

# Shetland Islands Council

## Statutory follow-up report

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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# Commission findings

1. The Controller of Audit made this report to update the Accounts Commission on the progress made by Shetland Islands Council on its improvement plan. The council had approved its improvement plan on 10 November 2010, when it accepted the Commission's recommendations arising from a public hearing which the Commission held in June 2010. In December 2011, the Commission welcomed the prompt action and progress made by the council with its improvement plan, but emphasised the need for such positive direction to be sustained and consolidated. Consequently, the Commission requested that the Controller of Audit provide it with a further report in 12 months' time.
2. The Commission accepts this latest report by the Controller of Audit. It welcomes the significant progress made by the council, particularly in continuing to develop a culture of continuous improvement.
3. The Commission is encouraged by improving relations between elected members, and between elected members and officers. This is helping to deliver clear strategic direction and leadership. Better training of elected members has played an important role in improving this leadership.
4. The council is showing how it can learn from good practice elsewhere in developing its management capacity, which it will need to deliver its ambitious improvement agenda. There have been significant improvements in how it manages finances and information. Indeed, it is particularly pleasing to note that the financial statements of the council have been given an unqualified opinion by the external auditor for the first time since 2004/05.
5. The Commission is mindful of the significant challenges faced by the council in reshaping services on a more sustainable basis. It will need to have a full appreciation of costs and carefully consider a wide range of options for delivering services. It is encouraging that the council is engaging well with its communities in discussing these challenges with them. It is therefore vital that the positive momentum of the council demonstrated in the Controller of Audit's report is maintained.
6. The Commission notes that the council's progress will be monitored as part of the annual audit process.

# Introduction

1. On 15 December 2011, the Accounts Commission considered a report on Shetland Islands Council. The December 2011 report was the latest in a series of statutory reports:
  - In December 2009, a statutory report from the Controller of Audit advised the Accounts Commission that the council's financial statements had been qualified for the fourth consecutive year and highlighted concerns about working relationships, governance and accountability, and the strategic leadership in the council.
  - In light of the issues covered in the report, the Commission held a public hearing in Lerwick in June 2010 and published its findings in August 2010.
  - In January 2011, the Commission considered a statutory report on the 2009/10 audit which highlighted that the auditors had given a qualified opinion on the financial statements of Shetland Islands Council for the fifth consecutive year.
  - In December 2011, the Commission considered a statutory report on the progress the council had made on its improvement plan since the public hearing.
2. In its findings on the December 2011 report, the Accounts Commission:
  - welcomed the prompt action and progress made by the council with its improvement plan. The Commission was encouraged that the council had put in place many of the basic but essential building blocks of Best Value, including new political and management arrangements
  - emphasised, 'the need for this positive direction and change to be sustained and consolidated, especially in the context of some considerable challenges to be faced by the council in the near future. The Commission believes that these challenges include: a continuing need to address financial constraints; the need to appoint a new Section 95 officer; the longer term appointment of a chief executive; and forthcoming council elections'
  - noted, 'positive indications that the council is developing a culture of continuous improvement: this change needs to be continued and the council needs to ensure that it has the capacity to do this'
  - noted that, 'the council also needs to do more to demonstrate more effective strategic financial management and to improve the capacity of its finance function, for example to avoid similar difficulties that were experienced this year in the timely and accurate preparation of accounts'
  - noted that it, 'is seriously concerned to note that the auditors have given a qualified opinion on the council's financial statements, due to the omission of the Shetland Charitable Trust results from the group accounts. This is the sixth year in succession that there has been a qualification of those statements. But the Commission notes that the council is committed in its improvement plan to addressing this situation during 2012'.

3. The Commission requested that the Controller of Audit provides it with a further report in approximately 12 months' time, to enable the Commission to review the council's progress in implementing actions and in maintaining the improvements it has made over the last 12 months. This report fulfils that requirement.
4. Members of the Accounts Commission also met with elected representatives and senior managers of the council in Lerwick on 31 May 2012 to discuss the findings on the statutory report published in January 2012.

# Overall conclusions

The council has continued to make good progress on its improvement agenda. It has appointed a permanent chief executive and a chief financial officer and agreed a medium-term financial plan which clearly sets out the challenges facing the council, together with actions to address these. The council's 2011/12 financial statements were of good quality and were not qualified. The council needs to continue to sustain its positive direction of travel and knows that it will need to take some difficult decisions to address the significant financial challenges it faces.

5. The council has continued to make good progress on its improvement agenda.
6. The council's financial management arrangements have improved significantly. For the first time in six years, the 2011/12 accounts were not qualified. The council still faces significant financial challenges but the improved quality of financial reporting means that the council is in a much better position to take clear, well-informed decisions.
7. In terms of the key issues highlighted by the Commission in its last set of findings, the council has:
  - appointed a new chief financial officer (section 95 officer)
  - agreed a revised single outcome agreement (SOA), council action plan and a refreshed improvement plan
  - agreed a medium-term financial plan
  - appointed a permanent chief executive and filled vacant director posts
  - consolidated many of the improvements to its governance and accountability arrangements, including the political management arrangements and agreed a new code of governance
  - continued to develop a corporate culture of continuous improvement.
8. Following the local government elections in May 2012, the council appointed a new political leader and convener and 13 of the 22 elected members are new. A series of well-attended induction training events for members were held following the elections. The leader and the convener have been working well together and, with other members, are setting a clear direction for the council.
9. The council has made good progress on its improvement agenda, but needs to ensure that the wide ranging and ambitious improvement plans are prioritised and managed in a sustainable way so that it has the capacity to deliver on its objectives.
10. The council will need to take some difficult decisions if it is to deliver its medium-term financial plan. This will be challenging for council staff and the residents of the islands who have been used to providing and receiving a high level and quality of services over recent years. It will also be challenging for the political and managerial leadership of the council who, as a group, are relatively new to their various roles.

# Summary of progress

The council has continued to sustain the improvement evident at the time of the last progress report. Elected members have shown clear leadership following the local government elections in May 2012, with a particular focus on the need to deal with the financial challenges facing the council. The council's financial management arrangements have improved significantly and the council has appointed a permanent chief executive.

The council still faces some significant challenges, not least in taking the difficult decisions which will be needed to deliver its medium-term financial plan.

11. My last statutory progress report in December 2011 noted that the council had 'taken prompt action to address the issues highlighted in the audit reports and in the Accounts Commission's findings and has made good progress to date on implementing many important elements of its improvement plan.' This continues to be the case.
12. Over the last 12 months, the council has sustained its improvement activity and has taken action to address some of the remaining areas identified as presenting risk. For example, the last report noted that financial management remained an area of significant concern. The council has taken steps to address this by appointing a new section 95 officer and strengthening the finance team. In September 2012, it agreed a five-year medium term financial plan and the council's financial statements for 2011/12 were not qualified.
13. The council continues to move in the right direction and the clear commitment to improve evident at the time of my last report has been sustained. The council's self awareness continues to improve and it understands that it must continue to focus on its priorities and what still needs to improve for the future.
14. [Exhibit 1](#) below illustrates some of the significant events which have taken place since the last statutory progress report considered by the Commission in December 2011.



**Exhibit 1****Timeline of key events since last statutory report**

Month	Key events
December 2011	Accounts Commission considers statutory progress report
January 2012	Accounts Commission findings published Chief financial officer (S95 officer) appointed
February	2011/12 budget approved
March	Council agrees a five-year asset investment plan
May	Local Government Election Appointment of new council leader and convener and appointments of committee chairs and members Clear messages from the council leadership about the challenges facing the council Induction and development programme for elected members begins
June	Council agrees approach to Health and Social Care Integration, reshaping care for older people and approves Community Health and Care Partnership (CHCP) agreement Directorate service plans start to go to committees Policies on organisational restructuring and redeployment agreed Asset management strategy agreed
July	Council agrees Single Outcome Agreement (SOA), Council Action Plan and revised Council Improvement Plan
September	Council agrees Blueprint for Education 2012-17 Council agrees medium-term financial plan 2012-17 Council agrees new Code of Corporate Governance and new Complaints Procedure Audited accounts signed off without qualification Permanent chief executive takes up post
October	Annual audit report to members and the Controller of Audit finalised
November	On-site audit work for this BV follow-up report 2013/14 budget seminars held by each directorate

Source: Audit Scotland

## Leadership, vision & strategic direction

The early indications are that the new political leadership is providing a clear strategic direction for the council. The interim chief executive's secondment has come to an end and the council has appointed a permanent chief executive.

15. In my last progress report, I noted that the council has established new political management arrangements and a new management structure. I also noted that the interim chief executive had led the work on improving the council with considerable commitment and resilience, guiding the council through a series of important and difficult decisions, including decisions on the schools estate and the 2011/12 budget process.
16. There have been significant changes to the political leadership of the council following the local government elections in May 2012. Thirteen of the 22 members are new and the former convener, leader and some chairs/vice chairs of committees did not stand for election.
17. The council has appointed a new political leader, and a new convener. Since their appointment, the leader and convener have been working in partnership to set a clear vision and priorities for the council, in particular the need to deal with the financial challenges that the council faces.
18. In a press release shortly after being elected, the leader said, 'The council needs to develop mutual trust and respect with its staff, and involve the community as much as possible in future decisions which will affect everyone in Shetland. The council is facing some tough challenges when it comes to spending, and it needs to be transparent and open in its decisions in the years ahead.' More recently the convener has stated, 'There is nothing caring about spending money we don't have. At the end of the day all we are doing is mounting up problems for our children and grandchildren'.
19. In July 2012, the council agreed the Shetland Single Outcome Agreement 2012/15 (SOA). The SOA describes how the objectives set out in the Shetland Performance Framework will be delivered through action by local agencies and partners under the umbrella of the Shetland Community Plan. Progress on the SOA is reported to the full council annually and to the Executive Committee on a bi-annual basis.
20. The council also agreed a Council Action Plan in July 2012 which drew together the key 2012/13 targets contained within its current savings plan, the Improvement Plan and the SOA. The aim of the Council Action Plan is to ensure that the council delivers the short-term objectives agreed by the previous council, while the newly elected council reviewed its medium- and longer-term objectives. Quarterly progress reports are submitted to the Executive Committee to allow members to monitor the delivery and progress of the plan.
21. In September 2012, the council agreed a strategic 'Blueprint for Education' which will result in changes to the provision of education services across the islands. At a local level, it also recently decided not to provide funding to two village halls. These examples indicate that the council is now more prepared, and better able, to take difficult political decisions than was the case in the past.

22. The council is currently reviewing its Corporate Plan and it is expected that an updated plan will be in place by February 2013.

## Management arrangements, performance management and planning

The council has continued to improve its planning, budgeting and performance management arrangements.

23. In the last progress report, I noted that the council has agreed a new management structure and has made significant progress in implementing the new arrangements.
24. Since then, the council has made appointments to all of the director posts and appointed a permanent chief executive. The new chief executive had only been in post for a matter of weeks when the on-site audit work was carried out. However, it was clear from the audit interviews that he already had a good understanding of the council and is working towards developing effective relationships with members and officers.
25. The corporate management team is led by the chief executive and includes the directors, the section 95 officer and the monitoring officer; they are working well together and have a strategic corporate agenda.
26. The council's approach to planning and budgeting continues to improve, and it plans to further integrate its arrangements through the next budget process. In July 2012, the council agreed the Action Plan 2012/13 that *'sets out targets, timescales, responsibilities and monitoring arrangements for a demanding work programme over the early months of the new council'*. Progress on the action plan is reported to the Executive Committee and full council on a six-monthly basis.
27. The council also continues to work on the development of its performance management arrangements as set out in the Planning and Performance Management Framework (PPMF). The PPMF details how the council's strategic and operational plans are linked and how progress against these plans will be monitored and reported.

## Financial management and accountability

The council's financial management arrangements have improved significantly. The 2011/12 financial statements received an unqualified audit opinion for the first time in six years. The council has appointed a new chief financial officer who has been instrumental in improving financial management in the council.

28. In its findings on my last report, the Commission noted that the council needs to, 'do more to demonstrate more effective strategic financial management and to improve the capacity of its finance function, for example to avoid similar difficulties that were experienced this year in the timely and accurate preparation of accounts'. The Commission also expressed serious concern about the successive qualified audit certificates as a result of the exclusion of the Shetland Charitable Trust's financial results from the council's group accounts.

29. In January 2012, the council made an appointment to the post of executive manager - finance, who is the section 95 officer for the council. Since taking up the post, he has been instrumental in improving the financial management arrangements in the council.
30. The council has improved the capacity of the finance department by making appointments to the team. This has improved the quality and clarity of financial reporting and the process of preparing the annual financial statements.
31. [Exhibit 2](#) contains some key messages from the 2011/12 annual audit report to elected members and the Controller of Audit.

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### Exhibit 2

#### Key messages in annual audit report

We have given an unqualified opinion that the financial statements of Shetland Islands Council for 2011/12 give a true and fair view of the financial position and expenditure and income of the council and its group for the year. We also certify that the accounts have been prepared in accordance with relevant legislation, applicable accounting standards and other reporting requirements. For the preceding six years, the council's financial statements had carried a qualification in relation to the non-consolidation of the Shetland Charitable Trust (SCT). It is a significant development in the council's financial reporting that the SCT has now been included in the group accounts and that, consequently, the audit opinion is now unqualified.

This year the financial statements were submitted on time, to the expected quality and accompanied with working papers of a high standard. As a result of these significant improvements, we were able to conduct our audit more efficiently.

*Source: Annual Audit Report to Elected Members and the Controller of Audit 2011/12: Audit Scotland*

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32. In February 2012, the council agreed the 2012/13 revenue budget of £119.0 million (2011/12 £127.4 million). This included a savings target of £15.6 million and a draw on reserves of £17.1 million. In September 2012, the council reported a revised 2012/13 revenue budget of £125.6 million, requiring an additional draw on reserves of £5.7 million. The report highlighted the financial challenges facing the council:
  - some planned savings would not be achieved which will result in a projected General Fund overspend of £2.603 unless alternative savings can be made
  - the Harbour Account is projected to achieve £1.484 million less in income.
33. The report also noted that the Housing Revenue Account (HRA) is projected to be within budget.
34. For a number of years, the council has met budget deficits by drawing significantly on its reserves (£35.8 million was drawn from its reserves in 2011/12). The council recognises that this level of funding from reserves cannot be maintained in the long term. In his June report on 2011/12 unaudited out-turn to the Executive Committee, the chief financial officer stated

clearly, 'the level of revenue spend is still running well in excess of the council's incoming resources which is neither affordable or sustainable'.

35. In September 2012, the council agreed a five-year medium term financial plan (MTFP) aimed at achieving financial sustainability and ensuring resources are properly aligned with its objectives and priorities. This sets out the council's plan to address the significant savings required to maintain a balanced budget while retaining a minimum level of reserve, and aims to achieve total savings of £38.360 million over the period, while maintaining a minimum reserve balance of £125 million.
  36. The financial plan sets out the council's budget arrangements for the next five years and each director is required to develop five-year resourced directorate and service plans based on their target operating budgets.
  37. A budget carry forward scheme has been introduced to encourage services to underspend against their budgets. Through the scheme, a service can carry 50 per cent of any one-off underspend into the following financial year, assuming it has met its overall budget.
  38. The council also has a 'spend to save' scheme in place that provides funding to a service in order to achieve savings at a later date, as long as they are achieved within three years.
  39. The MTFP is a good example of the improvements made to financial reporting which is now clearer and less ambiguous. This is in marked contrast to the way financial matters were reported in previous years. [Exhibit 3](#) contains extracts from the MTFP to illustrate both the financial position of the council and also the improved clarity of financial reporting.
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### Exhibit 3

#### Key messages in the medium-term financial plan

##### Current budget gap

3.18 As a result of a widening disconnection between income received by the council and the level of expenditure incurred by the council over a number of years, a structural deficit has been created which resulted in expenditure being £35.6 million higher than income during 2011-12. This deficit was met in full by drawing funds from the council's reserves.

##### Reserves Levels

3.20 The result of the council's structural budget deficit is that the reserves have decreased from a value of £465 million (in today's prices) in 2000 to the current value of £193 million in 2012.

3.22 In the face of reducing income as explained above, lower returns on reserves and a current structural deficit of £35.6 million per year, the council's reserves will be zero by 2016/17 if no corrective action is taken.

### **Medium-term financial plan reserves policy**

5.10 It is important to recognise that the 'Tolerable Reserves Floor' set by the council does not impact on the level of cuts required to deliver a balanced budget. Even if all reserves are utilised for the provision of services, the council would then still have to cut expenditure to match its incoming resources in order to meet its statutory duty of setting a balanced budget.

5.11 Therefore, the level at which members decide to set the Tolerable Reserves Floor, will only determine the speed of the cuts that are necessary to deliver a balanced budget and preserve a certain level of reserves for the future.

### **Addressing the budget gap**

12.12 Directorates will be required to address the budget gap set out in 12.9 above, in order to deliver budget proposals that are within the Target Operating Budgets set in 12.9 above.

12.13 There are two options available to directorates to fill budget gaps; identifying savings and introduce or increase existing fees and charges. In practice, a combination of both options will be adopted by directorates where there is scope to do so.

*Source: Shetland Islands Council - Medium Term Financial Plan 2012-17*

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40. The management accounts for the period April to September 2012, stated that the total projected draw on reserves for 2012-13 is £27.5 million net of an underspend of £1.4 million on capital programmes. This is a substantial improvement from 2011-12 when there was a draw on reserves of £35.8 million, but the report to the Executive Committee recognises that this level of draw on reserves in a single year, 'is unsustainable and therefore officers should be encouraged to continue to find management/efficiency savings wherever possible to bring this down'.
41. The medium-term financial plan sets out the path to a sustainable budget position, which is to be achieved through staged reductions over the next four financial years. As part of the process for moving towards this position, the general fund target operating budget has been set at £110 million for 2013-14. The budget has been divided among the directorates to give Directorate Target Operating Budgets. Each directorate is planning its 2013-14 activity in line with the allocated budgets. A budget seminar for each directorate was held in November and members were invited to attend to hear budget proposals. These seminars were well attended by members.

## **Building capacity & sustaining improvement**

The council continues to make good progress on its improvement plan and is building capacity by investing in training and development for members and officers. The council should review its improvement activity to ensure that it is being prioritised and managed effectively, so that it can assure itself that it has the capacity to deliver its objectives.

42. In the last progress report, I noted that the council had made good progress overall on its improvement plan. This continues to be the case.

43. The council has an extensive improvement agenda, which is managed in a number of plans and reported to a range of forums.
44. The council's initial improvement plan was put in place to address the Commission's recommendations following the public hearing in 2010. The improvement plan has been reviewed and revised over time and the council approved a refreshed improvement plan in May 2012.
45. The improvement plan is structured along the lines of the corporate assessment framework used by Audit Scotland and other inspection agencies, and the council uses it to inform its own self assessment. The plan is well structured, has clear lines of accountability and clear timescales. Each main area is led by a director, who is supported by officers from other departments to improve corporate working. Delivery against the improvement plan also forms a core element of senior management performance management arrangements.
46. The improvement plan is considered by the council alongside its other key plans on a bi-annual basis, and is reported and monitored by Corporate Management Team (through its 'Directors for Change' group) and the Executive Committee on a quarterly basis. The council also uses an Improvement Sounding Board of members and officers to manage improvement work. The most recent update report to full council in September 2012, indicates that the council is making good progress overall.
47. The council also has a large programme of reviews under way. Each review has a lead director, who, as on the improvement plan, is supported by officers from other directorates.
48. The programme contains 50 reviews which vary in size and are at different stages. As at November 2012, five are in the early stages, 25 are in progress and six have been completed. However, 14 have experienced some slippage and are categorised by the council as being overdue.
49. The council also has a number of smaller scale 'SOFIE' (Sussing Out Further Internal Efficiency) reviews. This programme is managed by the Directors for Change group and is essentially a quick, focused piece of peer review work from within the council.
50. Each component of the improvement work is well organised, has clear lines of responsibility and there are regular reports on progress and results. With such an ambitious and wide ranging improvement agenda, it is important that the council is prioritising the most important areas and not spreading its capacity too thinly. It needs to ensure that it is making the best use of the capacity that it has and should review the various strands of improvement work to assure itself that the scale and ambition is not compromising its ability to deliver improvement.
51. Following the council elections in May 2012, the council delivered a comprehensive induction programme for all elected members. The council has also developed a wide ranging on-going development programme for councillors, half of whom now have draft personal development plan in place. Attendance at training and development events has been good over all. This has included 80 per cent attendance over-all across a ten-day induction programme, 100 per

cent attendance at a budget development seminar and 91 per cent attendance at a Blueprint for Education seminar.

52. The council is also making progress on training and developing its workforce. It has developed a HR/workforce strategy supported by a learning and development programme.
53. Both members and officers are also increasingly attending local government meetings, forums and networking events.
54. The senior management of the council is working corporately, for example through the cross-departmental teams working on the improvement agenda. The council has also established a broader management forum 'Executive Plus' which brings together the directors and executive managers.
55. Working relationships among members and between members and officers are constructive. It is important that this is sustained in order to tackle the challenges ahead.

## Outlook

56. The council continues to move in the right direction and the clear commitment to improve evident at the time of my last report has been sustained. The council's self awareness continues to improve and it understands that it must continue to focus on its priorities and what still needs to improve for the future.
57. In order to sustain this positive direction of travel, the council will need to:
  - take the difficult decisions needed to deliver on the commitments contained in the medium-term financial plan, to put the long-term financial position of the council on a sustainable footing
  - review and prioritise its improvement activity to ensure it is sustainable.