

**A REPORT BY THE CONTROLLER OF AUDIT TO THE ACCOUNTS
COMMISSION UNDER SECTION 102(1) OF THE LOCAL GOVERNMENT
(SCOTLAND) ACT 1973**

SHETLAND ISLANDS COUNCIL

Introduction

1. The purpose of this report is to update the Commission on events in Shetland Islands Council. The report includes the outcome of the further audit work requested by the Commission in December 2009 following their consideration of my last report.

Background

2. On 9 December 2009, the Accounts Commission considered a report under S102(1) of the Local Government Scotland Act 1973 on the Shetland Islands Council Annual Audit 2008/09. The report noted that the council's financial statements had been qualified for the fourth consecutive year and highlighted concerns about working relationships in the council, governance and accountability, and strategic leadership.
3. The Commission requested me to carry out further focused audit work and report on the council's actions to address the issues which led to the qualifications of the financial statements and the financial challenges it faces. The work would also assess the current position on member/ member and member/ officer working relationships and the impact on strategic leadership within the council.
4. During January and February 2010 it became clear that the working relationship between the council and its chief executive was becoming untenable. By the end of February a negotiated settlement was reached which saw the chief executive leave his post.
5. Further audit work was carried out in March 2010 and involved file review, observation of the full council meeting on 24 March 2010 and interviews with 12 of the 22 elected members, officers and members of the public (including the former chief executive.)
6. The purpose of the audit work was to provide an update for the Commission and highlight some of the issues facing the council, with a particular focus on the appointment and subsequent departure of the chief executive. The audit work was not, however, intended to be a forensic investigation into all the circumstances surrounding the events leading to the chief executive's departure. There remains a significant level of disagreement between the key parties on many issues and it has not been practical to investigate every issue in detail within a reasonable timeframe and at a proportionate cost.
7. It is standard practice for draft audit reports to be shared with the council to check for factual accuracy. A draft report was sent to the council on 22 April 2010; by 28 April the draft report had been leaked to the media.

8. In addition to receiving comments on the draft report from the council, the audit team also received individual written comments from some elected members, a council officer, a union representative and legal representatives. Many of these responses serve to underline the continuing disagreements, the differences of interpretation and the lack of trust that exist within the council.

Overall conclusions

It is of serious concern that a significant amount of public money has been spent in reaching a negotiated settlement with the former chief executive. The events of recent months have resulted in a serious deterioration in working relationships within the council. There is a risk that this will continue to affect the council's ability to conduct business in an effective way. Elected members have not demonstrated their ability to set and maintain a clear strategic direction.

9. The council has had a range of serious problems during 2009 and 2010. The most significant problems relate to events surrounding the appointment and subsequent departure of the chief executive. The council appointed a new chief executive in May 2009, but in February 2010 it reached a negotiated settlement which led to his departure. These events have damaged working relationships in the council, as well as the council's reputation, and present a continuing risk to the organisation's ability to work effectively. This is particularly serious at a time when the council needs to take difficult decisions to sustain its current level of services whilst maintaining its target reserves balance and delivering its capital plans.
10. It is of serious concern that a significant amount of public money has been spent to settle the case with the chief executive. Using public money in this way is particularly unwelcome at a time of increasing financial pressures in public services, particularly since the council previously incurred costs to terminate the contract of a chief executive in 1999. It is clear that lessons were not learned from the earlier case.
11. The process for the recruitment and selection of the chief executive in 2009 was not sufficiently rigorous. Once an appointment was made, the council did not put a robust process in place to set clear personal objectives or manage the performance of the chief executive.
12. The chief executive was the subject of public criticism by some elected members, despite all members receiving legal advice about the risks that this might present for the council.
13. These factors played a significant part in the events which led to the departure of the chief executive and the negotiated settlement.
14. When it became clear that the council's relationship with the chief executive was becoming problematic, the council took appropriate external advice and the settlement was negotiated on a reasonable basis and in compliance with appropriate legislation.

15. The events of recent months have resulted in a severe deterioration in working relationships within the council. There is a risk that this will continue to affect the council's ability to conduct business efficiently and effectively.
16. The council has not demonstrated that it can set a clear strategic direction, supported by sound and consistent decision making. We found little evidence of elected members acting in the interests of Shetland Islands Council as a whole. Events over recent months have led to a significant proportion of members expressing concerns about the quality of strategic leadership in the council.
17. The council has a substantial level of reserves, but it faces challenges in achieving its financial strategy. It has agreed budget savings for 2010/11 but has yet to demonstrate how it can sustain its current level of service delivery in future years, whilst maintaining its target reserves balance and delivering its capital plans.
18. Services continue to be delivered to a high standard, albeit at a relatively high cost. Members and officers expressed the view that service delivery has not been compromised by the issues covered in this report. However, the senior officers on the Executive Team are currently covering corporate responsibilities in addition to their own departmental roles and the Executive Director – Education and Social Care is covering Chief Executive responsibilities in her role as Depute Chief Executive. This situation is not sustainable and increases the risk that services may be adversely affected.

Recruitment of the Chief Executive

The process for the recruitment and selection of the chief executive was not sufficiently rigorous.

19. The previous chief executive tendered his resignation in February 2009. On 25 March 2009 the council agreed a process for the recruitment of a new chief executive. This procedure fell short of what would normally be expected as good practice for such a significant post, and was less rigorous than the processes that had been used to appoint to the posts of Executive Director in 2007 and 2008. In particular, the sub committee appointed by the council to undertake this task chose not to take advice from human resources (HR) to engage external support other than for the development of the job advertisement.
20. Following the receipt of 38 applications for the post, the HR department used a set of criteria to develop a short list of nine applicants. A panel of seven members, supported by the HR manager, then selected five applicants from this short list to progress to the next stage of the recruitment process.
21. The five applicants were invited to attend a two day recruitment event on 18 and 19 May 2009. On 18 May applicants were invited to deliver a presentation based on a case study developed by the previous chief executive.
22. On 19 May applicants were interviewed by the full council; 19 of the 22 elected members participated. After approximately 90 minutes of deliberation,

the council held three secret ballots to select one preferred and one reserve candidate. The preferred candidate received 11 of the 18 votes; there was one abstention.

23. The recruitment and selection process fell short of good practice in a number of respects for a post of such significance. The council chose not to adopt a number of good practice recruitment activities, including psychometric testing and assessment centre exercises such as numerical and verbal reasoning or business case analysis.
24. Elected members were offered a set of potential interview questions including a core set of questions to be asked of all interviewees together with specific questions relating to each individual. Members chose not to use the specific questions, which had been designed to probe the detail of each candidate's experience and so help members assure themselves of the suitability of candidates.
25. A panel of 19 is not considered to be good practice as it makes it more difficult to conduct structured and detailed questioning of interviewees. It is, however, in line with the council's recruitment and selection policy.
26. A number of members and officers expressed reservations about the lack of rigour in the recruitment process, including the lack of external guidance and support, the limited assessment of candidates, and the interview process itself.
27. The council has recognised the shortcomings in the recruitment process it followed. In March 2010 the council agreed a different process for the recruitment of an interim chief executive who is to be appointed for a period of at least 18 months and up to two and a half years. The revised process includes external support.

Objective setting and performance appraisal for the Chief Executive

The council did not put in place a robust process to set personal objectives for the chief executive. There was no formal process to appraise and manage his performance. The chief executive was the subject of public criticism by some members. These factors played a significant part in the departure of the chief executive through a negotiated settlement.

28. Following the council decision on 19 May 2009, the new chief executive took up his post on 01 June.
29. Although the council's priorities were discussed as part of the interview process and some informal discussions took place, the incoming chief executive was not set clear personal objectives. There was no formal performance appraisal system in place.
30. The council contacted COSLA to seek advice about developing the organisation's overall performance management arrangements and implementing an appraisal system for the chief executive, but this did not take place until the chief executive had been in post for over four months, by which time serious tensions between the chief executive and some members were already evident.

31. These are fundamental areas of good practice which any organisation should have in place. The absence of clear performance management processes was a factor in the events that unfolded between June 2009 and February 2010 when the chief executive left his post. The lack of performance management arrangements meant there was no framework for formally assessing the chief executive's performance and holding him to account. Had clear objectives been set and performance appraisal arrangements been in place, some of the issues which subsequently arose could have been avoided or at least mitigated.

The negotiated settlement

It is of serious concern that a significant amount of public money has been spent to settle the case with the chief executive. Using public money in this way is particularly unwelcome at a time of increasing financial pressures in public services, especially since the council had previously been criticised by the Accounts Commission for the way it had handled the termination of the employment of a chief executive in 1999. It is clear that lessons have not been learned.

However, once the problematic relationship between the council and the chief executive was apparent, the council took appropriate external advice and the settlement was negotiated on a reasonable basis and in compliance with the relevant legislation.

32. The professional conduct of the chief executive became a matter of concern for some members soon after he took up the post. A range of complaints, allegations, and disagreements have been raised, and it is clear that this had a negative impact on working relationships and the reputation of the council has been damaged.
33. In September 2009 an elected member made a complaint to the council and the police about threats allegedly made by the chief executive in a telephone call. The council established an investigating committee which reported to full council in October. The committee found that the allegations were not proven.
34. Though external legal advisers were present, a number of members have expressed their dissatisfaction with the way the investigation was handled. There remains a perception amongst some members that the council was not adequately represented in legal terms.
35. The allegations were also investigated by Northern Constabulary and a report was submitted to the procurator fiscal, who concluded that no proceedings would be taken.
36. In November 2009, the chief executive raised concerns about public criticisms made about him by some members. The council sought legal advice and the convenor circulated an advice note to all members outlining the potential risks to the council.
37. In December 2009, six elected members made a formal complaint to the Convenor under the terms of Section 86(e) of the COSLA Chief Executives

Disciplinary Procedures and expressed the view that the chief executive had failed to establish and maintain a satisfactory working relationship with the council since his appointment. The letter outlined 20 areas of concern. The letter was reported in the local media the following day. This letter was passed onto the council's external legal advisors and was later used in considering the options available to the council in February.

38. The convenor's assessment was that the issues raised in the letter had been addressed through the relevant policies and procedures.
39. A number of members still hold the view that the complaints outlined in the letter were never fully investigated or properly dealt with and this remains a matter of ongoing correspondence between some members and the council. If more thorough and decisive action had been taken regarding this letter it may have affected the outcome of this situation.
40. During January and February 2010 it became clear that the working relationship between some elected members and the chief executive was becoming increasingly difficult. The council engaged COSLA to negotiate with the chief executive on its behalf. The council acted reasonably in employing external advisers with appropriate expertise to assist them.
41. The council's advisers considered a wide range of evidence and gave their views on the implications of each of the options available to members before the council made its decision. The advisers' view was that there were significant financial risks to the council should it pursue disciplinary action.
42. At a special meeting on 19 February the council decided to approve the negotiation of a compromise agreement with the chief executive. This resulted in the chief executive leaving his post with effect from 24 February 2010.
43. The cost to the council of the agreement is approximately of £285,000. The council will also incur additional costs relating to legal fees and other costs up to a capped level of £21,000. The cost to the council in relation to tax liabilities is not yet clear.
44. That public money has been used in this way is particularly unwelcome in a time of tightening public finances but, in the circumstances, the settlement was negotiated on a reasonable basis, taking account of the options available and in compliance with relevant legislation. The council considered the options open to it before deciding to negotiate a settlement. The amount of the settlement was judged by the council's advisers to be an appropriate sum based on the circumstances of the case. The council accepted the view of its advisers and approved negotiation of the compromise agreement.
45. A similar situation arose in Shetland in 1999 on the termination of the contract of the then chief executive. This led to the publication of Statutory Report S.R.99/5. The Accounts Commission made clear recommendations to the council regarding employment policies and the performance framework for future chief executives. It is clear that these lessons have not been learned. It is worth noting that a number of current elected members and officers were in post in 1999 and should have been aware of the implications of not having effective arrangements in place.

The post of Assistant Chief Executive

The deletion and subsequent re-instatement of the post of assistant chief executive contributed to the problems experienced in the council. Although there were communications with the assistant chief executive at an early stage in compliance with the Redeployment Policy, Trade Union consultation was not initiated as soon as practicable as set out in the council's Redundancy Policy.

46. The handling of matters in relation to the post of assistant chief executive has been a significant feature of events since Summer 2009. This issue has been a matter of concern for elected members and members of the public, and has been the subject of significant local media interest.
47. Following his appointment, the chief executive commenced a review of the post of the assistant chief executive. Council officers told us that the authority for reviews of this type dates back to a decision by council at a meeting in March 2002. This authorised the chief executive to 'take the necessary actions' which 'require a critical appraisal of the Council's overall strategic programmes of activities, a setting of priorities therein, an examination of alternatives and subsequent staffing rationalisation aimed at improving efficiency in the delivery of the required services.' Whether the 2002 approval was used appropriately in this case remains a matter of contention in the council.
48. In June 2009 communication began between the chief executive and the post holder on a future role for the assistant chief executive and the chief executive shared his plans with some senior members. In August 2009 this process resulted in the deletion of the post. On 24 August the Chief Executive met the postholder and also e-mailed all elected members to advise them of his decision to create a post of Head of Asset Strategy and that the post of Assistant Chief Executive was no longer required. The postholder was offered the choice of the position of Head of Asset Strategy (for a trial period of 6 months attracting the same pay and terms and conditions as the assistant chief executive post), a holding position within Legal Services as a corporate solicitor, or departure from the council by mutual agreement. These offers were in accordance with the council's redeployment policy. On 31 August the Chief Executive also e-mailed all elected members and staff to advise them of the change. Between 31 August 2009 and the beginning of January 2010 the postholder was on authorised absence from work on full pay.
49. On 9 December 2009, the council reinstated the post by approving a recommendation to invite the post holder 'to resume his duties as Assistant Chief Executive, with immediate effect, on his existing salary and terms and conditions of service, with a remit to undertake a range of strategic projects, in line with the requirements of the Council.' The recommendation to reinstate the post was made following an intervention by the Convener.
50. The council's Redeployment Policy does not specifically state that union consultation is necessary when redeployment is planned as a result of a restructuring process. However, the council's Redundancy Policy states that 'employees and their Trade Union representatives will be advised as soon as practicable of any proposals to reorganise service delivery that have implications for employees.'

51. The Trade Unions were only notified on 24 August that the post of Assistant Chief Executive was to be deleted and a new permanent post of Head of Asset Strategy created with immediate effect. Although the procedures followed complied with the Redeployment Policy, the Redundancy Policy was not followed as far as consultation with the Trade Union was concerned. As redundancy was, in effect, one of the options under consideration, this policy should have been followed.
52. It is clear that the process was not handled well and has contributed to the deterioration in working relationships within the council. The situation has not yet been fully resolved and remains the subject of correspondence between the postholder's legal advisers and the council. The postholder does not as yet have a clear remit or objectives.

Working relationships within the council

The events of recent months have resulted in a serious deterioration in working relationships within the council. There is a risk that this will continue to affect the council's ability to conduct business in an effective way.

53. It is clear that working relationships in the council have been under considerable strain. Tensions exist between members and members, between members and officers and between some officers.
54. The events of 2009 and early 2010 have led to members being publicly critical of one another, for example about the way in which the position of the chief executive was handled. Some members have also expressed concern that they have felt excluded from decision making.
55. A number of complaints are currently being considered by the Standards Commission with regard to the conduct of some elected members during this period. The Standards Commission's reports on these cases will need to be considered by the council when they are received.
56. Some officers have expressed concerns about what they see as a lack of support and professional respect by members, and consider that they are being unjustly blamed for events outwith their control. The events over recent months have also led to a deterioration in the working relationships between some officers.
57. There is now a level of mistrust between a significant proportion of the key stakeholders in the council and this is a barrier to conducting business in an efficient and effective way.

Strategic leadership

The council has not demonstrated that it can set a clear strategic direction, backed by sound and consistent decision making. We found little evidence of elected members acting in the interests of Shetland Islands Council as a whole. The events of recent months have led to a significant proportion of members expressing concerns about the quality of strategic leadership in the council.

58. Elected members are required to provide strong and consistent leadership. Having set a clear policy direction, they need to back this up with clear and consistent decision making. Strong leadership by members is particularly important when difficult financial decisions need to be made.
59. We found little evidence of strategic leadership or of elected members acting in the interests of Shetland Islands Council as a whole. Councillors have not demonstrated that they can set and maintain a clear strategic direction for the council. The convenor has sought to resolve the council's problems in a constructive way, but more inclusive decision making and decisive action might have led to a better outcome for the council.
60. The council continues to face significant challenges which will require clear strategic leadership from elected members. These include:
 - the rebuild of Anderson High School; this has been discussed by the council for over 18 years and continues to be an issue of considerable debate. As at 31 March 2009 the council had incurred expenditure of £5.54 million on the original proposed site. A large element of this is now a sunk cost as the site for the new school has been changed. In 1991 the council decided to build a new Anderson High School and two sites were identified - Staney Hill and the Knab site, which is the location of the current school. In 1999 the council decided to build on the Staney Hill site, but in 2003 took the decision to concentrate on the Knab site unless significant planning, financial or educational difficulties arose. Further delays took place in the following years as this decision was the subject of discussion by members, the media and members of the public. In June 2009, pending the outcome of an independent review the project was again put on hold. The results of this review were presented to the services committee of the council on 3 September 2009 when members decided to reverse the decision to build on the Knab site and to proceed with Staney Hill as the preferred site. This decision reflected the groundswell of public opinion and petitions against the council's earlier decision to proceed to the construction phase on the Knab site. On 16 September 2009, members voted to adopt the Staney Hill site as the preferred location for the purpose of undertaking statutory consultation on the relocation of a school.
 - the council's capital programme; this continues to be over-subscribed and some members characterise it as a 'wishlist' and 'unrealistic'. The council has recently agreed years two to five of a capital programme, within a financial policy framework. Capital projects are to be the subject of a 'Gateway' review process which was agreed in March 2010 and which aims to help manage the capital programme. However, previous systems

which sought to prioritise the programme have been abandoned by members.

61. In March 2010, the council signed an agreement with Total E&P UK Limited to allow them to build a gas plant at Sullom Voe. Elected members and council officers worked together to secure this deal which means that the Shetland Islands will benefit from new jobs. The council should consider what lessons it can learn from the experience and how this approach might be used to tackle the other challenges it faces.

2010/11 Budget and financial situation

The council faces a challenging financial future. It has agreed budget savings for 2010/11 but has yet to demonstrate how it can sustain its current level of services in future years whilst maintaining its target reserves balance and delivering its capital plans. This will require difficult decisions to be taken and clear and consistent leadership by elected members.

62. The 2008/09 annual audit report noted that 'in our opinion councillors have yet to demonstrate they are able to collectively take the difficult decisions required to reduce the draw on reserves in line with the agreed financial strategy.' The council used £23.02 million of its reserves in 2008/09 to fund its services. The unallocated balance on its reserves at 31 March 2009 was £280 million, but the council's budget forecasts show that the reserves will be reduced to the target of £250 million in the 2009/10 accounts. The council recognises it is not sustainable to use reserves for the delivery of services in this way.
63. In a report to members on 9 December 2009, the Head of Finance described the projections arising from the budget preparations as 'very worrying'. It went on to note that 'across all Funds and departments the Budget Proposals for 2010/11 exceed the No Growth projection (the basis for the Budget Strategy) by £16.3 million, or 14%. If these Budget Proposals were approved, it would destroy the existing financial policy framework and would totally deplete the Council's reserves in a decade or less.'
64. Following this report, officers worked to reduce the budget deficit gap and on 17 February 2010 the council set the budget for 2010/11. The budget was set with an approved draw of £2.0 million from reserves, which is in line with the council's current financial strategy.
65. The annual audit report also noted shortcomings relating to the council's budget setting process and budget monitoring reports. For 2010/11 budgets have been compiled on an incremental basis and the budget savings were identified primarily by top slicing service spending, without a review of the overall priorities and spending needs of the council.
66. The economic situation requires the council to prioritise spending, identify efficiencies and review commitments to ensure it can deliver its objectives and manage financial pressures. To face these challenges while ensuring the sustainability and quality of services, the council needs to develop an approach to budgeting which reflects its strategic priorities. In March 2010 the

council adopted a system to link the corporate plan, service planning and budgeting.

67. Budget monitoring reports are now being presented to members on a regular basis. The most recent position, covering the period 1 April 2009 to 31 December 2009, was reported to members in February 2010. The appointed auditor will continue to monitor these reports throughout the 2009/10 audit.
68. While the annual budget has been set, the council has yet to demonstrate how it can sustain its current level of services in future years whilst maintaining its target reserves balance of £250 million and delivering its capital plans. Councillors have not shown that they are able collectively to take the difficult decisions required to reduce the draw on reserves in line with the agreed financial strategy.
69. The appointed auditor will continue to monitor the 2009/10 budget and provide an update in the annual report to members.

Governance and accountability

The council needs to improve its governance and accountability arrangements. At this stage it seems likely that the council's financial statements will be qualified for a fifth consecutive year as a result of the accounting treatment of the Shetlands Charitable Trust.

Many of the issues in this report have been reported at length in the media and there are indications that a number of press reports have originated in leaks from within the council. This has a negative impact on the reputation of the council, on working relationships and on the council's ability to conduct business effectively.

70. The council has a wide range of member /officer working groups, many of which do not have a clear remit, and the meetings are not adequately minuted. This leads to a lack of clarity about decisions and direction.
71. The accounting treatment of the Shetland Charitable Trust resulted in the qualification of the financial statements in relation to group accounts for the fourth consecutive year in 2008/09. Group financial statements are required to present a complete picture of the council's activities and financial position. The council's group accounts do not include the Shetland Charitable Trust and its subsidiaries. It is the view of the appointed auditors that due to the nature of the council's relationship with the trust their omission results in a material mis-statement of the group accounts.
72. In a report to council on the matter dated 28 October 2009 the Head of Finance described this situation as 'a total impasse' and noted 'the plain fact is that the council can do no more to make the grouping of accounts happen. The council had asked once again for Charitable Trust cooperation, and had once again been refused, it is powerless to act further.' At its meeting in October 2009 the council confirmed its view that it had now done all it could do on the matter.

73. At the end of 2009 the trust consulted on options to change its composition, including an option for the trust to be made up of 8 elected members and 7 other trustees. In February 2010 the trustees voted against the proposed changes to the trust composition.
74. The council is currently looking into this issue and is discussing the evidence to support its case with the appointed auditor. It is likely that there will be a further qualification on the 2009/10 financial statements. The appointed auditor will provide an update in the Report to Members and the Controller of Audit on the 2009/10 Audit.
75. The accounts were also qualified due to the council's failure to account for its financial assets in accordance with accounting requirements. The Head of Finance has given assurances to the appointed auditor and to meetings of the council in December 2009 and March 2010 that this issue will be resolved for the 2009/10 accounts. The appointed auditor has confirmed that whilst the head of finance is still intending to resolve the issue for inclusion in the 2009/10 accounts, progress has been slow. This issue will be considered as part of the audit of the 2009/10 financial statements.
76. Good governance and accountability requires that decisions are made in a clear and transparent way and it is entirely appropriate that decisions are reported publicly. However, leaks have occurred during the decision-making process, for example relating to confidential information which formed part of the negotiations between the council, and the former chief executive, and there is a real risk that this may compromise the council's ability to achieve satisfactory outcomes.
77. This use of the media to further particular viewpoints is not unique to the Shetland Islands, but its extent has had a negative impact on the council's ability to conduct business effectively, on the reputation of the council and on working relationships.
78. The issues raised in this report highlight shortcomings in the way Shetland Islands Council conducts its business. It is important that the council addresses these issues to ensure that it is able to act in the best interests of the people of the Shetland Islands.

CAROLINE GARDNER
CONTROLLER OF AUDIT
05 May 2010