



Shetland Islands Council

2015/16 Annual audit report to Members and the Controller of Audit

September 2016

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The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies (www.audit-scotland.gov.uk/about/ac/). Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General (www.audit-scotland.gov.uk/about/).

The Accounts Commission has appointed David McConnell as the external auditor of Shetland Islands Council for the period 2011/12 to 2015/16.

This report has been prepared for the use of Shetland Islands Council and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

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Key messages

Audit of financial statements

- Unqualified auditor's report on the 2015/16 financial statements.
- Unqualified auditor's reports on the Zetland Educational Trust administered by the council.

Financial management and sustainability

- Financial management remains strong with a robust budget setting process in place.
- The council is financially sustainable currently and in the foreseeable future although rising demand for and costs of services will continue to place a strain on the council's capacity to deliver services at the current levels.
- The achievement of the savings set out in the council's Medium Term Financial Plan (MTFP) will be significant in ensuring the council's continued financial sustainability.

Governance and transparency

- The council has a strong governance structure in place.
- There is a sound system of internal control with an appropriate committee structure in place to identify and report on any areas of weakness.
- The council has an effective internal audit function and sound anti-fraud arrangements
- Integration Joint Board to deliver health and social care integration became operational during the year

Best Value

- The council continues to develop its arrangements for monitoring and reporting performance against strategic priorities.
- Substantial progress has been made towards delivering the objectives set out in the Corporate Plan.
- The council is meeting the requirements of the Public Performance Reporting (PPR) criteria.

Outlook

- Councils face rising demands for services and continued funding pressures alongside managing major reforms in welfare and health and social care.
- Effective arrangements for Best Value will be essential for efficient use of available resources, and strong governance and leadership will be needed to achieve continuous improvement.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Shetland Islands Council. The report is divided into sections which reflect our public sector audit model.
2. The management of Shetland Islands Council is responsible for:
 - preparing financial statements which give a true and fair view
 - implementing appropriate internal control systems
 - putting in place proper arrangements for the conduct of its affairs
 - ensuring that the financial position is soundly based.
3. Our responsibility, as the external auditor of Shetland Islands Council, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, summarised at [appendix II](#) and [appendix III](#), include recommendations for improvements.
6. [Appendix IV](#) is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Shetland Islands Council understands its risks and has arrangements in place to manage these risks. The council and executive officers group should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.
9. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of Shetland Islands Council will be Deloitte LLP. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditors as part of this transition.

Audit of the 2015/16 financial statements

Audit opinion	<ul style="list-style-type: none"> We have completed our audit of the council and its group and issued an unqualified independent auditor's report.
Going concern	<ul style="list-style-type: none"> The financial statements of the council, its group and the associated charitable trust have been prepared on the going concern basis. We are unaware of any events or conditions that may cast significant doubt on the council's, its group and associated charitable trust's ability to continue as a going concern.
Other information	<ul style="list-style-type: none"> We review and report on other information published with the financial statements, including the management commentary, annual governance statement and the remuneration report. We have nothing to report in respect of these statements.
Charitable trusts	<ul style="list-style-type: none"> We have completed our audit of the 2015/16 financial statements of the Zetland Educational Trust administered by Shetland Islands Council and issued an unqualified independent auditor's report for the trust.
Group accounts	<ul style="list-style-type: none"> Shetland Islands Council has accounted for the financial results of three associates and one joint venture in its group accounts for 2015/16. The overall effect of consolidating these balances on the group balance sheet is to increase total reserves and net assets by £110.354 million.
Whole of government accounts	<ul style="list-style-type: none"> The council submitted a consolidation pack for audit by the deadline of 26 August 2016. This has been audited and the certified return submitted to the NAO.

Submission of financial statements for audit

10. We received the unaudited financial statements on 27 June 2016, in accordance with the agreed timetable. The working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit to deadline.
11. In 20105/16, for the first time, local government group accounts are required to include the financial results of Integration Joint Boards (IJBs) in their area, where material. The Shetland Islands IJB was established on 20 June 2016 and became operational on 22 November 2016. The amounts concerned in 2015/16 are material and they have been consolidated into the group accounts.

Overview of the scope of the audit of the financial statements

12. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit Committee on 1 March 2016.
13. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2015/16 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

14. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. [Appendix I](#) sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.
15. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

16. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).
17. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial

statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

18. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of Shetland Islands Council we set our planning materiality for 2015/16 at £1.885 million (1% of gross expenditure). We report all misstatements greater than £0.020 million. Performance materiality was calculated at £0.942 million, to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our planning materiality level.
19. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original calculation remained appropriate.

Evaluation of misstatements

20. A number of presentational adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements.
21. Two misstatements have not been processed through the Council's financial statements by management. If adjusted these would result in a decrease in expenditure of £0.026 million in the 2015/16 Comprehensive Income and Expenditure Account, and an increase in the carrying value of Property, Plant and Equipment in the Balance Sheet at 31 March 2016 of £0.029 million.

Significant findings from the audit

22. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
 - The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
 - Significant difficulties encountered during the audit.
 - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
 - Written representations requested by the auditor.
 - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
23. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260

Untaken Annual Leave Accrual

24. Our review of the untaken annual leave accrual identified significant errors within the calculations for non-teacher school staff and for non-school staff. The non-teacher school staff calculations had used the incorrect number of working days and accrued holidays for some staff, while the non-school staff calculations had a number of errors in the spreadsheet formula used to calculate the accrual. The council agreed to correct these errors, the effect of which is a decrease of £0.605 million to the 2015/16 untaken annual leave accrual and an increase to the unusable reserves balance in the Balance Sheet.

Future accounting and auditing developments

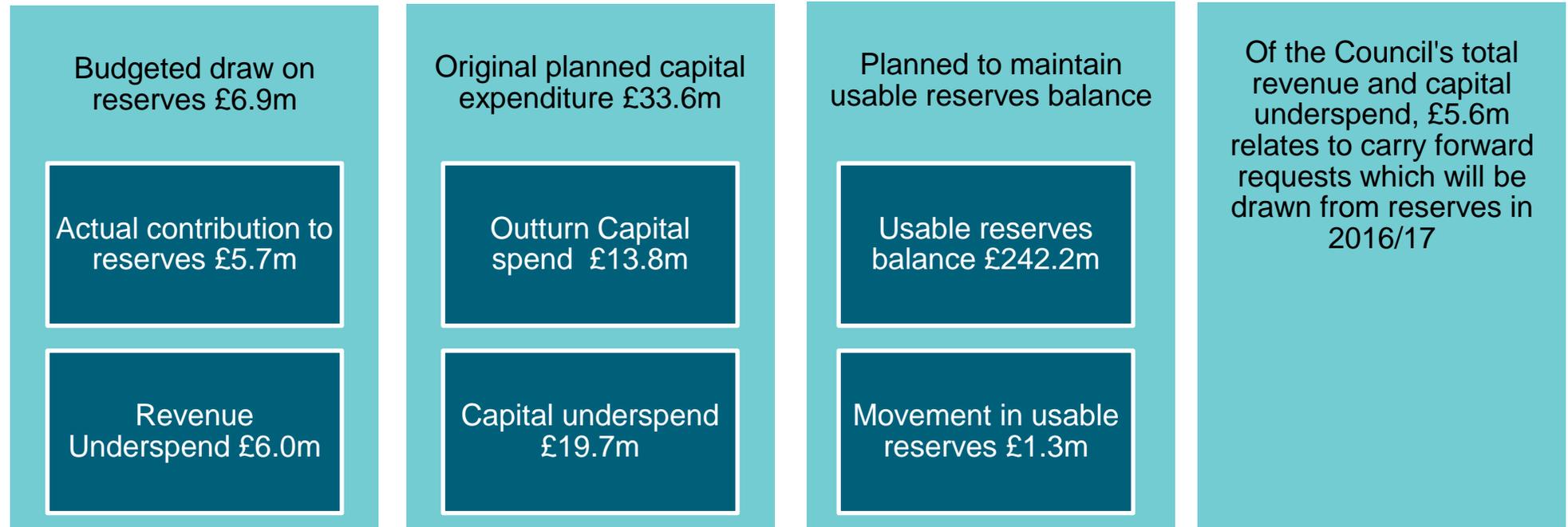
Highways network assets

25. The 2016/17 local government accounting Code will adopt a new measurement requirement for the valuation of the highways network asset. It will be measured on a depreciated replacement costs basis. This will have a significant impact on the value of local authority balance sheets.

Code of Audit Practice

26. A new Code of Audit Practice will apply to all audits from financial year 2016/17. There will be a focus on four areas:
- Financial sustainability
 - Financial management
 - Governance and transparency; and
 - Value for money
27. In addition, as well as the annual audit report, other significant outputs, such as the annual audit plan, will be published on Audit Scotland's website.

Financial management and sustainability



Financial management

28. In this section we comment on the council's financial outcomes and assess the council's financial management arrangements.
29. The council sets an annual budget to meet its service and other commitments for the forthcoming financial year. The setting of the annual budget impacts directly on residents as it determines council

tax and other fees and charges. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

Financial outcomes

30. Overall the council reported a deficit of £23.999 million on the provision of services in the 2015/16 Comprehensive Income and Expenditure Statement. Adjusting this balance to remove the

accounting entries required by the Code, the council's general fund increased by £0.804 million.

31. The 2015/16 budget, approved by the Council in December 2014, had a planned total draw on reserves of £6.946 million, including £3.326 million of savings. The actual outturn for the year was a contribution to reserves of £5.746 million. This was mainly due to one-off capital receipts for the sale of tugs and an underspend against the general fund of £5.998 million.

Exhibit 1: Draw on reserves

Spending area	Original Budget £m	Actual £m	Variance £m
General fund	12.98	6.63	(6.35)
Housing Revenue Account	(0.41)	(1.43)	(1.02)
Capital programme	0.17	(7.61)	(7.78)
Spend to Save	1.53	0.07	(1.46)
Other	(7.32)	(3.41)	3.91
Total draw on reserves	6.95	(5.75)	(12.70)

Source: Shetland Islands Council 2015/16 budget book and financial review

32. The underspend on the general fund was mainly due to underspends in the following services:

- Community Care Services - £2.0m underspend due to staffing underspends across the service
- Development Services - £0.7 million underspend due to increased income from local investments and underspending on Fairer Scotland scheme grants
- Infrastructure Services - £2.5 million underspend due to increased income from Scord quarry and underspending on ferry fuel costs.

33. The council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set to at least cover the costs of its social housing provision. Rent levels are therefore a direct consequence of the budget set for the year. The HRA budgeted for a £0.418 million contribution to the Housing Repairs & Renewal Fund in 2015/16 and the actual contribution for the year was £1.429 million. The increased contribution was mainly due to there being no capital expenditure funded from revenue during the year.

Financial management arrangements

34. As auditors, we need to consider whether councils have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
- the proper officer has sufficient status within the council to be able to deliver good financial management

- financial regulations are comprehensive, current and promoted within the council
 - reports monitoring performance against budgets are accurate and provided regularly to budget holders
 - monitoring reports do not just contain financial data but are linked to information about performance
 - members provide a good level of challenge and question budget holders on significant variances.
35. As part of the audit we reviewed the council's financial regulations and concluded that they are comprehensive. However we noted that they had not been updated for several years. Updated financial regulations are being considered for approval by the council in November 2016.
36. Financial monitoring reports (both revenue and capital) are submitted to the Council on a quarterly basis. Reports are comprehensive and well laid out. Service committees also receive directorate financial performance reports on a quarterly basis.
37. As auditors we attend a number of council and committee meetings each year. Members provide a good level of challenge and question budget holders on significant variances and service performance issues.

Conclusion on financial management

38. We have concluded that the council's financial management arrangements are satisfactory with close budget monitoring and regular reporting to members.

Financial sustainability

39. The council delivers a broad range of services, both statutory and discretionary, to its communities. Financial sustainability means that the council has the capacity to meet the current and future needs of its communities.
40. In assessing financial sustainability we are concerned with whether:
- there is an adequate level of reserves
 - spending is being balanced with income in the short term
 - long term financial pressures are understood and planned for
 - investment in services and assets is effective.
41. Effective long-term financial planning, asset management and workforce planning are crucial to sustainability.

Reserves

42. The overall level of usable reserves held by the council increased by £1.274 million compared to the previous year and totalled £242.229 million, refer Exhibit 2. The closing usable reserves balance at 31 March 2016 includes a number of earmarked commitments. The main commitments include:

- Harbour contingency of £43.3 million
- Repairs and renewals fund of £42.7 million
- Capital Fund of £65.1 million

Exhibit 2: Usable reserves

Description	31 March 2015 £ million	31 March 2016 £ million
General fund	12.998	11.790
Capital grants unapplied	0.643	0.053
Capital receipts reserve	73.840	85.173
Other Revenue / Statutory Funds	153.474	145.213
Total usable reserves	240.955	242.229

Source: Shetland Islands Council 2015/16 financial statements

43. The general fund reserve has no restrictions on its use. The principal purpose of holding a general fund reserve is to provide a contingency fund to meet unexpected events and as a working balance to help cushion the impact of uneven cash flows.
44. The council's strategic financial management plans require, in the medium and long term, the council to maintain its usable reserve balance at an appropriate level.

Financial planning

45. The council has responded to the challenging financial climate by adopting a medium term approach to financial planning. The council's Medium Term Financial Plan (MTFP) was updated in November 2015 and covers the period from 2015/16 – 2020/21. The aim of the MTFP is to help the council approve annual budgets that are balanced and affordable in the medium term, with a sustainable draw from investments in order to maintain usable reserves at their present value. Anticipated funding for the next 5 years is detailed in Exhibit 3 below.

Exhibit 3: Savings requirements

Description	2016/17 £000	2017/18 £000	2018/19 £000	2019/20 £000	2020/21 £000
General fund service expenditure	114,503	115,926	117,673	120,672	124,365
Income	6,910	6,719	6,777	7,871	8,044
Revenue Funding	93,744	91,722	90,305	89,890	94,238
Draw from investments	12,045	12,298	12,556	12,820	13,089
Savings required	1,804	5,187	8,035	10,091	8,994

Source: Shetland Islands Council Medium Term Financial Plan

46. The exhibit highlights that the council anticipates that there will be significant cash reductions in the general revenue grant from the Scottish Government over the forthcoming years, coupled with an ever increasing demand for Council services from areas such as Community Care.
47. In order to address the funding challenges the Council plans to:
- structure services in a way that maximises productivity and operates as efficiently and effectively as is possible;
 - prioritise service delivery
 - capture savings from improved and robust procurement and commissioning processes
 - improve the consistency and application of charging policies.
48. The Scottish Government settlement for 2016/17 resulted in a lower level of funding for the council than was planned. This required the council to revisit its budget for 2016/17 and begin discuss longer term plans for savings to meet the challenges over the following 3 years. The council is planning to address the challenges that lie ahead in line with the strategy outlined in the MTFP.

Action Plan no. 1

Capital programme 2015/16

49. The council approved its asset investment plan (capital programme) for 2015/16 in December 2014. Total capital expenditure for 2015/16 was £13.845 million and the most significant items of

expenditure were on the new Anderson High School and Sound Primary School.

50. The council reported an underspend of £19.747 million against its budgeted capital expenditure of £33.592 million (59% of the total programme). This underspend was mainly due to budget provisions included for the new Anderson High School (£14.8 million) and the Town Hall Conservation project (£1.2 million).

Action Plan no. 2

Asset Management

51. In February 2016 the council agreed its five year Asset Investment Plan 2016-21 which is aligned with its MTFP. The focus of the Asset Investment Plan continues to be on the maintenance of existing assets rather than the creation of new assets. The main exceptions to this will be the construction of the new Anderson High School, upgrading ferry terminals and purchase of new vessels.
52. Each year, as part of the annual budgeting process, an annual asset investment plan is agreed. Quarterly monitoring reports on capital expenditure are submitted to service committees, detailing the progress of capital projects within the current financial year.

Workforce Management

53. Effective workforce management is essential to ensure that the council maximises the effectiveness of its employees. A workforce strategy is key to setting out how the council will ensure it has appropriately skilled people in place to deliver its services. We

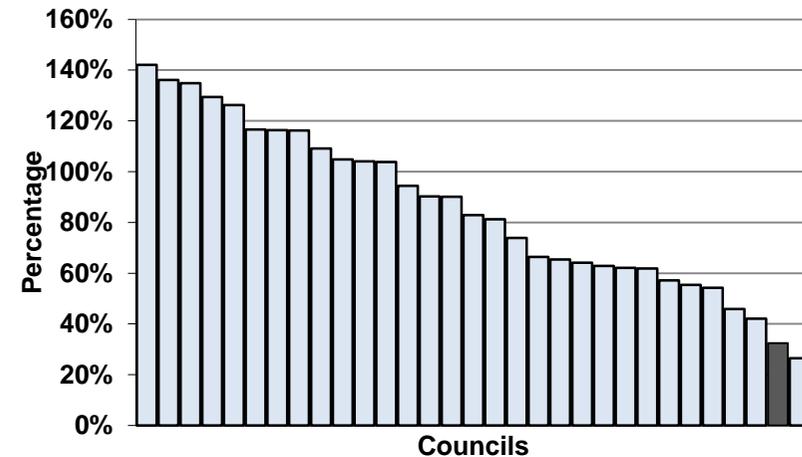
noted in our report in 2014/15 that the council had a number of policies and procedures in place relating to staff, however there was no overall workforce strategy in place. The council developed its workforce strategy during 2015/16 and a strategy for 2016-20 was approved in April 2016.

- 54. During 2015/16 there were 23 exit packages agreed with employees at a total cost of £0.345 million (2014/15 – 35 exit packages with a total cost of £1.033 million).

Treasury Management

- 55. At 31 March 2016 long term borrowing stood at £31 million, which is the same as the level at 31 March 2015. 2014/15 was the first time that Shetland had used external borrowing for 20 years and the borrowing was carried out in line with its Borrowing Policy and Strategy 2013-18.
- 56. Analysing long term borrowing as a proportion of net revenue stream gives an indication of the relative indebtedness of the council. Exhibit 4 shows long term borrowing as at 31 March 2016 as of net revenue stream a proportion of the actual outturn for the year for all mainland councils in Scotland. Shetland Islands Council continues to have the second lowest level in Scotland.

Exhibit 4: Scottish councils’ long term borrowing as a percentage of net revenue streams



Source: Scottish councils’ unaudited accounts 2015/16

- 57. Funds held for investment at 31 March 2016 were £287 million (£278 million 2014/15).
- 58. The council agreed the Annual Investment and Treasury Strategy for 2016/17 in February 2016 in line with the CIPFA Code of Practice for Treasury Management in the Public Services 2011. The strategy keeps the same types of investments for 2016/17 as previous years.

Pension liability

59. The net pension liability included in the council's balance sheet has decreased by £40,267 million from £183,396 million in 2014/15 to £143,129 million. The principal reason for this decrease is mainly as a result of the movement in the discount rate to calculate the annual liability.
60. The pension liability represents the difference between expected future pension payments and the underlying value of pension fund assets available to meet this cost. At the last triennial valuation at 31 March 2014 the Shetland Islands Council Pension Fund was 91.7% funded and had assets of £333 million. The next valuation will take place in 2017 with new contribution rates in place from 1st April 2018. It is expected that new contribution rates will increase convergence between the pension liability and the underlying assets.

Group Accounts

61. Local authorities are required to prepare group accounts in addition to their own council's accounts where they have a material interest in other organisations.
62. The council has accounted for the financial results of three associates and one joint venture in its group accounts for 2015/16. The overall effect of consolidating these balances on the group balance sheet is to increase total reserves and net assets by £110.354 million.

63. The net assets of the group at 31 March 2016 totalled £618.445 million, compared to a net asset position of £606.538 million in 2014/15. This positive movement largely relates to the significant decrease in the pension liability within the council's accounts.

Shetland Charitable Trust

64. The Shetland Charitable Trust (SCT) is included in the council's group accounts as an associate. The Code defines an associate as an entity over which the reporting entity has significant influence. During 2015/16 seven of the fifteen trustees of the SCT were councillors which is the main reason that the SCT was included within the group accounts.
65. In June 2016 the Council received a report on a review of the governance arrangements at SCT carried out during 2015/16. The governance review proposed that the number of councillor trustees should be reduced from seven to four. However the Council decided that in future no councillors will be put forward to serve as trustees for SCT. This change in the governance arrangements and any impact on the structure of the council's group accounts will need to be reviewed in future years.

Conclusion on financial sustainability

66. We have concluded that the council is containing its expenditure within annual budgets and has an appropriate medium term financial plan in place. Overall we conclude that the financial position is sustainable currently and in the foreseeable future, although rising demand for and costs of services will continue to

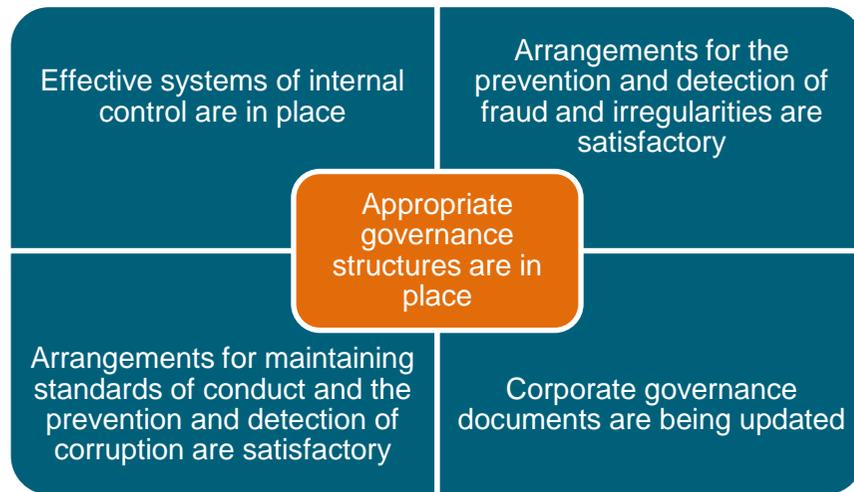
place a strain on the council's capacity to deliver services at the current levels.

change in valuation methodology will have a significant impact on the value of assets in the council's balance sheet from 2016/17.

Outlook

67. Councils face increasingly difficult financial challenges. In the context of overall reductions in public sector budgets, between 2010/11 and 2016/17, Scottish Government funding for councils decreased by 11 per cent in real terms to almost £10 billion. At the same time, demand for council services has increased, largely due to population changes. Increased pension contributions and national insurance changes will create further cost pressures on the council.
68. In common with many other councils, Shetland Islands Council is now reporting gaps between income and the cost of providing services over the next few years. With further funding pressures expected, councils face difficult decisions to balance their budgets. The council's medium term financial plan includes £32 million of savings required from 2017/18 to 2020/21 to support maintaining the current level of usable reserves in line with the council's reserves policy. Decisions must be based on a clear understanding of the current financial position and the longer-term implications of decisions on services and finances.
69. The council are prepared for the introduction of Highway Network Assets in 2016/17. The Roads Service will populate the valuation spreadsheet provided by consultants to enable a valuation to be included within the draft annual financial statements. As noted in the management commentary within the annual accounts, this

Governance and transparency



70. Members and management of the council are responsible for establishing arrangements to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements. We concluded that the council has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

Corporate governance

71. The council’s corporate governance framework is centred on the full council, supported by seven standing committees. It also has four functional committees which are responsible for taking decisions within their respective scope of responsibility. Committees are well attended by elected members and papers are subject to a high level of scrutiny.

Local code of corporate governance

72. The council has developed and adopted a local code of corporate governance which reflects the key components as set out in the CIPFA/SOLACE Framework Corporate Governance in Local Government: A Keystone for Community Governance. Although this code highlights that it should be reviewed on an annual basis, there is no evidence that this has been done and the current version is dated September 2012. This was highlighted in our 2014/15 annual report and the code was scheduled to be reviewed by April 2016.

73. Constitutional documents, such as the scheme of administration and delegations, are currently being updated and it is intended that they will be approved in November 2016. Following this, the code of corporate governance will be reviewed and submitted to the council for approval in February 2017.

Action Plan no. 3

Internal control

74. As part of our audit we reviewed the high level controls in a number of systems fundamental to the preparation of the financial statements. Our objective was to obtain evidence to support our opinion on the council's financial statements.
75. What were the results of our review and how did this impact on our audit approach, if at all. We reported our findings to the Audit Committee in May 2016. No material weaknesses in the accounting and internal control systems were identified which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. Our findings included a number of recommendations to enhance the control system in operation.

Internal audit

76. Internal audit provides members and management of the council with independent assurance on risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.
77. Our review of internal audit concluded that the internal audit service operates satisfactorily in accordance with Public Sector Internal Audit Standards and that we could place formal reliance on the planned areas set out in the 2015/16 Annual Audit Plan.

ICT audit

78. Our ICT audit work during 2015/16 generally found that the ICT controls in place at the council are satisfactory. However, we note following the successfully completion of a change to the backup process, the ICT department is planning their business continuity provision and expect to reduce the recovery times substantially for some applications.

Arrangements for the prevention and detection of fraud

79. Overall we concluded that the council's arrangements in relation to the prevention and detection of fraud and irregularities were satisfactory.

National Fraud Initiative in Scotland

80. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. Matching data obtained from the systems of participating bodies allows the identification of potentially fraudulent claims on the public purse including housing benefit fraud, occupational pension fraud and payroll fraud. If fraud or overpayments are not identified in a body, and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.

81. As part of our audit work we consider the council's approach to the NFI exercise. We noted areas for improvement in the council's engagement with the NFI process as part of our 2014/15 annual audit report. Internal audit at the council are reviewing the NFI arrangements at the council during 2016/17.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

82. The arrangements for the prevention and detection of corruption in Shetland Islands Council are satisfactory and we are not aware of any specific issues that we need to record in this report.

Transparency

83. Citizens should be able to hold the council to account about the services it provides. Transparency means that citizens have access to understandable, relevant and timely information about how the council is taking decisions and how it is using its resources.

84. Through our audit approach we gave consideration to:
- the clarity and presentation of the council's committee papers, budget monitoring reports and financial statements
 - the regularity with which the council excludes the press or public from agenda items under the Local Government (Scotland) Act 1973
 - the council's approach to public performance reporting

- accessibility of information via the council website.

85. Overall we concluded that the council has appropriate arrangements in this area.

Freedom of Information requests

86. During 2015/16 the council received 911 FOI requests and 837 requests (92%) were responded to within 20 days. Of the 911 FOI requests received, all information was provided for 797 requests (87%) with partial or no information provided for the remaining 114 requests. During the period there were four appeals against denial of FOI requests but no decisions were overturned. One of these appeals was appealed further to the Office of the Scottish Information Commissioner which was upheld.

Integration of health and social care

87. The Public Bodies (Joint Working) (Scotland) Act received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland. The Act requires councils and NHS bodies to integrate the governance, planning and resourcing of adult social care services, adult primary care and community health services and some hospital services.
88. Shetland Islands Council and NHS Shetland decided to follow the body corporate model, creating an Integration Joint Board to plan and commission the health and social care services for their area.

89. The Shetland Islands Integration Joint Board was established on 27 June 2015 and first met on 20 July 2015. At this meeting it approved the appointment of the Chief Officer and Chief Financial Officer and membership of the Board. The Strategic Commissioning Plan was approved at a meeting on 20 November 2015 with applicable functions and budgets delegated to the IJB.
90. The IJB has produced financial statements for 2015/16 covering the period 27 June 2015 to 31 March 2016, which have been audited by Audit Scotland and will be reported to the Integration Joint Board in a separate Annual Audit Report for 2015/16 by 30 September 2016.

Local scrutiny plan

91. The 2016/17 Local Scrutiny Plan (LSP) prepared by the Local Area Network (LAN) of scrutiny partners for the council was submitted to Shetland Islands Council in April 2016.
92. The LSP highlights that no scrutiny risks have been identified which require specific scrutiny by the LAN in 2015/16, however there are a number of areas where the LAN will carry out ongoing oversight and monitoring. These include:
- financial planning
 - health and social care integration
 - self evaluation within the Education department
93. These areas will be revisited as part of the shared risk assessment process in 2016/17.

Outlook

94. Councils will continue to operate in a changing environment within continuing financial constraints. Under these circumstances councils will be obliged to consider the delivery of services by different means. Good governance will be particularly important where council resources and service delivery are devolved to third party organisations.
95. Partnership, joint working and arm's length organisations have become increasingly popular vehicles for planning and delivering council services and there is a sustained national focus on their use. Where council services are being delivered by third party organisations it will be crucial that the council implements robust assurance and governance arrangements to deliver best value while at the same time ensuring an appropriate level of accountability for public money. Community planning and health and social care integration will require an ongoing focus on governance and assurance to ensure that the council's priorities are being achieved.

Best Value



- 96. Best value is a key factor to consider when planning policies, programmes and projects and when taking any spending decisions. The council should have systems and processes to ensure that it can demonstrate that it is delivering best value by assessing and reporting on the economy, efficiency, effectiveness and equality in service provision.

Procurement

- 97. In 2009 the Scottish Government introduced an annual evidence-based assessment, the procurement capability assessment (PCA), to monitor public bodies' adoption of good purchasing practice and as a basis for sharing best practice.

- 98. The annual PCA was replaced by the Procurement & Commercial Improvement Programme (PCIP) which focuses on the policies and procedures driving procurement performance and the results they deliver. PCIP introduced a revised assessment methodology and new scoring and performance bands with councils being assessed every two years. The revised assessment results are not comparable with the previous PCA scores. Scotland Excel began undertaking PCIP assessments for local authorities in May 2016, and the cycle will continue until November 2016.
- 99. The Council approved a new Commissioning and Procurement Framework in April 2016 following work on reviewing the council's policies and strategies on commissioning and procurement. One of the aims of the review was to review existing policies and procedures to ensure that they comply with all relevant legislation and guidance including changes in EU Regulations that take effect in 2016/17.

Shared services

- 100. During 2014/15 the council reached an agreement with Aberdeen City Council to jointly share the Head of Finance at Aberdeen City Council to carry out overall responsibility for the proper administration of both councils' finances. This arrangement was for an initial period of twelve months from December 2014, with a review to be carried out during the year.
- 101. Following the review in December 2015 it was decided that the council should look to appoint an Executive Manager – Finance on a

permanent basis. Following a recruitment exercise in February 2016 an Executive Manager – Finance was appointed on a permanent basis from April 2016.

Following the public pound

- 102. Local authorities have a statutory responsibility to comply with the Accounts Commission/COSLA Code of Guidance and funding external bodies and following the public pound.
- 103. Although the council does not make use of Arms-Length External Organisations (ALEOs), we confirmed that the council has appropriate arrangements in place in respect of community grants, economic development grants and funding provided to procure services from the third sector.
- 104. During 2017 Audit Scotland, on behalf of the Accounts Commission for Scotland, will undertake a review of the Following the Public Pound Code in conjunction with an update of the definition of ALEOs to assist councils to apply the principles of good governance to the funding arrangements for ALEOs and similar bodies.

Performance management

- 105. The council is committed to having a strong framework in place for monitoring and reporting performance. During 2016 work has been carried out to standardise the content of Directorate and Service Plans and performance reports within the council and to better align them with the content of the council's Corporate Plan. It is intended

that once this work is completed it will be collated in a Performance Management Handbook for approval by the council.

- 106. The council also participates in the Local Government Benchmarking Framework (LGBF) which brings together performance indicators for a range of services as well as service costs and customer satisfaction.

Overview of performance targets in 2015/16

- 107. The Council agreed a new Corporate Plan for the period 2016-20 in September 2015. The plan sets out the priorities for the council over the next four years as well as setting out important challenges. It also includes twenty aims that the council plans to achieve by 2020.
- 108. Directorate and Service Plans will be linked to achieving the outcomes that are set out in the Corporate Plan. Service committees receive performance reports for each relevant directorate on a quarterly basis during the year and a year end report in May. Our review of the 2015/16 directorate performance reports from May 2016 noted that the council is reporting good progress against the actions for each directorate with very few being classed as having a risk of not completing the target action.

Statutory performance indicators (SPIs)

- 109. The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report but expects councils

to provide citizens with fair, balanced and engaging performance information reporting.

110. For 2015/16 three (SPIs) were prescribed:

- SPI 1: covering a range of information relating to areas of corporate management such as employees, assets and equalities and diversity
- SPI 2: covering a range of information relating to service performance
- SPI 3: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

111. Overall we concluded that the council's arrangements for publication were satisfactory.

Local performance audit reports

112. A summary of any significant local performance audit reports issued during the year at [appendix II](#).

National performance audit reports

113. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued which are of direct interest to the council. These are outlined in [appendix III](#). Shetland Islands Council has processes in place to ensure that all national reports and their impact on the council are considered by Members.

Equalities

114. The Equality Act 2010 introduced a new public sector 'general duty' which encourages equality to be mainstreamed into public bodies' core work. The Act requires that by no later than 30 April 2015 and every two years thereafter, public bodies must publish a report on the progress made to achieve the quality of outcomes it has set.

115. The council reported on progress against the outcomes in April 2015 as part of the report for Shetland's Community Planning Partnership.

Outlook

116. In common with other councils, Shetland Islands Council faces the key challenges of reducing budgets, an aging population with higher levels of need and the public expectation of high quality services. Savings have been made in recent years largely by reductions in the workforce. However, as choices on how to address funding gaps become increasingly difficult, councils will have to focus on making the very best use of all available resources and to challenge existing ways of doing things. A strong and effective performance management framework will be critical to the success of the council achieving its key priorities and achieving best value.

Appendix I: Significant audit risks

The table below sets out the financial statement audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

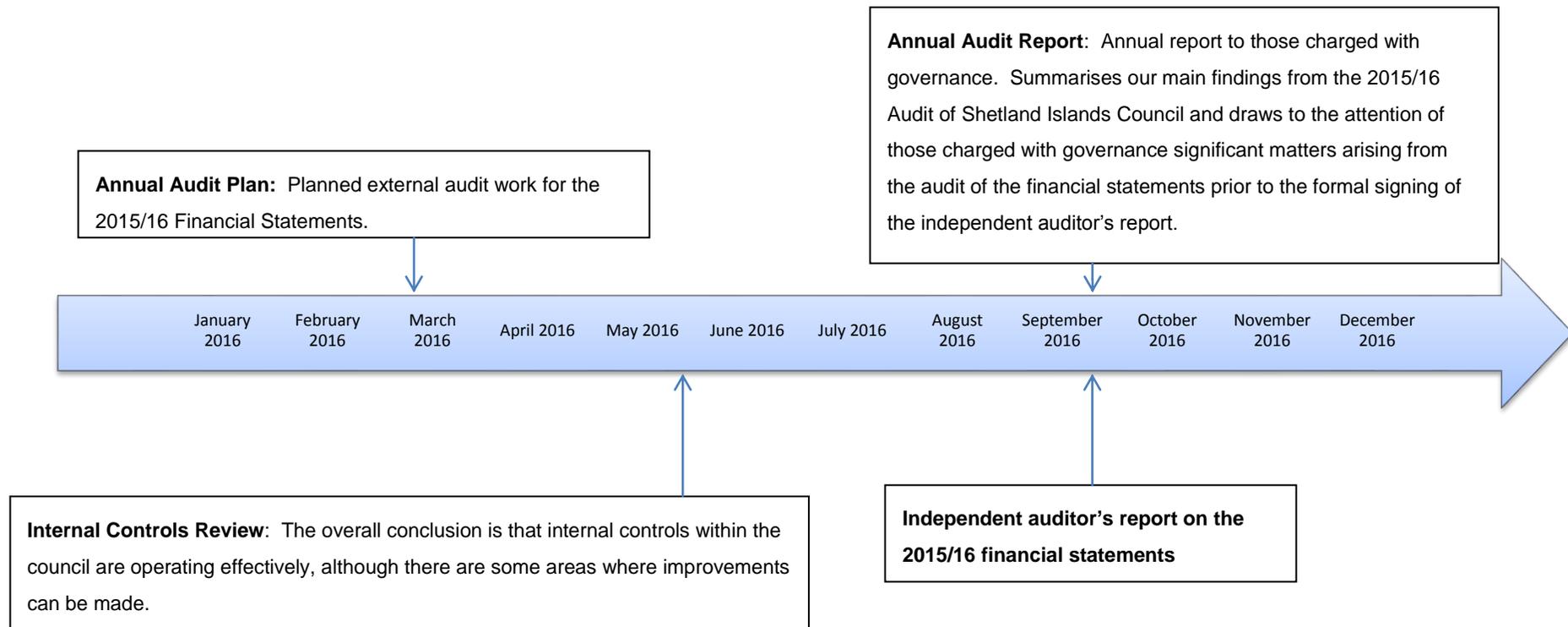
#	Audit Risk	Source of assurance	Results and conclusions
Financial statement issues and risks			
1	<p>Management override of controls</p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> • Detailed testing of journal entries • Review of accounting estimates • Evaluating significant transactions that are outside of the normal course of business • Focused testing of accruals and prepayments 	<p>From our audit testing of risk areas we did not identify any incidents of management override of controls.</p>
2	<p>Income</p> <p>The Council receives a significant amount of income in addition to Scottish Government funding.</p> <p>The extent and complexity of income means there is an inherent risk of fraud in accordance with ISA 240.</p>	<ul style="list-style-type: none"> • Evaluation of accounting policies for income and expenditure • Detailed testing of journal entries • Analytical review of income streams to confirm completeness and identify any unusual transactions or variation in income • Substantive testing of income to 	<p>From our audit testing of income, we did not identify any areas of concern.</p>

#	Audit Risk	Source of assurance	Results and conclusions
		confirm occurrence and accuracy of amounts in the financial statements	
3	<p>Valuations</p> <p>The financial statements of Shetland Islands Council include valuations which rely on significant assumptions and estimates. The extent of subjectivity in the measurement and valuation of these balances represents a risk of material misstatement.</p>	<ul style="list-style-type: none"> • Completion of 'review of the work of an expert' for professional valuer • Focussed substantive testing of key areas 	<p>From our review of the work of the professional valuer and focused substantive testing, no issues or misstatements were identified.</p>
4	<p>Group accounts</p> <p>There is a risk that the group accounts disclosures in the financial statements do not include accurate and reliable financial information for SCT.</p>	<ul style="list-style-type: none"> • Early financial statements planning meeting and review • Regular audit liaison meetings with finance staff 	<p>We worked with finance staff on this matter during the year to ensure sign-off deadlines were achieved. We audited the working papers provided by the council in support of the group accounts disclosures in the annual accounts.</p> <p>The SCT financial information is properly disclosed in the council's annual accounts.</p>
5	<p>Integration Joint Board</p> <p>The Shetland Islands Integrated Joint Board (IJB) was established in June 2015 and will be required to prepare its own annual accounts for 2015/16. Shetland Islands</p>	<ul style="list-style-type: none"> • Early financial statements planning meeting and review • Regular audit liaison meetings with finance staff 	<p>We discussed this matter with finance staff during the year to ensure issues were identified early on. We audited the working papers provided by the council in support of the group accounts disclosures in the annual</p>

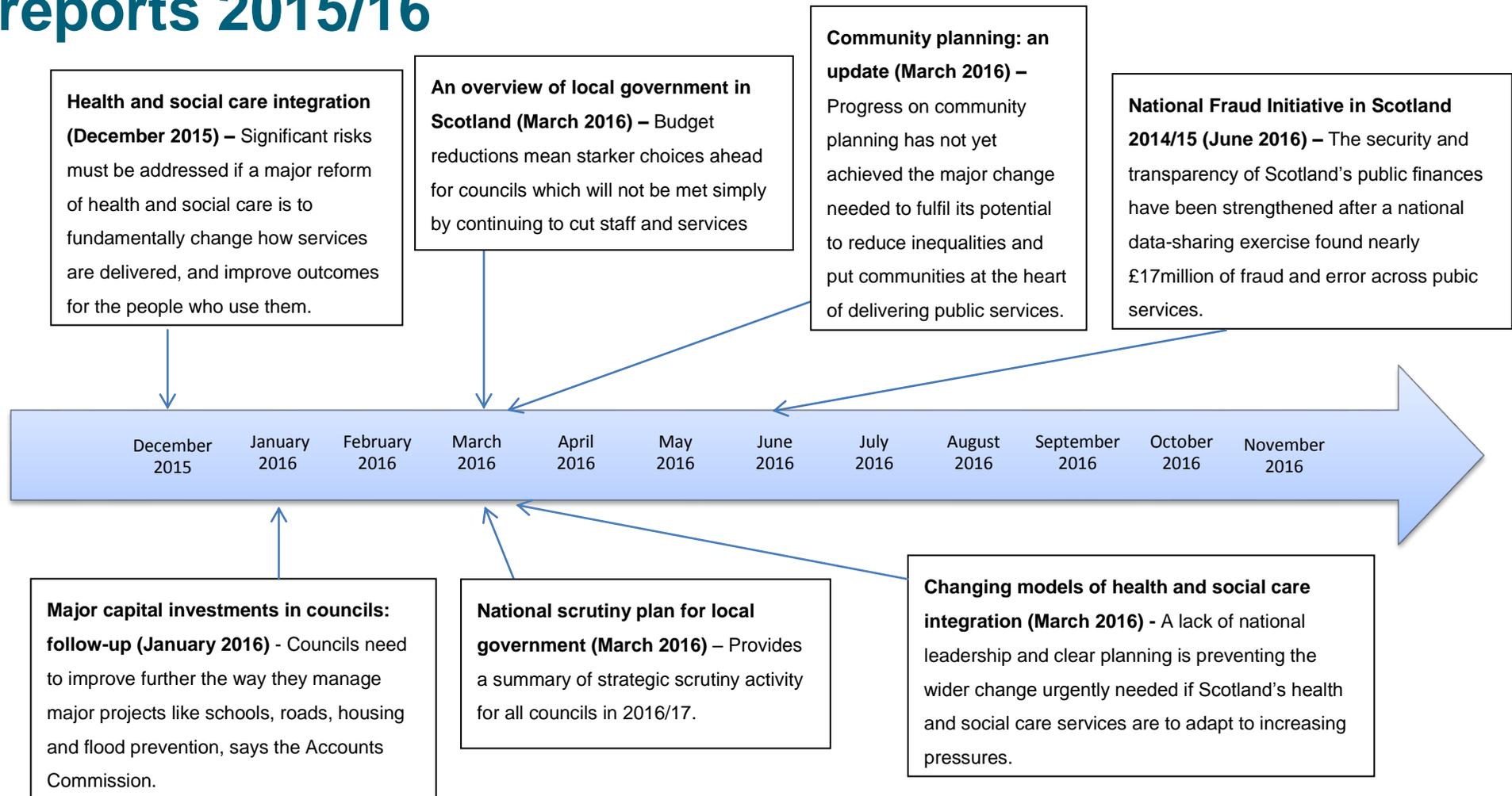
#	Audit Risk	Source of assurance	Results and conclusions
	<p>Council will be required to include the IJB in its assessment of entities for inclusion in the group accounts and to consider relevant financial and governance disclosures regarding the IJB for 2015/16.</p> <p>There is a risk that the Council may not account for the IJB appropriately within its annual accounts.</p>		<p>accounts.</p> <p>The IJB financial information is properly disclosed in the council's annual accounts.</p>
Wider dimension issues and risks			
6	<p>Governance documents</p> <p>Many of the governance documents and policies in place at the council have not been reviewed for several years.</p> <p>There is a risk that the documents do not reflect current recommended practice or current arrangements at the council.</p>	<ul style="list-style-type: none"> • Reviewing governance documents in place to confirm their adequacy. • Monitoring arrangements for updating and reviewing the governance documents 	<p>The council has adequate governance documents in place, however these should be reviewed and updated on a regular basis to ensure that they remain relevant.</p>
7	<p>Business continuity</p> <p>It may be difficult to recover some ICT applications at the council within the Recovery Time Objectives.</p> <p>There is a risk that council services would be</p>	<ul style="list-style-type: none"> • Monitoring the work being carried out by the council's ICT department 	<p>ICT audit work during the year found that ICT controls are satisfactory and that ICT staff at the council are carrying out work which should reduce the recovery times for applications.</p>

#	Audit Risk	Source of assurance	Results and conclusions
	disrupted if applications cannot be recovered promptly.		
8	<p>Financial planning</p> <p>The council's Medium Term Financial Plan sets out how the council plans to achieve a sustainable financial position and maintain its level of usable reserves. The plan includes challenging savings targets, with a funding gap of £32 million over the period to 2020/21. There is a risk that the council will not be able to achieve the savings required</p>	<ul style="list-style-type: none"> • Monitor the council's financial position via revenue budget reports presented to full Council and meetings with officers. • Ongoing review of council's progress delivering savings options. • Review of council's revised long term Financial Strategy. 	<p>We have concluded that the council's financial management arrangements are satisfactory. However large savings targets will still need to be achieved in future years.</p>
9	<p>Capital investment</p> <p>The council's Asset Investment Plan is focussed on maintaining the existing council assets and requires borrowing in future years to cover the funding shortfall. There is a risk that an appropriate level of capital spending may not be sustainable in the future.</p>	<ul style="list-style-type: none"> • Review delivery of the annual capital programme during the audit of the council's 2015/16 financial statements. • Development of long term asset investment plan • Adoption of a balanced 2016/17 to 2020/21 Asset Investment Plan. 	<p>The council has a long term capital investment plan which is monitored and updated regularly. However there was a large underspend for capital in 2015/16 and this has been noted in the action plan in appendix IV.</p>

Appendix II: Summary of Shetland Islands Council local audit reports 2015/16



Appendix III: Summary of Audit Scotland national reports 2015/16



Appendix IV: Action plan

No.	Page /Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	14/48	<p>Medium Term Financial Plan</p> <p>The council's Medium Term Financial Plan requires significant savings to be delivered over the coming years.</p> <p>Risk</p> <p>Savings are not achieved and there is a larger draw on reserves than planned. This could impact on funding available for council services and lead to the council not being able to achieve outcomes.</p> <p>Recommendation</p> <p>The Council should ensure it continues to monitor and manage the planned areas for savings in order to ensure that savings targets are met.</p>	<p>The Council will continue to monitor and manage the planned areas for savings working towards ensuring that savings targets are met through the quarterly monitoring reports and the budget process.</p>	<p>Jonathan Belford, Executive Manager – Finance</p> <p>Ongoing</p>

No.	Page /Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2.	14/50	<p>Capital Programme Slippage</p> <p>There was an underspend of 59% in the 2015/16 capital programme.</p> <p>Risk</p> <p>Delays in the capital programme impact on the council's ability to deliver its objectives.</p> <p>Recommendation</p> <p>Reasons for capital slippage should be investigated and appropriate action taken to minimise the risk of future delays with capital projects. This should include learning lessons from past delays.</p>	<p>The extent of the slippage noted is due to the scale of the projects involved (new AHS and Halls of Residence) rather than the widespread delays across the Council's 5-year Asset Investment Plan. At the time of setting the Asset Investment Plan for 2015/16, the new AHS and Halls of Residence projects were not finalised nor were there forecasts on spending over Plan available.</p> <p>This is an area that continues to be monitor closely and reported to the Council. Budget Responsible Officers and Project Managers are routinely challenged on the deliverability of project programmes.</p>	<p>Robert Sinclair, Executive Manager – Capital Programme</p> <p>Ongoing</p>

No.	Page /Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	18/73	<p>Code of Corporate Governance</p> <p>The council's local code of corporate governance (September 2012) contains a requirement to be reviewed on an annual basis. However, no annual review has been carried out by members and officers. In addition, six monthly updates on the local code of corporate governance have not been presented to the Audit Committee as required.</p> <p>Risk</p> <p>The local code of corporate governance is not effective and does not reflect current legislative and good practice requirements.</p> <p>Recommendation</p> <p>The local code of corporate governance should be reviewed annually by members and officers to ensure its ongoing effectiveness and regular updates should be provided to the Audit Committee.</p>	<p>A governance documents review project has been ongoing during 2016, recognising the changes that have been made to some of the Council's governance arrangements since 2012. A revised set of documents will be issued to the Council on 2 November for approval. Following this, the governance arrangements will be reviewed by February 2017, taking account of the new "Delivering Good Governance in Local Government: Framework" (CIPFA/SOLACE, 2016), and a revised Code of Corporate Governance presented to the Audit Committee and Council in February 2017.</p>	<p>Jan Riise, Executive Manager – Governance & Law</p> <p>February 2017</p>