. We will also follow up findings reported previously on Best Value to assess the pace and depth of improvement.

62. For 2022/23 the Accounts Commission directed auditors to report on the effectiveness of the Council's leadership and the development of the Council's strategic priorities. In carrying out the thematic work auditors considered the following questions:

- How clear is the new Council vision and its priorities?
- How effectively have the views of citizens and communities been reflected in the priorities and decisions taken by the Council?
- How effectively do the Council priorities reflect the need to reduce inequalities and climate change?
- How good are the delivery plans and is there alignment of financial, workforce, asset and digital plans with the Council's priorities?

63. We also assessed the performance of the Council and its performance reporting and the council approach to climate change.

64. The results of this work were reported to elected members at the Audit Committee on 19 September 2023 and full council on [27 September 2023](#). This report will be published on the Audit Scotland website soon.

65. The key findings in this report are:

- The Council continues to have a clear vision based on challenges facing the Islands. These are contained in "Our Ambition": the Council's strategic plan.
- Performance measures are now aligned to "Our Ambition" but these are not focussed enough and lack medium or longer-term targets. The annual performance reporting lacks data to support its narrative, which is mainly positive and does not provide insight into areas where performance is poorer. The Council's "Performance Explorer" interactive website provides good, detailed performance information, but doesn't reflect the priorities and commitments in "Our Ambition" and links to data are not well-used in the progress update.
- Shetland has a relatively strong performance, based on LGBF data: 55 percent of indicators are in the top two quartiles with 51 percent of indicators in the top quartile compared to other councils, but this performance relative to other councils has decreased. Resident satisfaction scores remain high, except for housing.
- The Council's community engagement network is well-established and the Council plans to develop a community engagement strategy. Locality Plans are still not established, and the extent of participatory budgeting is unclear.
- The Council has a net zero target for 2045 and is developing a plan.
- Service plans and revenue budgets are up-to-date and consistent with "Our Ambition". Other plans, including workforce and asset investment plans, are not yet aligned with "Our Ambition".

- A Council General Fund revenue budget gap of £3.2 million for 2023/24 is part of a much larger planned use of reserves totalling £37 million. This includes £18m harbour income and investment returns of £15 million.
- The total useable reserves decreased last year (2022/23) (£40 million) and the projected reduction in 2023/24 is £24 million) with amounts being used to support services and capital investment. If this continues, then the council reserves could run out in 15 years.
- The Council has made progress on recommendations, reported one year ago, in the 2022 BVAR. There is evidence of progress in almost all areas, but no area is fully complete yet.

66. The audit recommendations made in the BV thematic report, with the management responses, are included in [Appendix 1](#) of this report.

The Council does not demonstrate full compliance with the SPI direction.

67. The Accounts Commission issued a new [Statutory Performance Information Direction](#) in December 2021 which applies for the three years from 2022/23. It requires a council to report its:

- performance in improving local public services (including those provided with its partners and communities), and progress against agreed desired outcomes (SPI 1). The Commission expects this reporting to allow comparison both over time and with other similar bodies (drawing on Local Government Benchmarking Framework and/or other benchmarking activities)
- own assessment and audit, scrutiny and inspection body assessments of how it is performing against its duty of Best Value, and how it has responded to these assessments (SPI 2).

68. We reviewed the performance against the SPI direction in our BV thematic report this year. We do not believe that the Council has fully complied with the Direction. Although data analysis is available on the Council's website; is reported to committee; is sufficiently detailed; includes comparison with other councils and over time, Our judgement is the Council is not doing well enough in balanced reporting. Performance indicators and outcome reporting lacks focus and doesn't reflect the priorities in Our Ambition.

The Council has made progress on implementing previous BVAR findings, but none are yet complete

69. Shetland Islands Council received a full Best Value Assurance report in August 2022. As part of our annual work programme, we followed up on agreed actions from that report.

70. Exhibit 4 summarises our assessment of each of the outstanding recommendations. This shows that some progress has been made on progressing previous BVAR findings, but none are yet complete. There has

been no significant progress on developing a “change” or transformation programme.

Governance arrangements are appropriate and operated effectively

71. Shetland Islands Council’s governance arrangements have been set out in the annual governance statement in the annual accounts. We have reviewed these arrangements and concluded that they are appropriate and effective.

72. Scrutiny arrangements appear to be working well in the Council.

The council is currently developing a Climate Change Strategy and Action Plan

73. In January 2020, Shetland Islands Council acknowledged a Climate Emergency and the Climate Change Programme was set up. The importance of climate change has been recognised in the corporate plan. "Sustainable future for Shetland" forms part of “Our Ambition” and tackling Climate Change is one of the ten priorities. “Our Ambition” includes eight actions linked to Climate Change.

74. The Council has set an organisational net zero target by 2045 and is currently developing a Climate Change Strategy and Action Plan to set out how they plan to achieve this. This is being done using the data and recommendations gathered through the net zero route map project. The Council intends to publish annual progress reports.

75. A climate change webpage has been created, which signposts users to more information on climate change: how they can get involved and details on available funding opportunities.

The Council is open and transparent

76. The Council continues to be open and transparent, with all agendas, reports and minutes published on the Council website. In addition, there is livestreaming of council meetings.

77. The Council’s website allows the public access to a wide range of information including the register of councillors’ interests, current consultations and service performance data. In addition, the home page provides updates on recent developments and links to useful information, including how to access cost of living support and advice.

78. The Council makes its annual accounts available on its website. These include a management commentary which adequately explains the Council’s financial performance for the year.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Review of Access</p> <p>It was established that no periodic review is carried out on the list of employees with access to the Pay360 Information Management system.</p> <p>Risk – Those who shouldn't have access may have access.</p>	<p>Periodic reviews should be carried out to ensure that access is limited to appropriate users.</p> <p>Exhibit 6</p>	<p>In line with the recommendation, carry out periodic reviews on the list of employees with access to the system and action any changes as required.</p> <p>Executive Manager - Finance December 2023</p>
<p>2. Daily reconciliations</p> <p>Automated daily reconciliation reports and exception reports are produced by the PAY360 Income Management system.</p> <p>It was established that these reports are reviewed and, if necessary, actioned. However, the review and any actions taken was not being evidenced.</p> <p>Risk – Anomalies may not be identified and actioned correctly.</p>	<p>The review and any actions taken should be evidenced.</p> <p>Exhibit 6</p>	<p>In line with the recommendation, document the review of the daily reconciliation and exception reports.</p> <p>Executive Manager - Finance December 2023</p>
<p>3. Reserves</p> <p>The Council's reserves have reduced for the first time in eight years. While there are no short- or medium-term issues around the reserves</p>	<p>The Council should review and update the reporting of income and expenditure projections in the medium-term financial outlook, to ensure they include all reasonable assumptions and</p>	<p>As part of the development of the MTFP 2023-28 we will engage with external audit around good practice on the content and disclosure within medium term financial planning. This would be</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>position, there is scope to enhance reporting of current projections and clarify the elements of reserves available to support these plans.</p>	<p>elements of the financial position and their impact on projected reserve balances.</p> <p>Exhibit 7</p>	<p>reflected into the next MTFP, due in July 2024.</p> <p>Executive Manager - Finance July 2024</p>

BVAR Thematic report recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>BV 1. Annual progress Reporting</p> <p>The Council performance is reported via the Our Ambition performance progress report dashboard but there is a positive focus on the narrative reporting without any insight to areas where performance is poorer.</p> <p>Links to data in the interactive dashboard should be made in addition to the narrative.</p> <p>Risk: Insight into the areas of poorer performance is not being given and the data is not being used to demonstrate performance in the dashboard narrative.</p>	<p>Annual Progress Reporting should present a balanced view of progress and demonstrate links to data in the interactive dashboard.</p>	<p>We will work with Services to present a more balanced view including both good performance and areas where performance could be improved. To be included in the Q2 Directorate Performance Reports.</p> <p>We will review how data is linked in the Dashboard by December 2023.</p> <p>The Annual Progress report 2023 will present a balanced view of progress and demonstrate links to data in the interactive dashboard</p> <p>Responsible officer: Chief Executive</p> <p>Agreed date: June 2024</p>
<p>BV 2. Performance indicators</p> <p>The performance indicators and actions are not clearly linked to the objectives or key to the commitments in the Our Ambition plan. Existing indicators have been aligned to priorities in the plan but more work is needed to reflect the priorities of the plan and a review of the</p>	<p>The framework of indicators and actions to support “Our Ambition” should be streamlined and reduced to enable focus on the areas that demonstrate progress on key priorities.</p>	<p>We will review the Performance Indicators with Services to ensure that they reflect the priorities in Our Ambition and that there is no overlap/duplication.</p> <p>Since Performance Indicators are approved by Council we would look to take a report to Council in the final quarter of 2023/24 in order to begin</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>number of indicators should be undertaken.</p> <p>Risk: Performance indicators are not reflective of the key commitments of Our Ambition.</p>		<p>2024/25 with the revised indicators.</p> <p>Responsible officer: Chief Executive</p> <p>Agreed date: March 2024</p>
<p>BV 3. Resident participation in decision making</p> <p>The Council is bound by the charter to carry out a full tenant satisfaction survey at least every three years, with the latest taking place in Spring 2023. The opportunities to participate in council decision making 2023 results are showing 52.8% against a Scottish average of 74.8%, and a fall from the previous result of 59.8% in 2019.</p> <p>Risk: The decisions taken by the council may not be reflective of the priorities of local residents</p>	<p>Further engagement is required to encourage tenant participation in Council decision making.</p>	<p>The next Tenant Satisfaction Survey will be due in Spring 2026. Further development of our Tenant Participation Strategy is planned with refreshed engagement with tenants using a variety of methods.</p> <p>Responsible officer: Anita Jamieson</p> <p>Agreed date: Spring 2026</p>
<p>BV 4. Community engagement strategy</p> <p>The Council plans to complete a community engagement strategy, and it has a target date of 4 December 2023 for completion.</p> <p>Risk: The Community empowerment theme from our ambition is not being fully met.</p>	<p>A community engagement strategy should be completed</p>	<p>A community engagement policy is in development and will be reported to the Council for approval in December 2023</p> <p>Responsible officer: Vaila Simpson</p> <p>Agreed date: December 2023</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>BV 5. Use of reserves</p> <p>There is an increased reliance on the use of reserves to balance their budget over the last two years. It is projected that £37million will be required for the General Fund for 2023/24.</p> <p>Risk: There is a long-term sustainability risk for the delivery of services given the increased reliance on reserves</p>	<p>The Council needs to address its significant increase in reliance on reserves, if it is to avoid impacts on services in the long-term as reserves run out.</p>	<p>The position is well understood and forms a key pillar of influence on Council decision making. However in common with most, if not all LAs, sustainability is an elusive target. An alternative approach will be agreed by Senior Managers for use in 2024/25 revenue budget setting, which seeks to establish balanced budgets, with a demonstrable reduction in reliance on reserves year on year.</p> <p>Responsible officer: Paul Fraser Agreed date: March 2024</p>
<p>BV 6. Capital programmes</p> <p>The slippage or underspend in the capital programme is a recurring issue for the Council, with underspends noted in 2021/22 and 2020/21.</p> <p>Risk: There is a risk that capital programmes are optimistic and not aligned to the Our Ambition plan.</p>	<p>The Council should assess whether capital programmes are optimistic and if an adjustment is required to plans. Capital and workforce plans should be aligned to Our Ambition plan.</p>	<p>Officers accept that the Capital Plan has seen a high level of underspend. An alternative approach will be agreed by Senior Managers for use in 2024/25 budget setting, which seeks to ensure that the approved capital plan reflects only projects that are certain to proceed, thus creating a more stable financial position.</p> <p>Responsible officer: Paul Fraser Agreed date: March 2024</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>b/f 1 PPE</p>	<p>The property valuer should introduce as part of the annual valuations, similar to</p>	<p>This was incorporated in the Valuation Terms of Engagement sent to the</p>

Issue/risk	Recommendation	Agreed management action/timing
	<p>the exercise carried out as part of the audit to documentation their consideration of those assets not subject to valuation in the year to demonstrate that the carrying amount does not differ significantly from the current value.</p>	<p>Councils internal valuer as part of the year end process.</p> <p>Closed</p>
<p>b/f 2 NFI</p>	<p>The Council should assess whether the team currently assigned responsibility for administering the NFI scheme locally have sufficient capacity and authority for seeking action across the whole of the Council</p>	<p>Internal Audit are now taking on the role of scrutiny of the NFI scheme with the support of the Finance and other services across the Council.</p> <p>Closed</p>

Shetland Islands Council

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