



Shetland Islands Council

Report to the Audit Committee, Members of the Council and
the Controller of Audit on the 2019/20 audit

Issued on 11 September for the meeting on 23 September 2020

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Introduction

The key messages in this report

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our final report to the Audit Committee (“the Committee”) of Shetland Islands Council (“the Council”) for the 2019/20 audit. The scope of our audit was set out within our planning report presented to the Committee in March 2020.

This audit was carried out under unusual circumstances, being a remote audit conducted during the national lockdown in response to COVID-19. We recognise the extra pressure faced by Council staff in preparing the annual accounts and in preparing for the audit. We engaged early with management on the potential implications of COVID-19 for the preparation of the annual accounts as well as the audit, and management confirmed their desire to work to the original reporting timescale. While the shift to remote working placed pressure on the original timetable for preparation of the annual accounts and completion of the audit, we have worked closely with management to mitigate this whilst maintaining audit quality as our number one focus.

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the **four audit dimensions** that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of the Accountable Officers’ duty to secure best value.



Introduction (continued)

The key messages in this report (continued)

I would like to draw your attention to the key messages of this paper:

Conclusions from our testing

Based on our audit work completed to date we expect to issue an unmodified audit opinion.

The impact of COVID-19 has led to a material uncertainty being identified by the Council's property valuers in relation to the valuation of the Council's estate. As a result, we expect to include an 'Emphasis of Matter' paragraph within our audit report.

Following changes made as a result of our audit, we are satisfied that the management commentary and annual governance statement comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of the Council.

The auditable parts of the remuneration report have been prepared in accordance with the relevant regulation.

A summary of our work on the significant risks is provided in the dashboard on page 10.

We have identified 1 misstatement in excess of our reporting threshold of £160,000 up to the date of this report arising from an event after the balance sheet date, as set out on page 26, which has not been corrected. One corrected adjustment arising from events after the balance sheet date has also been made, as set out on page 16. We have not identified any disclosure deficiencies.

Status of the financial statements audit

There are no matters outstanding.

Conclusions on audit dimensions

As set out on page 3, our audit work covered the four audit dimensions. This incorporated the specific risks highlighted by Audit Scotland.

Our separate detailed report is presented along with this paper and sets out our findings and conclusions on each dimension. In accordance with the Code of Audit Practice, we have included our overall conclusions within this report.

The outbreak of COVID-19 has brought unprecedented challenges to organisations around the country. It is not yet known what long-term impacts these will have on populations and on the delivery of public services, but they will be significant and could continue for some time. While our reports makes reference to COVID-19 where relevant in each of the dimensions, we have not considered the full impact of COVID-19 on the Council at this stage.

Financial Management - The Council drew on £21.72m of reserves in 2019/20 (up from £15.31m in 2018/19). The Council has strong financial management arrangements in place. We welcome improvements noted in financial reporting and the accuracy of budgeting and encourage the Council to address our outstanding recommendations in relation to budget setting, review of the finance function and engagement in the NFI exercise.

The inadequate interaction with internal audit, highlighted by the Chief Internal Auditor, is a significant matter of concern, potentially impacting on the Council's ability to ensure it has an effective governance and control environment in place.

While the Council has arrangements in place to prevent and detect fraud and corruption in the procurement function, further work is needed to ensure that these are sufficient.

Introduction (continued)

The key messages in this report (continued)

Conclusions on audit dimensions (continued)

Financial sustainability - The Council achieved short-term financial balance in 2019/20 and has set a balanced budget for 2020/21, utilising an unsustainable draw on reserves. The current reserves held are at an acceptable level. It is also positive to note that the Council is actively assessing the financial impact of COVID-19.

The Council recognises that it is not financially sustainable. It's medium-term outlook is optimistic and has not been reviewed in the year. The Business Transformation and Service Redesign Programmes have suffered delays – which are likely to be made worse by COVID-19 – and it is not clear that they can deliver the savings required.

In a significant number of areas, we have not noted any improvement in the year.

Governance and transparency - The Council continues to have strong leadership in place. This has been particularly evident in the response to COVID-19, the streamlined decision making arrangements and the arrangements for developing the Council's recovery plan. Appropriate governance arrangements have been put in place in response to the COVID-19 pandemic.

The Council continues to be open and transparent, although it remained non-compliant with the Community Empowerment Act until September 2020 and is now non-compliant with the Public Bodies Act requirement to review the Integration Scheme with the NHS and IJB.

The IJB has made good progress during the year, achieving financial balance and setting a balanced budget for the first time in 2020/21. The risks of COVID-19 on both the financial position and performance of the IJB will remain ongoing, however, we are satisfied that there are plans in place to carry out a comprehensive review of the MTFP during 2020/21.

There remain a number of areas where we have not identified improvements and where we would encourage the Council to focus as it demonstrates its commitment to continuous improvement, for example its approach to self-assessment and community consultations.

Value for money – The Council has revised its Performance Management Framework in the year. Reporting on performance in the year was curtailed as a result of the new framework and the outbreak of COVID-19. There has been insufficient reporting for us to conclude on the Council's performance in the year.

The performance of the Council is showing evidence of improvements in a number of areas in the Local Government Benchmarking Framework (LGBF), although there has been a decline in performance in more areas. It is important that the Council take any lessons learned as it moves into the recovery phase from COVID-19 to consider alternative approaches to service delivery.

The Scottish Housing Regulator has preliminarily concluded that the Council's performance in relation to housing and homelessness had not improved in 2019/20, except for a slight increase in tenant satisfaction scores. The Council has confirmed that it is prioritising improvement in this area and has reported that improvements have been made in the year and is satisfied that this improvement will be reflected in future engagement with the regulator.

While we have identified issues with the implementation of the acquisition of Shetland Leasing and Property Developments Limited (SLAP) and the College Merger, we are satisfied that these projects continue to represent value for money.

Introduction (continued)

The key messages in this report (continued)

Conclusions on audit dimensions (continued)

Best Value

The Council has a number of arrangements in place to secure Best Value. While the Council continues to demonstrate improvements in a number of areas and is committed to improvement, further improvements are needed in key areas and the Council needs to ensure that the pace of change is appropriate.

Our conclusions and detailed findings are included in our separate report submitted along with this report. Management have agreed to all the recommendations and are in the process of implementing them.

Next steps

An agreed Action Plan is included as an Appendix on page 27 of this report in relation to the financial statements audit. A separate Action Plan on the findings of the audit dimensions work is included in our separate report. We will consider progress with the agreed actions as part of our 2020/21 audit.

Added value

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

This is provided throughout both of our reports. In addition, as information has emerged as a result of the COVID-19 pandemic, we have shared guidance with management on areas to consider in relation to internal controls, fraud risks and annual reporting. In addition, invites have been issued to our weekly webinar "Responding to COVID-19: Updates and practical steps" which are open to anyone to join.

Pat Kenny
Audit Director

Financial statements audit



Quality indicators

Impact on the execution of our audit

Management and those charged with governance are in a position to influence the effectiveness of our audit, through timely formulation of judgements, provision of accurate information, and responsiveness to issues identified in the course of the audit. This slide summarises some key metrics related to your control environment which can significantly impact the execution of the audit. We consider these metrics important in assessing the reliability of your financial reporting and provide context for other messages in this report.

Area	Grading	Reason
Timing of key accounting judgements	●	Key accounting judgements, such as property, plant and equipment (PPE) valuations and net defined benefit pension asset support was provided on time and were of good quality.
Adherence to deliverables timetable	●	We were informed early of an anticipated delay in receiving information and worked with management to accommodate this. Information was provided by this revised timetable and management responded promptly to follow-up queries.
Access to finance team and other key personnel	●	Deloitte and the Council have worked together to facilitate remote communication during the audit. This has included effective use of such technologies as Microsoft Teams and Deloitte Connect.
Quality and accuracy of management accounting papers	●	On the whole documentation provided has been a good standard. This included documentation that easily reconciled to the draft financial statements.
Quality of draft financial statements	●	A full draft of the annual accounts was received for audit on the 8 July 2020. The draft was of a high standard with limited changes required, although we have made recommendations for improvement which management should note for 2020/21.
Response to control deficiencies identified	●	Control deficiencies in relation to IT have been identified, set out on page 19, which management have confirmed they will address in 2020/21.
Volume and magnitude of identified errors	●	Financial adjustments identified through our work relate entirely to events after the balance sheet date. We have not identified any disclosure deficiencies.



Lagging



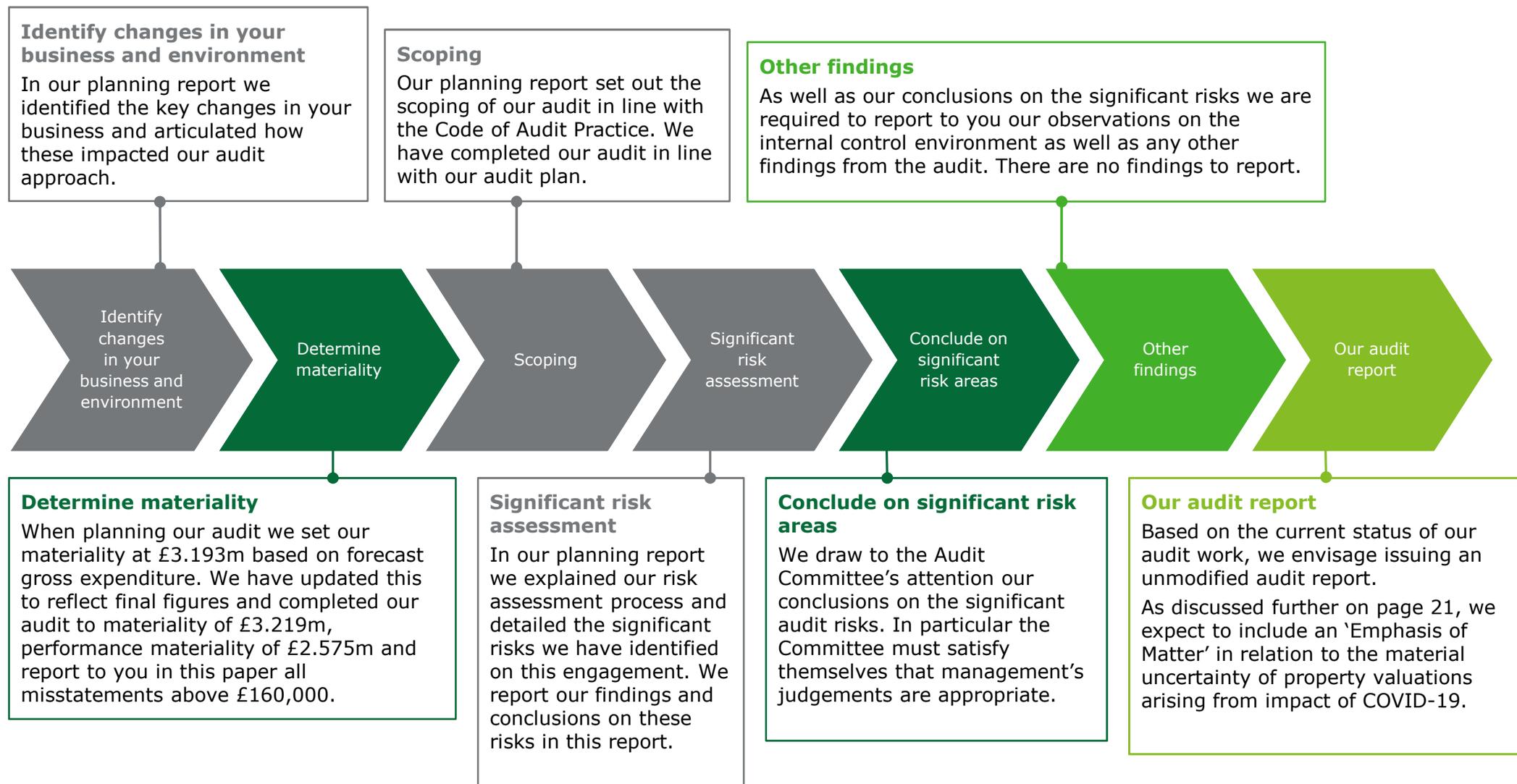
Developing



Mature

Our audit explained

We tailor our audit to your business and your strategy



Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Consistency of judgements with Deloitte's expectations	Comments	Slide no.
Recognition of grant income			D+I		Satisfactory	11
Management override of controls			D+I		Satisfactory	12

Overly prudent, likely to lead to future credit



Overly optimistic, likely to lead to future debit.

D+I: Testing of the design and implementation of key controls

Significant risks (continued)

Risk 1 - Recognition of grant income

Risk identified

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

Key components of income for the Council are summarised in the table below. The General Revenue Grant and Non-Domestic Rates income which are directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100% to third party evidence therefore there is little scope for manipulation. Similarly, the income from the IJB relates to services commissioned from the Council and can be verified 100%. Council tax and housing rent income are set through the annual budget process with no management judgement and therefore have a low risk of fraud. Similarly, other Service Income includes fees and charges across all Services, which are set through formal approval processes, with no history of fraud or error. Finally, we perform detailed assurance work on housing benefits and therefore are satisfied that these amounts are not a significant risk area.

The significant risk is pinpointed to the recognition of grant income, comprising capital grants and contributions and grants credited to services.

Key judgements and our challenge of them



Grant income is a significant risk due to:

- management judgement in determining if there are any conditions attached to a grant and if so whether the conditions have been met; and
- complex accounting for grant income as the basis for revenue recognition in the accounts will depend on the scheme rules for each grant.

Deloitte response



We have performed the following:

- assessed management's controls around recognition of grant income; and
- tested a sample of capital grants and grants credited to services to confirm these have been recognised in accordance with any conditions applicable and applicable accounting standards.

Type of income	2019/20 (€m)	Significant risk
<u>Taxation and Non-Specific Grant Income</u>		
Council tax income	9.643	
Non domestic rates	25.925	
Revenue support grant	55.412	
<i>Capital grants and contributions</i>	<i>10.130</i>	✓
<u>Service Income</u>		
<i>Grants credited to services</i>	<i>20.955</i>	✓
Housing Benefit Subsidy	3.186	
Housing Revenue Account	7.116	
IJB commission income (book entry)	23.018	
Harbour Account	35.328	
Other Service Income	16.251	

Deloitte view

We have concluded that grant income has been correctly recognised in accordance with the requirements of the Code of Practice on Local Authority Accounting.

Significant risks (continued)

Risk 2 - Management override of controls

Risk identified

In accordance with ISA 240 (UK) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.



Deloitte response

We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- the Council's results throughout the year were projecting overspends in the year. This was closely monitored with a good understanding of the reasons for the variances; and
- senior management's remuneration is not tied to particular financial results.

We have considered these factors and other potential sensitivities in evaluating the judgements made in the preparation of the financial statements.

Significant and unusual transactions

We did not identify any significant transactions outside the normal course of business or any transactions where the business rationale was not clear.

Journals

We have performed design and implementation testing of the controls in place for journal approval.

We have used Spotlight data analytics to risk assess journals and select items for detailed follow up testing. The journal entries were selected using computer-assisted profiling based on areas which we consider to be of increased interest.

We have tested the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting. No issues were noted from the testing completed.

Accounting estimates and judgements (see next page)

We have performed design and implementation testing of the controls over key accounting estimates and judgements.

We reviewed accounting estimates for biases that could result in material misstatements due to fraud, as set out in the summary on the following page. We concluded that overall the changes to estimates in the period were balanced and did not indicate a bias to achieve a particular result.

We tested accounting estimates and judgements including the pension liability, valuation of property assets and provisions, investments and fishing quota focusing on the areas of greatest judgement and value. Our procedures included comparing amounts recorded or inputs to estimates to relevant supporting information from third party sources.

Deloitte view

We have not identified any significant bias in the key judgements made by management based on work performed.

We have not identified any instances of management override of controls in relation to the specific transactions tested based on work performed to date.

Significant risks (continued)

Risk 2 - Management override of controls (continued)

Key judgements The key judgement in the financial statements are those which we have selected to be the significant audit risks around the recognition of grant income (page 11). While not considered to be significant audit risks, we have considered the assumptions used to calculate the pension liability (page 16), the valuation methodology for property valuations (page 15), and the recognition of expenditure (page 17). In the table below, we set out our challenge of the assumptions used in the determination of provisions, investments and fishing quota. As part of our work on this risk, we reviewed and challenged management's key estimates and judgements including:

Estimate / judgement	Details of management's position	Deloitte Challenge and conclusions
Provisions	<p>The total provisions held within the Council's balance sheet is material, at £5.839m. The balance is primarily comprised of the pension cessation costs as a result of the Shetland College, Train Shetland and NAFC merger, accounting for £5.080m (increased from £3.271m in 2018/19). The calculation of this amount has been determined by the Council's independent actuary.</p>	<p>We examined the rationale for each provision, including a retrospective review of amounts provided in 2017/18 and 2018/19. We have also challenged the completeness of the provisions made through discussion with the Council's legal advisors.</p> <p>For the pension cessation costs, we confirmed that the calculation was provided by the same actuaries we assessed for the pension liability. We have confirmed that the amount recorded by the Council is in line with the amount provided by the actuary.</p> <p>We concluded that the provisions made were reasonable.</p>
Investments	<p>The Council holds investments at fair value, with valuations provided to the Council by independent fund managers. The value of investments at the year end was £314.033m.</p> <p>When the fair value of financial assets and liabilities cannot be measured based on quoted prices in active markets (i.e. Level 1 inputs), their fair value is measured using valuation techniques. Where possible, the inputs to these valuation techniques are based on observable data, but where this is not possible judgement is required in establishing fair values. These judgements typically include considerations such as uncertainty and risk.</p>	<p>Investments are managed by external fund managers, with the valuation of investments provided by them independently. While the balance sheet value is material, the Council only records what they are advised by the independent fund managers in terms of valuations and gain/losses on disposals. The Council have little scope to manipulate the balances as the fund managers provide monthly reports with a comprehensive breakdown of additions, disposals and revaluations.</p> <p>We have consulted with financial instrument experts to review the assumptions and valuations performed by the fund managers, as well as agreeing the valuation of investments to third party evidence or developing a point estimate based on adjusted net asset values.</p> <p>We have not identified any issues through our work.</p>

Significant risks (continued)

Risk 2 - Management override of controls (continued)

Estimate / judgement	Details of management's position	Deloitte Challenge and conclusions
Fishing Quota	<p>The Council holds a substantial amount of fishing quota, leased to third parties for use in the year. The value of fishing quota at the year end was £30.2m.</p> <p>The valuation of fishing quota is performed by an independent expert. The price that quota attract is affected by the quantity of Fixed Quota Allocation Units (FQAs) in the market.</p>	<p>All valuations are completed by an external expert. Deloitte are satisfied that the independent valuer is suitably competent and has the capabilities to carry out a valuation of the fishing quotas held by the Council.</p> <p>We have assessed the objectivity and competence of management's expert and developed an independent estimate of the value based on information obtained from the active market in the year. We have also assessed the Council's valuation against fishing quota held by similar local authorities and assessed the movement against the movement in the market in the year.</p> <p>We have concluded that fishing quota are held at a reasonable value.</p>

Other areas of audit focus

Property valuations

Risk identified

The Council is required to hold property assets within Property, Plant and Equipment at a modern equivalent use valuation. The valuations are, by nature, significant estimates based on specialist and management assumptions and which can be subject to material changes in value. We did not identify this as a significant risk in our Audit Plan as our property specialists, Deloitte Real Estate, reviewed the methodology applied by the Council's valuer in previous years and concluded it was robust.

The Council has had an independent valuation carried out at 31 March 2020 for the purposes of the 2019/20 financial statements as part of its five-year rolling programme. The impact of COVID-19 has led to a material uncertainty being identified by the Council's property valuer regarding the valuation of properties. Although our overall assessment of the risk level regarding the Council's property valuation, has not increased to 'significant', we expect to include an 'Emphasis of Matter' in our Independent Audit Report.



Key judgements

The valuation method has not changed from the prior year and is in line with International Financial Reporting Standards, with a rolling programme of revaluation being carried out in line with previous years. The Council's revaluation has resulted in a net upward revaluation to property values of £16.15m.

The valuer identified a material uncertainty due to the impact of COVID-19 on individual markets, this is in line with RICS guidance published on 18 March 2020, as follows:

"The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a 'global pandemic' on 11 March 2020, has impacted global financial markets and travel restrictions have been implemented by many countries.

Market activity is being impacted in many sectors. As at the valuation date, I consider that less weight can be attributed to previous market evidence for comparison purposes, in informing opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement.

This valuation is therefore reported on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – should be attached to the valuation than would normally be the case."



Deloitte response

- We have engaged our property specialists in relation to the impact of COVID-19;
- We have assessed the presentation of revaluation movements and impairments, taking into account revaluation reserves for individual assets, and the disclosures included in the financial statements; and
- We have reviewed the valuers report and assessed managements disclosure of the key source of estimation uncertainty.

Deloitte view

Based on the audit evidence obtained, we are satisfied that the valuation of the Council's estate is appropriate. However, we expect to include an 'Emphasis of Matter' in our Independent Audit Report due to the material uncertainty identified by the valuers concerning valuations at 31 March 2020 due to the impact of COVID-19 on the property market.

Following changes made as a result of our audit, we are satisfied that this has been appropriately disclosed in the notes to the financial statements.

Other areas of audit focus (continued)

Defined benefits pension scheme

Background

The Council participates in two defined benefits schemes:

- Scottish Teachers' Superannuation Scheme, administered by the Scottish Government; and
- The Shetland Islands Council Pension Fund, administered by the Council.

The net pension liability has decreased from £209.906m in 2018/19 to £171.912m in 2019/20. The decrease is combination of a reduction of £27.671m in the fair value of the assets and a reduction of £65.665m in the liabilities as a result of demographic changes and financial assumptions. This total includes the impact of the McCloud adjustments.

The Council's pension liability continues to be affected by the McCloud legal case in respect of potential discrimination in the implementation of transitional protections following changes in public sector pension schemes in 2015. Following recent consultation published by the SPPA subsequent to the year end, the actuary has amended its estimate of the impact of McCloud to only include members that were in service before 1 April 2012. This has resulted in a reduction of £1.992m to the liability disclosed in the draft accounts which has been updated in the final accounts. The actuary has made this adjustment to past service costs, but has not made any allowance within the current service costs for the impact of McCloud, therefore does not fully represent the cost of the benefits accruing for current service. The Council's actuary has estimated that the potential impact of this is a £0.303m understatement of the liability. This is an estimate and the actual cost could be different. As this amount is not material, management have not made this adjustment to the accounts and this has been reported as an uncorrected misstatement at page 26.

In the current year there was an additional legal case - the Goodwin judgement - that has an impact on the scheme. The judgement, subsequent to the year-end, is in respect of a Teacher's Pension case where there was deemed to be discrimination in spousal transfer on death of the member (where a male widower was deemed to be discriminated against through receiving a different level of benefits than a female widow). The actuary has amended its estimates to take into account this case, which has resulted in an increase in liability of £0.622m to the liability disclosed in the draft accounts which have been updated in the final accounts.

Deloitte response

- We assessed the independence and expertise of the actuary supporting the basis of reliance upon their work.
- We reviewed and challenged the assumptions made by Hymans Robertson, including benchmarking as shown the table below.
- We have obtained assurance over the controls for providing accurate data to the actuary.
- we assessed the reasonableness of the Council's share of the total assets of the scheme with the Pension Fund financial statements.
- we have reviewed and challenged the calculation of the impact of the McCloud and Goodwin cases on pension liabilities.
- we reviewed the disclosures within the accounts against the Code.

	Council	Comments
Discount rate (% p.a.)	2.3	Prudent and reasonable
Consumer Price Index (CPI) Inflation rate (% p.a.)	1.9	Prudent end of reasonable range
Salary increase (% p.a.)	2.4%	Real salary increases 0.5% above CPI inflation
Pension increase in payment (% p.a.)	1.9	Reasonable
Pension increase in deferment (% p.a.)	1.9	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	21.4	Prudent
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	22.7	Prudent

Deloitte view

Following receipt of the updated accounts to reflect the changes to the liability for both McCloud and Goodwin arising from events after the balance sheet date (net impact was a reduction in liability of £1.4m), we are satisfied that the net pension liability disclosed in the accounts is materially correct. The Council's actuary has estimated the potential impact of McCloud on the current service cost as £0.303m which has been recorded as an uncorrected misstatement on page 26.

Other areas of audit focus (continued)

Expenditure recognition

Risk identified

In accordance with Practice Note 10 (*Audit of financial statements of public sector bodies in the United Kingdom*), in addition to the presumed risk of fraud in revenue recognition set out in ISA (UK) 240, as discussed further on page 12, auditors of public sector bodies should also consider the risk of fraud and error on expenditure. This is on the basis that most public bodies are net spending bodies, therefore the risk of material misstatement due to fraud related to expenditure may be greater than the risk of material misstatement due to fraud related to revenue recognition.

We have considered this risk for the Council and concluded that we are satisfied that the control environment is strong and there is no history of errors or audit adjustments. This has therefore not been assessed as a significant risk area, but continued to be an area of audit focus.



Deloitte response

We performed the following procedures using data analytics to address the above risk:

- A review of the number and median value of invoices processed in the year. As illustrated in table opposite, based on the median amount, the Council would need to omit over 23,000 invoices at year-end to result in a material error. We noted that in the month following the year-end, a total of 3,009 invoices were processed. We therefore concluded that a risk of material misstatement was remote.
- An analytical review to test the completeness and accuracy of year-end creditor balances. We have not identified any issues from the testing performed.

	Invoice Analysis
Median invoice amount	£135.20
Average number of invoices processed per month	4,821
Number of invoices that would need to be unrecorded to cause a material misstatement	23,809
Total invoices processed in April (one month after year-end)	3,009 (total value £5.682m)

Deloitte view

We have concluded that expenditure has been correctly recognised in accordance with the requirements of the Code of Practice on Local Authority Accounting.

Other areas of audit focus (continued)

Charitable trusts

Risk identified

From 2013/14, all Scottish Councils who act as sole trustees for any registered charities have to fully comply with the Charities Accounts Regulations. This requires Charities SORP compliant accounts to be prepared for each charity, and a separate audit of each. Shetland Islands Council administers one such registered charity – Zetland Educational Trust.

As the gross income the Trust is less than £100,000, the Council has opted to prepare the charitable trust accounts on a receipts and payments basis in accordance with The Charities Accounts (Scotland) Regulation 2006. Fully compliant Charities SORP accounts are therefore not required and disclosure is limited to that specified in the Regulations.

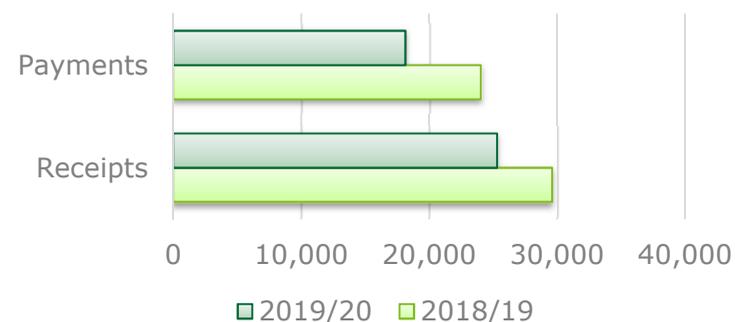


Deloitte response

We have assessed that the Statement of Receipts and Payments and the Statement of Balances to ensure these have been prepared in accordance with the Charities Accounts (Scotland) Regulations 2006. Minor amendments were requested through our audit and these were corrected by management.

A summary of the key movements is provided in the table adjacent. We note that receipts have declined by 15% in the year, with payments declining by 25%. The decline in payments is primarily linked to the fact that significant disbursements were made in 2018/19 for special equipment and promoting knowledge of Shetland which did not recur in 2019/20 (declining by 72% in total). This was offset to a degree by a 48% increase in disbursements for educational excursions.

Charitable Trust Payments and Receipts (£)



Deloitte view

During our audit of Zetland Educational Trust Fund we have found no issues, apart from those discussed above, which were corrected by management.

Other significant findings

Internal control and risk management

During the course of our audit we have identified internal control and risk management findings, which we have included below for information.

Area	Observation	Priority
IT controls	<p>Our IT specialists have performed detailed work on six of the Council's IT systems and have identified a number of control deficiencies. Feedback has been provided to management setting out the details of these findings for implementing improvements. The findings include: No independent oversight over change management; no data classification policy; no ongoing awareness training provided to Council IT users; no segregation of duties enforced between business users and admin users (in five systems); no user access reviews are performed (in five systems); no formal starters and leavers process, and weak password parameters (in one system).</p> <p>Management have accepted these findings and plan to address these in 2020/21.</p>	

The purpose of the audit was for us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you.

Low Priority

Medium Priority

High Priority

Other significant findings (continued)

Financial reporting findings

Below are the findings from our audit surrounding your financial reporting process.

Qualitative aspects of your accounting practices:

The Council's accounts have been prepared in accordance with the Local Authority Code of Practice (the Code). The accounting policies adopted are in line with the Code. The Council's annual accounts include numerous areas of good practice, including the use of graphics, tables and signposting; linking with the national performance framework and outcomes; explaining the Council's redesign and transformation programmes; providing useful narrative on climate change and COVID-19; and overall providing a commendably fair and balanced overview of performance in the year.

Significant matters discussed with management:

Significant matters discussed with management related primarily to the impact of COVID-19 on the organisation, including the impact of the material valuation uncertainty on PPE valuations.

Other matters relevant to financial reporting:

We have not identified other matters arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

We will obtain written representations from the Council on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist. A copy of the draft representations letter has been circulated separately.

Our audit report

Other matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report.



Our opinion on the financial statements

Our opinion on the financial statements is expected to be unmodified.



Material uncertainty related to going concern

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting.

While the Council is faced with financial sustainability challenges (as summarised on page 5), there is a general assumption set out in Practice Note 10 (Audit of financial statements of public sector bodies in the United Kingdom) that public bodies will continue in operation, therefore it is appropriate to continue as a going concern.



Emphasis of matter and other matter paragraphs

As discussed on page 15, we expect to include an 'Emphasis of Matter' paragraph within our audit report in relation to the material uncertainty associated with the property valuations. There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



Other reporting responsibilities

The annual accounts are reviewed in their entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

Our opinion on matters prescribed by the Controller of Audit are discussed further on page 23.

COVID-19 outbreak

Impact on the annual accounts and audit

The current crisis is unprecedented in recent times. The Council is directly exposed to the practical challenges and tragedies of the pandemic, and is undergoing major, rapid operational changes in response.

The uncertainties and changes to ways of working also impact upon the reporting and audit processes, and present new issues and judgements that management and the Council need to consider. CIPFA has issued guidance relating to the impacts on the annual accounts to assist in making relevant disclosures. We summarise below the key impacts on reporting and audit:

Impact on Council annual accounts

The Council need to consider the impact of the outbreak on the annual accounts including:

- Principal risk disclosures;
- Change in the funding regime for 20/21;
- Property valuation material uncertainty;
- Impairment of non-current assets;
- Allowance for expected credit losses;
- Fair value measurements based on unobservable inputs;
- Onerous contracts and any potential provisions;
- Going concern; and
- Events after the end of the reporting period.

Impact on our audit

COVID-19 has fundamentally changed the way we have conducted our audit this year including:

- Teams are primarily working remotely with some challenges in accessing 'physical' documentation and with availability of some Council staff;
- The teams have had regular status updates to discuss progress and facilitate the flow of information;
- Consideration of impacts on the areas of the financial statements and annual accounts listed has been included as part of our audit work in the current year and comments have been included where appropriate within this report; and
- In conjunction with the Council staff, we will continue to consider any developments for potential impact up to the finalisation of our work in September 2020.

Your annual accounts

We are required to provide an opinion on the auditable parts of the remuneration report, the annual governance statement and whether the management commentaries are consistent with the disclosures in the accounts.

	Requirement	Deloitte response
Management Commentary	The management commentary comments on financial performance, strategy and performance review and targets. The commentary included both financial and non financial KPIs and made good use of graphs and diagrams. The Council also focusses on the strategic planning context.	<p>We have assessed whether the management commentary has been prepared in accordance with the statutory guidance. Minor amendments were required as a result of our audit work.</p> <p>We have also read the management commentary and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p> <p>Following minor amendments made during the course of the audits, we are satisfied that the management commentary has been prepared in accordance with guidance, is consistent with our knowledge and is not otherwise misleading.</p>
Remuneration Report	The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior Councillors and Senior Employees of the Council.	We have audited the disclosures of remuneration and pension benefits, pay bands, and exit packages, and we can confirm that they have been properly prepared in accordance with the regulations.
Annual Governance Statement	The Annual Governance Statement reports that the Council governance arrangements provide assurance, are adequate and are operating effectively.	We have assessed whether the information given in the Annual Governance Statement (AGS) is consistent with the financial statements and has been prepared in accordance with the accounts regulations. We have required management to make changes to significant governance issues in the year, relating specifically to the Council's non-compliance with the Public Bodies (Joint Working) (Scotland) Act 2014, which required the Integration Scheme to be reviewed by the end of June 2020.

Appendices



Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit Committee and the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA (UK) 260 to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report;
- Our internal control observations; and
- Other insights we have identified from our audit.

The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan.

Use of this report

This report has been prepared for the Audit Committee and the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the procedures performed in fulfilling our audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.



Pat Kenny, CPFA

For and on behalf of Deloitte LLP

Glasgow | 11 September 2020

Audit adjustments

Uncorrected misstatements

The following uncorrected misstatements have been identified up to the date of this report. The uncorrected misstatements have no impact on the overall General Fund position.

		Debit/ (credit) CIES £m	Debit/ (credit) MIRS £m	Debit/ (credit) in net assets £m	Debit/ (credit) reserves £m	If applicable, control deficiency identified
Pension Liability – McCloud current service costs	[1]	0.303	(0.303)	(0.303)	0.303	N/A
Total						

[1] As discussed on page 16, the actuary has not made any allowance within the current service costs for the impact of McCloud, therefore does not fully represent the cost of the benefits accruing for current service. The Council's actuary has estimated that the potential impact of this is a £0.303m understatement of the liability. As the pension liability is fully mitigated by statutory adjustments, this misstatement has no impact on the overall General Fund position.

Clearly trivial differences

When we presented our planning paper in March 2020, the Committee requested that we report the total impact of clearly trivial differences identified through our work. We have noted the aggregate value of all trivial differences (those below our reporting threshold of £0.16m) which have not been reported or corrected. It is important to note that these differences are not necessarily errors as we have not investigated them in detail, given their triviality. The gross value of trivial differences identified through our audit was £1.241m, of which £0.525m are factual or extrapolated errors, with a potential impact on the general fund of £0.289m.

Action plan

Recommendations for improvement

No.	Area	Recommendation	Management Response	Responsible person	Target Date	Priority
1	<i>Review of expert reports</i>	<p>In our review of reports received by management in relation to property valuations, investment values and fishing quota valuations, we noted that initially the property valuation did not include a material uncertainty and that the fishing quota valuation did not include detailed narrative supporting the valuation and consideration of key matters (such as EU Withdrawal).</p> <p>While it is appropriate to engage experts to assist in valuing complex balances, the valuation ultimately remains management's judgement and management should carry out reviews to assure themselves as to the reasonableness of the valuations provided and judgements reached.</p>	The finance team undertakes an annual 'lessons learned' exercise following the conclusion of the annual audit. This exercise will capture any learning points that have arisen during the 2019/20 audit and will be incorporated into planning for the preparation of the 2020/21 accounts.	Executive Manager – Finance	30/06/21	Medium
2	<i>IT controls</i>	Given the substantial number of control deficiencies identified in the six IT systems examined (page 19), management should review existing controls and policies, making appropriate adjustments to satisfy themselves that the control environment is appropriate and that controls are designed effectively and appropriately implemented.	The Council acknowledges the findings and will review the controls and policies in place for the systems that were inspected as part of the audit process.	Executive Manager – ICT	31/03/21	Medium

We have followed up the recommendations made in our 2018/19 annual report in relation to the financial statements and are pleased to note that all 3 recommendations – in relation to property valuations, IFRS 16 and review of the annual accounts – have been fully implemented.

Our other responsibilities explained

Fraud responsibilities and representations



Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.



Required representations:

We have asked the Council to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity or group.

We have also asked the Council to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



Audit work performed:

In our planning we identified the risk of fraud in the recognition of grant income and management override of controls as a key audit risk for your organisation.

During course of our audit, we have had discussions with management and those charged with governance.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements

Concerns:

No concerns have been identified regarding fraud.



Independence and fees



As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2020 in our final report to the Audit Committee.

Fees

The audit fee for 2019/20, in line with the fee range provided by Audit Scotland, is £206,338 as analysed below:

	£
Auditor remuneration	135,898
Audit Scotland fixed charges:	
Pooled costs	14,000
Performance Audit and Best Value	47,790
Audit support costs	8,650
Total proposed fee	206,338

In addition, the audit fee for the charitable trust audit is £400.

There are no non-audit services fees proposed for the period.

Non-audit services

In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

Relationships

We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its Council and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its Council and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.

We are not aware of any relationships which are required to be disclosed.

Quality of public audit in Scotland

Annual report 2018/19

Audit Scotland published its annual assessment of audit quality carried out on the audit work delivered by Audit Scotland and appointed firms. A copy of the full report is available: <https://www.audit-scotland.gov.uk/report/quality-of-public-audit-in-scotland-annual-report-201819>

Public audit in Scotland

Recent high-profile corporate collapses in the private sector have led to considerable scrutiny of the audit profession. The Brydon review is looking into the quality and effectiveness of the UK audit market. The Kingman review, the Competition and Markets Authority market study of the audit services market and the Business, Energy and Industrial Strategy Committee's report on the Future of Audit have all reported on structural weaknesses in the private sector audit regime. The reviews are placing a strong focus on the need for independence of auditors from the bodies they audit.

The public audit model in Scotland is fundamentally different to the private sector audit regime and is well placed to meet the challenges arising from the reviews of the auditing profession. Public audit in Scotland already operates many of the proposed features to reduce threats to auditor independence including:

- independent appointment of auditors by the Auditor General for Scotland and Accounts Commission
- rotation of auditors every five years
- independent fee-setting arrangements and limits on non-audit services
- a comprehensive Audit Quality Framework.

The Audit Scotland Audit Quality and Appointments (AQA) team will continue to develop its activities to provide the Auditor General for Scotland and Accounts Commission with assurance about audit quality. The Audit Quality Framework will be refreshed to take account of the findings from the first two years of its application and to reflect on the developments in the wider audit environment. Further development is planned over the following year to include:

- enhancing stakeholder feedback
- reviewing the structure and transparency of audit quality reporting.

Key messages

The programme of work carried out under the Audit Quality Framework provides evidence of compliance with auditing standards and the Code of audit practice (the Code), together with good levels of qualitative performance and some scope for improvements in audit work delivered in the period 1 April 2018 to 31 March 2019.

Independent external reviews of audit quality carried out by The Institute of Chartered Accountants of Scotland (ICAS) show evidence of compliance with expected standards:

- ICAS did not identify any concerns with audit opinions
- 55 per cent of financial audit files reviewed by ICAS over the last two years were graded as limited improvement required, the remaining reviews were graded as improvement required (*100% of Deloitte files – limited improvement*)
- ICAS noted considerable improvements in the documentation of performance audits and Best Value assurance reports.

Other performance measures showing good performance include:

- 78 per cent of internal reviews of financial audits in the last two years required only limited improvements (*100% of Deloitte internal reviews graded as no improvement required*)
- all audit providers have a strong culture of support for performing high-quality audit
- stakeholder feedback shows audit work has had impact
- non-audit services (NAS) are declining in number and value and requests made complied with the Auditor General for Scotland and Accounts Commission's NAS policy.

AQA monitors progress against areas for improvement. A common area for improvement in the last two years has been the need for better documentation of audit evidence. In 2018/19 further areas for improvement were identified in:

- the use of analytical procedures
- the application of sampling.



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