Shetland Islands Council

Report to Members and the Controller of Audit on the 2008/09 Audit

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October 2009

Contents

Key Messages

Audit Opinion

Following the qualification of the audit opinion on the 2007/08 financial statements, the Accounts Commission considered a report by the Controller of Audit under Section 102(1) of the Local Government (Scotland) Act 1973. The Commission reported that it expected the council to take all appropriate action to resolve this situation during 2008/09. It is disappointing therefore to report that in 2008/09 we have given a qualified opinion on the financial statements of Shetland Islands Council (the council) on two issues, the group accounts and the accounting treatment of financial assets.

Following some structural changes to Shetland Development Trust (SDT), the council has consolidated the results of the SDT into the 2008/09 group accounts. This is an improvement on the 2007/08 position. However the group accounts still do not include the Shetland Charitable Trust (SCT) and its subsidiaries. It remains our view that the substance of the council's relationship with this body represents a significant interest and their omission results in a material mis-statement of the group accounts.

In February 2009 the council's elected members unanimously approved a recommendation from the chief executive for the results of the SCT to be requested from the trust for inclusion in the council's group accounts. In March 2009 the same councillors acting in their capacity as trustees of the SCT voted against providing the information required by the council to facilitate the consolidation of the trust's results into the group accounts. The new chief executive is currently reviewing the council's position on this issue for 2009/10.

The second qualification relates to the council's failure to account for its financial assets in accordance with accounting requirements. The council has total investments of £216.25 million in the balance sheet which are financial assets. Included in these investments are bonds of £90.08 million. Since 2007/08, the council has used a nominal interest rate in valuing its financial assets and bond calculations instead of the effective interest rate required by the Code of Practice on Local Authority Accounting. Despite assurances made during the audit of the 2007/08 accounts that the council would apply the effective interest rate in the 2008/09 financial statements, this was not done. Nor has the council produced calculations to enable us to calculate the value of this error at 31 March 2009. We are therefore unable to determine whether the accounts are materially correct. The processes for producing accounts which comply with the Code of Practice on Local Authority Accounting should be reviewed for 2009/10.

The council is heavily reliant on the financial accountant for the production and submission of the annual financial statements and for dealing with queries throughout the audit. Our review identified that the council did not complete all the required core financial statements for 2008/09. This could become a more serious issue as the council prepares for the introduction of IFRS.

Financial Performance

The council's net operating expenditure in 2008/09 was £102.78 million. This was met by central government and local taxation of £98.28 million, resulting in a deficit of £4.50 million, 4.37% of the net operating expenditure for the year. After taking account of statutory adjustments, £6.51 million was required to cover the general fund deficit and take the balance to zero in line with council policy.

The overall draw on reserves was £23.02 million, £6.51 million to meet the general fund deficit, £2.25 million to meet reserve fund expenditure and £14.26 million to meet capital expenditure. Whilst this draw was £8.98 million less than the budgeted draw on reserves of £32.0 million, the council recognises it is not sustainable in the long-term to utilise its reserves for the delivery of services. The council has set a target to reduce and then maintain a reserves balance of £250 million. The unallocated balance on reserves at 31 March 2009 was £280 million. However the council's 2009/10 budget forecasts the use of £30.7 million from the discretionary reserves which would take the reserves down to the councils target balance of £250 million.

If the council is to maintain its target level of reserves over the longer term, it is important the priorities for service delivery and the capital programme are clear and reflected in the financial plans. An area where the council are progressing this is in respect of the "Blueprint for the Education service". In January 2008 the services committee presented a report to undertake the blueprint review. The council's broad educational mission is to develop principles based on equality, entitlement, access and quality of delivery to take forward education in Shetland over the next ten years within budget. Action plan areas and a timetable were approved on 12 March 2009 with updates provided at each cycle of the services committee detailing progress made on the development of these action plans.

It is also important actual performance against the council's revenue plans and capital plans is closely monitored and reviewed on a regular basis to take account of continuing financial pressures. Relevant to this, we identified a number of areas which need to be addressed by the council. They are summarised below:

- the council's budget setting process leads to budgets that are incremental and budget savings are identified by top slicing without a review of the overall priorities and spending needs of the council
- the council has acknowledged that delivery of care at home packages are currently close to saturation point. As demand increases, there will be a need for the council to target resources on high priority areas, ensuring care assessments are based on need and not availability
- the financial regulations say that the head of finance should make suitable reports and recommendations to the council as is deemed necessary. Our review found that only one revenue budget monitoring report, covering the period 1 April 2008 to 31 August 2008, has been

presented to council members for 2008/09. Discussions with officers highlighted this should have been undertaken on a quarterly basis

- the current strategy for the general fund capital programme is to limit the draw on reserves to £20.0 million per annum. On this basis the capital programme appears to be heavily over-subscribed. Projects to be completed or commenced before 2013/14 amount to £231.28 million. This is before the inclusion of Anderson High School at the current estimated cost of £49.0 million
- in September 2009 a report 'Impact of Shetland Charitable Trust Funded Bodies Review Group' was presented to the services committee. The proposals from this group are that the council helps to fund sports facilities that are currently provided by Shetland Recreational Trust (SRT) using grant funding from the SCT. This could cost the council in the region of £0.87 million per annum. This is not included in current budget projections and adds to ongoing financial pressures
- in 2007/08 the council acknowledged unclear project briefs and delays in approving capital projects resulted in building projects being deferred and extra costs being incurred. To address this a capital project best practice methodology report was approved in May 2009. Going forward, the council needs to ensure that this methodology is fully implemented for all capital projects
- a capital project of particular note is the Anderson high School where plans have been under discussion since April 1991. To date £5.54 million has been spent on the project. However the council has recently decided to change the proposed site of the school which will lead to further costs being incurred and delays being experienced with the build.

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. To achieve this prioritisation of the council's revenue and capital plans will be required in the future. Effective scrutiny and monitoring of the progress made against these plans will also be vital.

Performance

The council continues to deliver a wide range of very high quality services. This is confirmed by a wide range of favourable inspections in schools, social care, housing, adult learning and other areas.

The quality of working relationships between officers and members can influence the reputation of the council and impact on the efficiency of its services. At the time of writing this report we have become aware of some high profile relationship issues involving the new chief executive and members. There is a risk that these issues will adversely impact on the council's ability to deliver its objectives.

Audit Scotland issued a report on the council's best value arrangements in 2005. Progress reports have identified that the council is making progress against the improvement areas included in the best value report. Key improvements made include the 2008-11 corporate plan which includes the targets and priorities of the community plan. Governance arrangements have been strengthened with the establishment of the audit and scrutiny committee. However, there remain a number of key issues where improvement has still to be achieved particularly in the areas of procurement and the introduction of a comprehensive system for measuring asset management performance.

We are currently working with other scrutiny bodies to introduce a new approach to planning and delivering scrutiny. In April 2010, we shall produce a single shared risk assessment of Shetland Islands Council. This will be used by all scrutiny bodies to produce a single plan of work, including our new approach to best value. Progress on the issues identified in this report will inform that risk assessment.

The co-operation and assistance given to us by Shetland Islands Council staff throughout our audit is gratefully acknowledged.

AUDIT SCOTLAND

October 2009

Introduction

1. This report is the summary of our findings arising from the 2008/09 audit of Shetland Islands Council (the council) and other relevant work carried out by Audit Scotland. A number of detailed reports have already been issued in the course of the year in which we make recommendations for improvements (see Appendix A). We do not repeat all of the findings in this report. Instead we focus on the financial statements and any significant findings that have arisen from our review of the management of strategic risks. This includes consideration of how the council has managed the risks identified in our Strategic Audit Risk Assessment which was issued to the council on 31 March 2009.

2. The report uses the headings of the new corporate assessment framework, which is being developed for Best Value 2 (BV2) and for joint scrutiny work. The framework is founded on the characteristics of a best value council. Using evidence gathered in the course of the audit, supplemented by other work by Audit Scotland and other scrutiny bodies, we comment on the council's position this year.

3. Our comments are made on the basis of information made available in the course of the annual audit. We do not offer an overall best value judgement because we do not have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time and for that to form the basis of a proportionate best value audit. This report is a step towards that goal.

4. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest to the council are:
    - the impact of the race equality duty on council services
    - improving energy efficiency
    - asset management in councils
    - overview of drug and alcohol services
    - mental health overview
    - civil contingencies planning
    - strategic procurement.

5. We mention the key findings from these reports and the implications for the council in the performance and use of resources sections of this report. Full copies of the studies can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk.

6. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and have agreed to take the specific steps set out in the column headed *Planned Management Action.* We do not expect all risks to be eliminated or even minimised. What we are expecting to see is that the council understands its risks and has in place mechanisms to manage them. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to be duly assured that the proposed action has been implemented.

7. This report is addressed to members and the Controller of Audit. It will be published on our website after consideration by the council. The Controller of Audit may use the information in this report for her annual overview of local authority audits to the Accounts Commission later this year. The overview report is published and used by the Accounts Commission as the basis for its annual briefing to the Scottish Parliament's Public Audit Committee and the Local Government and Communities Committee.

Financial statements

Introduction

8. In this section we summarise key outcomes from our audit of the council's financial statements for 2008/09, comment on the significant accounting issues faced, and provide an outlook on future financial reporting issues.

Audit Opinion

9. We have given a qualified opinion on the financial statements of Shetland Islands Council. The *Code of Practice on Local Authority Accounting in the United Kingdom – a Statement of Recommended Practice (the SORP)* requires group accounts to be prepared by local authorities where they have interests in entities meeting the definitions of subsidiaries, associates and joint ventures. Group financial statements are required to present a true and fair view of the authority's activity and financial position. The council has not included the results of the SCT in its group financial statements for 2008/09. In our opinion, the substance of the council's relationship with this body represents a significant interest and their omission results in a material mis-statement of the group accounts.

10. Based on prior year financial statements, we estimate that this body would contribute:

- a deficit position of approximately £3.03 million to the Group Income and Expenditure Account (resulting from income of £13.17 million and expenditure of £16.20 million)
- net assets of approximately £219.51 million to the Group Balance Sheet (resulting from fixed assets of £23.02 million, investments and loans of £200.16 million, net current assets of £3.34 million and long term liabilities of £0.32 million).

This issue is discussed further at paragraphs 24-35.

Key Risk Area 1

11. The 2007 SORP introduced major changes in accounting for financial instruments, including a requirement that the effective interest rate method be applied to certain financial assets to determine the interest and investment income for inclusion within the income and expenditure account. The council did not apply this method in the 2007/08 financial statements resulting in an unadjusted error of £1.43 million. The council again failed to apply this method in the 2008/09 financial statements. As a result we were unable to obtain sufficient evidence to express an unqualified opinion. However based on the level and value of these assets we believe this non compliance results in a material mis-statement of the financial statements. This is discussed further at paragraphs 36-39.

Key Risk Area 2

12. The audit opinion concludes that, except for:

- the omission of these amounts from the group accounts
- any adjustment that might have been necessary had we been able to obtain sufficient evidence in respect of the effective interest rate calculation

it has been certified that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

13. We were satisfied with the disclosures made in the statement on the system of internal financial control and the adequacy of the processes put in place by the council to obtain assurances on systems of control.

Preparation of the accounts

14. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. Despite the fact that no major changes were introduced to accounting practice, by the 2008 SORP, the statements were of a basic standard and required revision to meet SORP requirements and to enhance the reader's understanding of the accounts.

15. The council did not complete the Accounting Code of Practice disclosure checklist until August 2009. There were a number of instances where earlier use of this document could have improved compliance with proper accounting practice. Limited work had been undertaken on the preparation of the group financial statements with none of the notes being updated from 2007/08 to reflect the inclusion of the SDT. In addition some of the core financial statements within the group did not reconcile and no back up could be provided to support the reported figures. This resulted in additional audit work and delayed completion of our audit work beyond our original timetable agreed with the council.

16. The council has now adjusted the financial statements to reflect audit findings. There are no unadjusted errors that require to be reported to the head of finance and the audit and scrutiny committee. Details of significant accounting issues arising in the course of our audit where adjustments to the financial statements were required include:

- the inclusion of additional information in relation to the 2008/09 qualification and how this will be taken forward (recurring issue also reported in 2007/08)
- fixed asset accounting errors see paragraphs 41-43
- an over-statement of £5.13 million in respect of both the debtors and creditors figures within the balance sheet
- the incorrect valuation of investments within the pension fund which resulted in an adjustment of £602,000

- significant amendments to the figures included within the Statement of Total Recognised Gains and Losses (STRGL), with adjustments of £15.252 million to the revaluation arising on fixed assets and an adjustment of £7.825 million to £30.722 million in respect of the revaluation arising on available for sale financial assets.

Key Risk Area 3

17. Working papers to support the 2008/09 accounts were generally satisfactory, but could be further improved by updating descriptions and dates to reflect current accounting practice and accounting periods. Opening balances should also be updated for the final audited figures carried forward from the previous year.

18. The council is heavily reliant on the financial accountant for the production and submission of the annual financial statements and for dealing with queries throughout the audit. The updated group financial statements were not provided to audit for review until 22 September 2009. Our review identified that the group cash flow statement had not been prepared. Instead the council has included the single entity cash flow statement within the group financial statements. This constitutes an omission of a core financial statement and is non compliant with the SORP. This could become a more serious issue as the council prepares for the introduction of International Financial Reporting Standards (IFRS). This is discussed further at paragraph 58-60.

19. We work in partnership with finance to clarify our requirements and help improve the processes for the preparation and audit of the financial statements. Particular steps in 2008/09 included early work on the council's income and expenditure account and the early audit of the council tax and non domestic rate income accounts. We also carried out some early testing on balance sheet items including debtors, creditors, and cash and bank. We originally planned to undertake early work on fixed assets and financial instruments but, due to ongoing technical issues with the capital accounting system and the non receipt of investments information, this was not possible. Discussions will be held with finance staff on how best to refine the process for 2009/10 going forward.

20. The accounts were certified by the target date of 30 September 2009 and are now available for presentation to members and publication. The financial statements are an essential means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

Group accounts

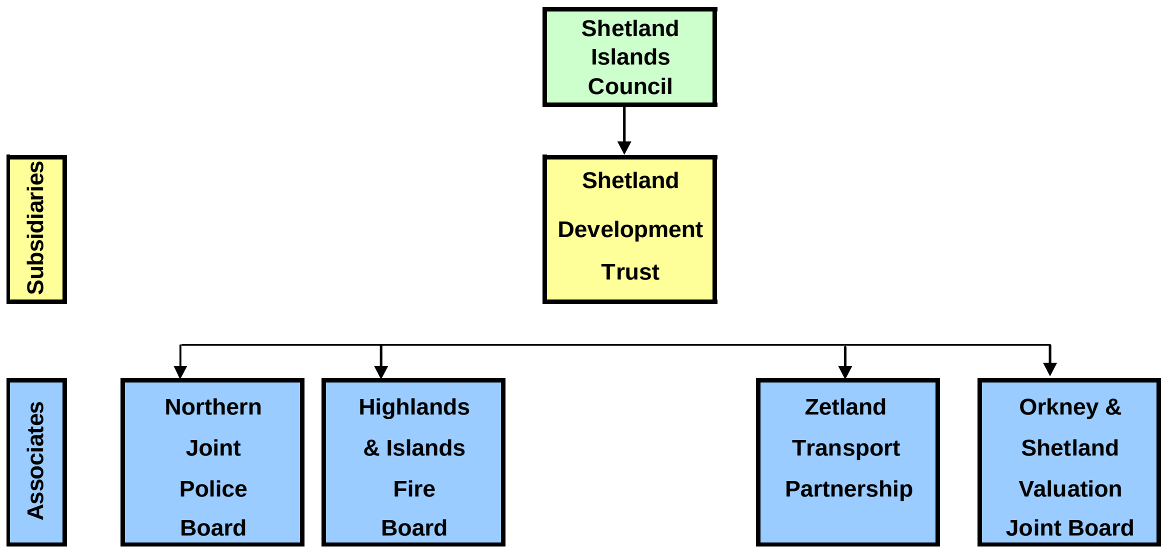
21. The diversity of service delivery vehicles used by local authorities' means that consolidated group accounts are required to give a true and fair view of a council's income and expenditure.

Group entities

22. The council has disclosed an interest in one subsidiary and four associates and have included them in its group accounts in accordance with the SORP (refer to Exhibit 1 below). All four associates are audited by Audit Scotland and audit assurance has been taken from this. The auditor of the subsidiary is an external body who was provided with a questionnaire in accordance with ISA 600 in order to obtain audit assurance. The questionnaire covered areas such as professional competence, audit opinion, governance and internal control. This provided useful context to enable us to conclude our audit of the group.

Exhibit 1

- Shetland Island Council Group Structure



23. We would like to highlight the following issues:

- in accordance with recommended accounting practice, key policies for component bodies such as pension costs and the valuation of fixed assets at market value; have been aligned with the council with the exception of the SDT. Within the group financial statements SDT is consolidated as a subsidiary. Proper accounting practice requires a charge to be made to the income and expenditure account for pension costs based on FRS17 Retirement Benefits. The auditors of SDT have confirmed that the trust is exempt from the requirement to adopted FRS 17 in the preparation of its financial statements. This non-compliance has been disclosed within the notes to the group financial statements. The SDT reports its fixed asset equity investments at cost and current asset investments are shown at the lower of historic cost and market value. Within the council financial statements all investments are shown at fair value which is based on the quoted market bid price provided by the council's external fund managers. This non-compliance has been disclosed within the notes to the group financial statements

- Shetland Development Trust, Zetland Transport Partnership and Orkney and Shetland Valuation Joint Board all received unqualified audit opinions from their external auditors
- Northern Joint Police Board and Highlands and Islands Fire Board both received qualified audit opinions from their external auditors. Proper accounting practice requires a charge to be made to the income and expenditure account for pension costs based on FRS17 Retirement Benefits. The Local Government Pension Reserve Fund (Scotland) Regulations 2003 provides the statutory basis for removing the FRS17 charge from the general fund so that only the actual pension payments are charged. However, this legislation does not cover the new pension schemes established with effect from 6 April 2006, by the Police Pensions (Scotland) Regulations 2007 and the Fire-fighters Pension Scheme (Scotland) Order 2007. The auditors of these joint boards have confirmed that they will qualify their audit opinions as the FRS17 charges relating to these schemes have been removed in the financial statements. As the council consolidate the net worth of associates, this issue has no impact on figures included in the council's group accounts.

Group accounts audit qualification

24. Following the qualification of the audit opinion on the 2007/08 financial statements, the Accounts Commission considered a report by the Controller of Audit under Section 102(1) of the Local Government (Scotland) Act 1973. The Commission reported that it expected the council to take all appropriate action to resolve this situation during 2008/09.

25. Following the Commission's report, council members, on the 18 February 2009, unanimously approved a recommendation from the chief executive for the results of the SCT to be requested from the trust for inclusion in the council's group accounts. We are pleased to note the council has consolidated the results of the SDT into the 2008/09 financial statements, with the exception of the group cashflow statement. However, on 26 March 2009 the same council members, acting as trustees of SCT, unanimously approved a recommendation not to make the SCT accounts available to the council for consolidation based on the conclusions of legal advice.

26. Following the appointment of the new chief executive in June 2009 the current view of senior officers is that the results SCT should not be included in the group's financial statements. We continue to disagree with this view and in our opinion, its omission results in a material mis-statement of the group accounts. We have therefore issued a qualified opinion on the financial statements for the third consecutive year. (4^{th} year of qualification on the group by us and the previous auditors)

27. We have not reviewed the structure of the trust or expressed any concerns about the trust's relationship with the council. Our concerns about SCT relate to the group accounting issue only.

Whilst the trust is a separate entity, with its own status to consider, because of the nature of the council's relationship with the SCT we are of the opinion that in order to comply with accounting requirements, the financial results of SCT should be consolidated into the council's group accounts. We acknowledge that in reaching its decision not to provide the accounts for consolidation by the council, the trust's prime interest appears to be in preserving the monies it holds to be used for the benefit of the Shetland community. However as auditors we have a statutory responsibility to report our opinion as to whether or not the financial statements give a true and fair view, in accordance with relevant legal and regulatory requirements and the SORP. We are of the opinion that the following factors support the inclusion of SCT in the council's group accounts.

28. **Structure:** SCT has 24 trustees – the 22 SIC councillors, the Lord Lieutenant of Shetland and the head teacher of Anderson High School. The previous chief executive of the council was also chief executive of SCT until 2008. In 2008/09 there were some operational and managerial changes within the SCT, including the appointment of a trust general manager to replace the council's chief executive. In a report to the council on 4 July 2007 the chief executive acknowledged that the structure of the trust "provides a coordinated approach such that community benefits can be maximised and that clear accountability for performance is vested principally with the elected members, albeit in an extended and separate but related role".

29. **Purpose of SCT:** the purpose of the trust is to make grants or loans for any charitable purpose which benefits the Shetland Islands or its inhabitants. SCT provide services (arts and culture, amenity and environment, recreation and care facilities) which benefit the council community in addition to those services provided by the council There is evidence that if the trust no longer existed the council would provide these services instead or subsidise the trust in providing the services:

- on 3 December 2008 a report was agreed by the council which discussed the impact of the world financial crisis on the council and the SCT. The report acknowledged the charitable trust relies heavily on investment income to fund its current service provision. The report stated "if the circumstances in the markets jeopardise the trust's ability to fund the various activities covered at present the council will need to consider whether it will need to provide alternative funding"
- the charitable trust reduced costs by working with the council and transferring the funding of activities on 1 April 2006 from the Islesburgh Trust back to the council. The total funding that the charitable trust gave to the Islesburgh Trust in 2005/06 was £1.075 million
- on 1 April 2005 the council took over the activities of the Shetland Welfare Trust, a recipient of grant funding from the Shetland Charitable Trust. The funding that the charitable trust previously provided was £2.850 million. This is a transfer of activity back to the council to reduce the overall cost to the charitable trust.

30. **Financial relationships:** The SCT was created by SIC to receive the oil disturbance payments (until the agreement was terminated at 1 Sept 2000) which otherwise would have been received by the council. Total disturbance payments paid to SIC totalled £81 million. The trusts current sources of income are investment income and rental income with no ongoing financial support from/ to the council. However the following inter-related transactions that have taken place between the council and the SCT also support the inclusion of these bodies in the council's group accounts:

- Shetland Leasing and Property Developments Limited (SLAP), is a wholly owned subsidiary of the charitable trust, purchasing, developing and letting various properties throughout Shetland. SLAP purchased four ferries which it leased to the council. The council approached SLAP to enquire if it would consider selling the ferries directly to them. The board of SLAP considered this proposal and decided to concentrate on its core activities of leasing and property development and therefore agreed to the sale of the four ferries for £20 million to the council on 31 March 2006. This joint decision between the council and SLAP has had the beneficial effect of reducing lease payments on the general fund by £2.25 million per annum (although it had an immediate effect of reducing the available reserves by £20 million)
- in February 2006, the council purchased all shares in Shetland Towage Ltd, a wholly owned subsidiary of the Shetland Charitable Trust, for a consideration of £3.6 million as part of the council's rationalisation of port activities. The assets received had a value of £5.5 million. The staff of Shetland Towage were subsequently transferred to the council which is now providing towage services at the Sullom Voe Terminal
- in 1997 the council sold to and leased back from SCT the oil terminal. Rents for the oil terminal paid to the council and then paid onto SCT were £17m at March 08. Annual rental income approx £1.7m.

31. **Council involvement in the activities of the trust:** As part of joint working arrangements, council officers can influence how the funds of the SCT are distributed:

- council officers are included on a working group to review organisations funded by SCT. The council nominees were appointed to develop terms of reference for the group in March 2009
- on 30 March 2000 trustees approved a report which authorised the Director of Education and Community Services to act on behalf of the SCT and approve applications from community development and community support grants to organisations operating in Shetland.

32. **Review of SCT:** on 25 March 2009 a report by the chief executive recommended approval be given to proceed with the engagement of Dundas and Wilson to undertake a legal review, on behalf of the council of its relationship with the SCT. The report highlights examples of the considerable interaction between the council and the trust. It refers to the challenge to the trust by the Office of the Scottish Charities Regulator (OSCR) to review its governance arrangements. The report states the council's

concern that an increased proportion of non-elected council member trustees could reduce considerably the benefits of close working. It further highlights the council has invested a considerable amount of community assets in the trust and has obviously interest in how these are managed. It proposes the council reviews alternative options and the implications of these to manage the funds currently within the remit of the SCT.

33. On 3 September 2009 a report asked members to agree to a number of service, management and budget changes as a result of the proposals made by the Shetland Charitable Trust Funded Bodies Review Group. The group has representation from both councillors, trustees, the general manager of the SCT, the council's head of finance, executive director of infrastructure and executive director of education and social care. The work plan of the group was to review all of the activity funded by the SCT. There are significant financial implications to the council arising from the proposals. It is estimated the cost to the council would be in the region of £1.27 million per annum, which equates to approximately 1% of the gross expenditure budget.

34. Discussions are ongoing with senior officers regarding the relationship between the council and SCT and its implications for the accounts.

Key Risk Area 1

Trust funds

35. Local authorities with registered charitable bodies are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial statements is required for each trust fund. However the Office of the Scottish Charities Regulator (OSCR) has deferred the date of full implementation until 2010/11. This means that reliance can be placed on the existing disclosures for trust funds in the council's financial statements, supplemented by appropriate working papers.

Other accounting issues

Financial instruments audit qualification

36. As reported above, the 2007 SORP introduced major changes in accounting for financial instruments. A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another. The main area for consideration was the council's external investments. The investments are shown at a fair value of £216.25 million in the council's balance sheet as at 31 March 2009 (£257.27 million at 31 March 2008). Since 2007/08 the council has used a nominal interest rate in valuing its financial assets based on the quoted market bid price provided by the council's external fund managers.

37. The SORP requires the effective interest rate method be applied to these financial assets to determine the interest and investment income to be included in the 2008/09 income and expenditure account, and associated prior year adjustments. Included in the investments are bonds of £90.08 million. More specifically, it is necessary to formally calculate an effective interest rate where a bond has been purchased at a premium or discount to ensure this is amortised over the life of the bond.

38. During the audit of the 2007/08 financial statements the council provided calculations which estimated that the difference between the nominal interest rate used by the council and the effective interest rate resulted in a difference of approximately £1.43 million as at 31 March 2008. The net effect of which was to overstate the general fund balance by £1.43 million and understate the available for sale reserve by the corresponding amount.

39. It is of concern that despite management assurances within the 2007/08 report to members and ongoing requests during the audit year that this exercise be undertaken nothing was progressed until August 2009. The council has now deferred this work to 2009/10. As a result we have been prevented from obtaining sufficient appropriate evidence to determine whether the accounts are materially correct. Our audit opinion is therefore qualified on this issue.

Key Risk Area 2

Financial asset impairment

40. At each year end an assessment should be made of whether there is evidence that any financial asset or group of financial assets may have suffered a decrease in its value i.e. its value has been impaired. As in 2007/08, the council did not carry out a review of its assets in 2008/09 to consider whether an impairment review was necessary. Written assurances have been obtained from the head of finance to confirm that he is not aware of any financial assets requiring significant revaluation as at 31 March 2009. To comply with the SORP the council should ensure an assessment is carried out at 31 March 2010 to identify any assets that may require revaluation.

Key Risk Area 3

Fixed assets

41. In the last two years we have reported that audit work on fixed assets has identified a number of errors in the way in which the council accounted for the disposal of assets. It is of concern that this continues to be an issue in 2008/09. Specifically, these were in relation to the entries within the revaluation reserve and capital adjustment account, and the calculation for the loss or gain on disposals. A total adjustment of £1.13 million was required to be made to both the revaluation reserve and capital adjustment account.

42. The calculation for the loss or gain on disposals required to be adjusted by £1.59 million. This was made up of two errors. Firstly the council incorrectly included a gain on sale figure of £864,000 when this was a loss on sale within the asset register. In addition, as we reported in our review of internal key financial controls report in May 2009, there are weaknesses within the capital accounting system. We identified system generated errors which amended the reported loss on sale to £727,000.

43. Given the number of issues identified within our review, the council should ensure weaknesses within the fixed asset register and the capital accounting system are fully addressed in 2009/10.

Key Risk Area 3

Non-adjusting event after the balance sheet date

44. On 3 September 2009, the services committee recommended the decision to build the new Anderson High School on the existing Knab site be reversed and the council proceed to purchase the Lower Staney Hill site for building of this educational facility. The SORP states that where an event is indicative of conditions that arose after the balance sheet date (non-adjusting event) the amounts recognised in the statement of accounts should not be adjusted. However the nature of the event and an estimate of the financial effect or a statement that such an estimate cannot be made reliably should be disclosed. The council has now added this disclosure to the 2008/09 financial statements.

45. Within the 2008/09 financial statements the council has capitalised £3.07 million in respect of expenditure incurred at the Knab site within assets under construction. The council decision will result in this amount being written off to revenue within the 2009/10 financial statements. This project is considered further at paragraphs 83-95.

Contingent liability

46. In his report to council on 19 August, the head of finance identified the estimated contribution of £8.3 million from the council to the Shetland Islands Pension Fund. This payment is to meet the ongoing cost of absorbing Shetland Towage Limited (STL) employees into the council pension fund. Disclosure of this issue has now been added to the 2008/09 financial statements. We understand that the head of finance will provide an updated report to councillors in due course on how this is to be financed and accounted for.

Audit testing

47. As part of our work, we took assurance from a number of the council's main financial systems. The results of our review of key controls were reported to the council in our internal key financial controls assurance report in May 2009. We assessed the following central systems as having a satisfactory level of control for our purposes:

- Payroll
- Creditors
- Debtors
- Cash and Bank
- Non-domestic rates
- Council tax
- Housing Rents
- Housing Benefit
- Pension Contributions
- Pension payments

48. We relied on the work of internal audit in the following areas to support our work:

- Payroll
- Creditors
- Debtors
- Housing Rents
- Housing Benefits

49. Major weaknesses were identified within the capital accounting system due to ongoing technical difficulties. As a result we were unable to place reliance on the system and carried out additional work to compensate.

Key Risk Area 3

Prevention and detection of fraud and irregularities

50. At the corporate level, the council has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. These arrangements include an anti-fraud and corruption policy, a whistle blowing policy, codes of conduct for elected members and staff, and defined remits for relevant regulatory committees. However, it has been recognised that the anti-fraud documents are out of date and are due to be updated over the coming months.

Key Risk Area 4

NFI in Scotland

51. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and

payroll fraud. The NFI has generated significant savings for Scottish public bodies (£40 million to 2008). If fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

52. The most recent data matching exercise was carried out in October 2008 and national findings will be published by Audit Scotland in May 2010. The council had 3,247 matches and has recorded some progress with four categories of match: creditors' history, creditors standing, housing benefit and payroll pensions. No progress has been recorded against the other two categories. The council aim to address the majority of the matches for the next NFI update report. No savings have occurred from the data matching activity to date.

Exhibit 1.

Number and progress on main categories of NFI data matches

Category	Total matches	Processed	In-progress	Fraud identified	Error identified	Amount saved (£)
Creditors history	1234	6	35	0	0	0
Creditors standing	807	8	0	0	0	0
Housing benefit	228	0	2	0	0	0
Payroll pensions	110	3	0	0	0	0

www.nfi.gov.uk management information for Shetland Islands Council 24 July 2009

Housing benefit

53. Audit Scotland took over the inspection responsibilities of the Benefit Fraud Inspectorate in Scotland in April 2008. Our specialist team are carrying out a programme of risk assessments of benefits services in all councils over a two year period.

54. The risks to the council's benefits service were assessed in 2008 and a detailed report was issued. The report highlighted that although the benefits service is performing well, a number of risks to continuous improvement were identified, including:

- the Finance Service Plan 2008/09, which is the key strategic document for the service, lacks a clear focus on what the benefits service should deliver each year against national and local objectives
- the council has no specific counter-fraud function and relies on the DWP to investigate suitable cases on their behalf
- the Anti-Fraud policy, which has not been updated since 2002, and the Fraud Sanctions policy do not reflect current legislation and working practices.

55. The council has responded to the risks we identified with an action plan, although this has yet to be updated with any progress. We believe the actions will make a positive contribution to improving the

benefits service. With the exception of one risk, the agreed timescale for completion within the action plan has now passed. We would therefore recommend the council review their progress against the action plan as soon as possible to provide assurances that the agreed work has been completed. We will monitor progress in the next inspection cycle, which starts in 2010.

Key Risk Area 4

Legality

56. Through our planned audit work we consider the legality of the council's financial transactions. In addition the head of finance confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with relevant legislation and regulations.

State aid

57. The only legality issue arising from our audit which requires to be brought to members' attention relates to an ongoing state aid issue. In November 2007 the EU Commission issued its decisions on three of the council's schemes, namely 'First Time Shareholders', 'Fishing Vessel Modernisation' and 'Fish Factory Improvement'. These decisions were all negative and required a full repayment to the council of grants paid plus compound interest added from the date of payment. The Commission addressed its decision to the UK Government and the council is obliged to recover the monies from the beneficiaries within 4 months of the decision although the council have appealed against this ruling. Management assurances have been obtained from the head of finance that the council has reviewed its arrangements to ensure no other breaches of state aid rules have taken place in 2008/09.

Financial reporting outlook

IFRS adoption

58. Local government will move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2010/11. Because local government has already adopted some aspects of IFRS, we expect the transition to be fairly smooth. Indeed, next year, councils will be expected to account for PFI projects on an IFRS basis. But it is important that the council starts the transition period in 2009/10. A comparative balance sheet as at 1 April 2009 will be required and whole of government accounts will also be required on an IFRS basis from 2009/10.

59. LAAP Bulletin 80, Implementation of IFRS – Outline Project Plan (March 2008), provides a basic project plan identifying the major milestones for the implementation of IFRS by 2010/11. This is intended to be the starting point for local authorities looking to develop their own project plans. The key dates in the plan are the latest dates that CIPFA would recommend for the implementation of that particular step.

60. Discussions with finance officers highlighted that detailed work on IFRS is not due to commence until October 2009. As a result, many of the deadlines recommended by the outline project plan have not been met. However, like most other local authorities, the council has now contracted with CIPFA and PWC for IFRS support. The council did not sign up until July 2009 and missed the initial training sessions provided in April 2009. It should be noted that although the support will provide training, project management and technical advice, the council needs to allocate additional resources to meet the proposed timetable.

Key Risk Area 5

Pension funds

61. The introduction of the IFRS based accounting code of practice in 2010/11 is likely to require separate pension fund reports and accounts, something also supported by LASAAC. Although it is unlikely pension funds will be separate audit appointments (as they are not statutory bodies in their own right) it may be necessary for us to treat them separately. This is something we will be discussing with the CIPFA Directors of Finance Group.

Carbon trading commitment

62. From April 2010 a new and complex system for charging for carbon emissions will be introduced by the European Union (EU). The council will be required to purchase and account for carbon credits to cover all of its non transport related energy usage. Incentives and penalties will be built into the system to encourage a reduction in carbon emissions.

63. The energy manager presented a report to the planning board in June 2009 which outlined the background to and operation of the carbon reduction commitment (CRC). The council has taken part in the 'Consultation on the draft order to implement the CRC' published by the Department of Energy and Climate Change.

64. The council has undertaken detailed monitoring and has provided a breakdown of this information to the planning board. The council has also considered the financial implications of the CRC which will need to be included in both the 2009/10 and 2010/11 revenue estimates exercise.

Key Risk Area 3

Use of resources

Financial results

Operating performance 2008/09

65. In 2008/09, the council spent £165.29 million on the provision of public services. The council's net operating expenditure in 2008/09 was £102.78 million. This was met by central government and local taxation of £98.28 million, resulting in a deficit of £4.50 million, 4.37% of the net operating expenditure for the year.

66. The budget set for 2008/09 was based on a Band D council tax level of £1,053 and a planned contribution of £32 million from reserves: £4 million to cover the general fund deficit; £8 million to cover reserve fund expenditure and £20 million general fund capital programme support.

67. After taking account of statutory adjustments, £6.51 million was required to cover the general fund deficit. This was offset against a smaller than anticipated draw on reserves for reserve fund and capital expenditure of £2.25 million and £14.26 million respectively. The overall draw on reserves was therefore £23.02m, £8.96 million less than originally budgeted.

68. The overspend on the general fund was mainly due to an unbudgeted cost of £2.81 million for single status back pay and a transfer of £2.25 million from the capital programme for expenditure not meeting the definition of capital. Before inclusion of these unbudgeted costs, the draw on reserves was £3.1 million under budget. This was due to large underspends in the education and social care staffing budgets where activities had not progressed as planned, a reduction in private sector housing grants and a reduction in rent rebates.

69. The introduction of the Concordat with the Scottish Government resulted in the consolidation of some separate funding grants within the revenue support grant in 2008/09 (including supporting people grant £108,000). When compared to the previous year, this has had the effect of increasing funding from the revenue support grant and also increasing service net expenditure. The change may limit the comparability of income and expenditure in the previous year.

Housing revenue account

70. The council is required by legislation to maintain a separate housing revenue account and to ensure rents are set to at least cover the costs of its social housing provision. The budget set for 2008/09 was based on an average weekly rent level of £54.93, an increase of 2% on the previous year, and a planned contribution of £2.50 million from the housing repairs and renewals fund.

71. The housing revenue account shows a deficit on HRA services of £0.26 million for 2008/09. A total draw of £1.77 million was required from the housing repairs and renewals fund to allow a contribution of £0.36 million to fund capital expenditure and £1.41 million to take the HRA account to zero in accordance with council policy. Capital receipts from council house sales exceeded expectations in 2008/09.There was also a lower draw on reserves as a result of fewer house purchases than originally planned.

Significant trading operations

72. The council has two significant trading operations, highways and building maintenance. Although both operations made a deficit in 2008/09, they met the statutory break even target by returning a cumulative surplus of £0.13 million and £0.08 million respectively over the three year period to 31 March 2009.

73. The deficits in 2008/09 were largely due to the single status back pay accruals. As single status costs will now be a recurring annual expense, the council should ensure charges are sufficient to cover the additional costs going forward. If the operations continue to make a deficit they will fail to meet the statutory break even target.

Key Risk Area 6

Reserves and balances

74. Exhibit 1 shows the balance in the council's funds at 31 March 2009 compared to the previous year. Funds include a capital fund which may be used to defray capital expenditure or repay loan principal, a repair and renewal fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets, a reserve fund which can be used to defray certain expenditure on the harbour undertaking and for any other purpose which is solely in the interests of the county and its inhabitants, and an insurance fund. At 31 March 2009, the council had total funds of £295.44 million, a decrease of £10.0 million on the previous year.

75. The council has earmarked elements of these funds totalling £15.03 million. The council aim to reduce demand on reserves over the medium term so that the draw on reserves to fund general fund expenditure will be zero by 2012/13. The long term aim is to maintain the general fund reserves (excluding the earmarked elements) to a minimum threshold of £250 million. The council's view is this level of reserves will minimise the risk that the council will be unable to fund future capital expenditure on infrastructure development and remain debt free. The unallocated balance on these reserves at 31 March 2009 is £280.41 million, well above the minimum threshold amount of £250.0 million. The council will need to closely monitor both capital and revenue expenditure to ensure financial targets and the reserves strategy are met in the longer term.

Key Risk Area 7

Exhibit 1

Reserves

Description	31 March 2009 £ Million	31 March 2008 £ Million
General Fund	0.07	0.10
Capital Fund	114.59	116.55
Repair and Renewal Fund	92.96	101.31
Insurance Fund	87.60	87.22
Reserve Fund	0.22	0.27
	295.44	**305.45**

Group balances and going concern

76. Excluding SCT, the overall effect of inclusion of the council's group entities is to reduce net assets by £16.78 million on the group balance sheet, mainly because of pension liabilities. However, all group bodies' accounts have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax. If SCT were included within the group entity this would contribute net assets of approximately £219.51 million to the Group Balance Sheet, based on the prior year audited financial statements.

77. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Northern Police, Highland and Islands Fire and Orkney and Shetland Valuation) had an excess of liabilities over assets at 31 March 2009 due to the accrual of pension liabilities. In total these deficits amounted to £327.45 million (2007/08 £352.24 million), with the council's share being £34.5 million (2007/08 £36.08 million). As noted at paragraph 23, the police and fire board accounts were qualified for the legislative omission in respect to the new police and fire pension schemes which became operational on 6 April 2006 and the impact that this has on the accounting requirements of FRS 17 'Retirement Benefits'.

Capital performance 2008/09

Capital outturn 2008/09

78. The council's prudential indicators for 2008/09 were set in February 2008. These show that capital expenditure is to be financed from cash reserves and the funding resources available to the council, and that no capital borrowings would be required during 2008/09.

79. Capital expenditure in 2008/09 totalled £22.78 million, an increase of £4.0 million from 2007/08, £21.98 million of which related to the council's capital programme. The trend in capital investment and sources of funds is reflected in exhibits 2 and 3. Overall, an underspend of £3.78 million against the revised budget was reported on the council's capital programme for 2008/09, representing a £1.56 million overspend on the general fund and a total underspend of £5.34 million between the reserve fund, HRA and harbour account. Total project slippage of £1.39 million has been carried forward to 2009/10 for completion of other programmes, including Montfield care homes £0.30 million, Mid Yell Junior high School £0.17 million and Uyeansound Harbour Development £0.10 million.

80. Included within the overall underspend is £3.61 million in relation to the HRA. The main area of slippage was £1.38 million due to delays in property purchases and conversion works with the HRA's additional housing stock programme. The total underspend also incorporates £1.56 million in relation to unbudgeted capital receipts from council house sales.

81. Expenditure in relation to the Scottish housing quality standards was £0.14 million under budget, although the kitchen contract, phase 1, is now complete. The council made a submission to the Scottish Government in May 2008, where it was indicated there should be compliance with the Scottish housing quality standard by 2015.

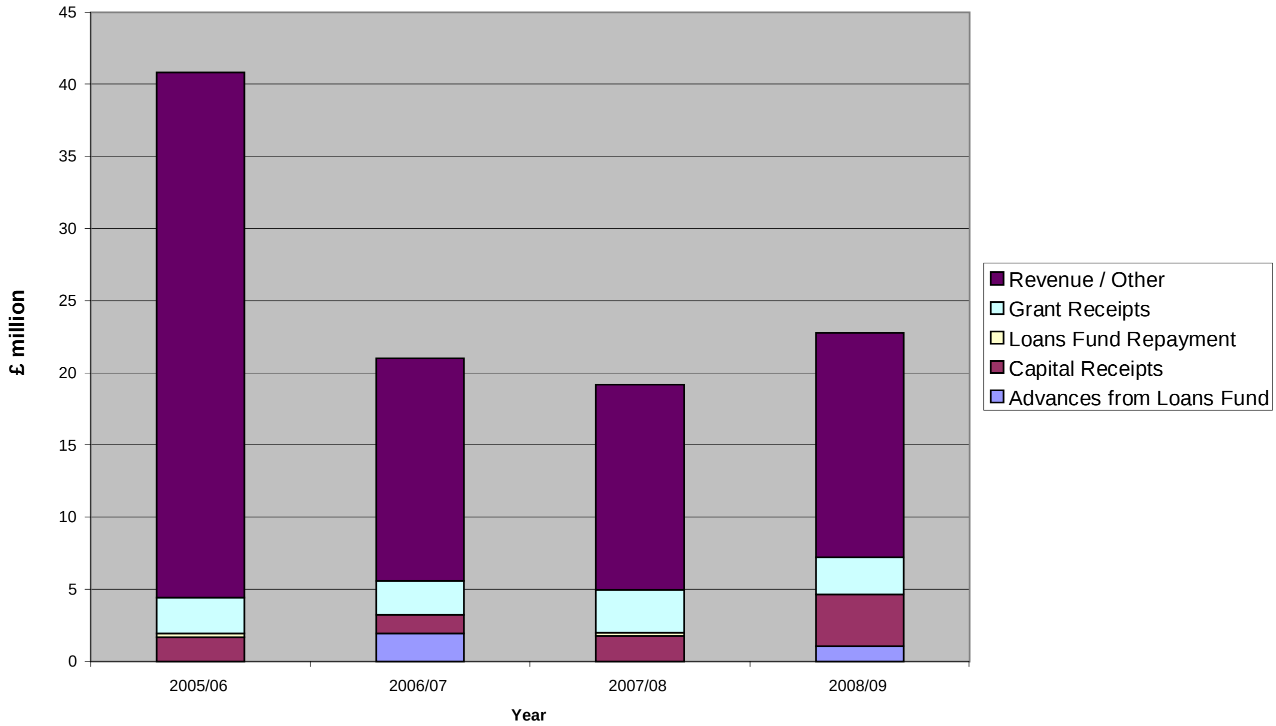
Exhibit 2

Sources of finance for capital expenditure 2005/06 to 2008/09

	2005/06 Actual £M	2006/07 Actual £M	2007/08 Actual £M	2008/09 Actual £M	2008/09 Budget £M
Advances from the loans fund	0	1.98	0	1.07	3.95
Capital Receipts	1.70	1.26	1.77	3.61	1.00
Capital Receipts – used to repay loans fund	(0.26)	0	(0.21)	0	0
Government Grants	2.50	2.36	2.99	2.56	0.04
Revenue / Other	36.39	15.41	14.23	15.55	23.60
Total	**40.33**	**21.02**	**18.79**	**22.78**	**28.59**

Exhibit 3

Sources of finance for capital expenditure 2005/06 to 2008/09



Capital project management

82. We reported last year that in October 2008 a report was presented to the audit and scrutiny committee which considered the handling of a number of proposed key capital projects within the council. This highlighted that unclear project briefs and delays in approving capital projects have resulted in building projects being deferred and extra costs being incurred. The audit and scrutiny committee called for the development of best practice guidance for the conduct of capital projects in the council. This has resulted in a best practice methodology report being presented and accepted by the council in May 2009.

83. The council currently has a number of high profile projects under development. These include Anderson High School, Mid Yell Junior High School and Mareel Cinema and Music Venue. The costs and timescales for each of these projects are discussed below.

84. **Anderson High School**: Various options and proposals have been considered and examined since the process of constructing a new school was first agreed in April 1991. The two main locations considered during this time are the site of the current Anderson High School at the Knab site and an area on the lower part of Staney Hill, the Clickimin site.

85. Following publication of a best value review of education in November 2002, in March 2003 the services committee approved a recommendation that 'the provision of Additional support needs (ASN)

facilities for pupils 12-21 years old be ‘fast-tracked’ within the AHS taskforce brief to ensure that the facilities are provided at the earliest date possible.’ The committee also approved the recommendation to examine ‘the suitability of the existing Anderson High School site for new school buildings, the inclusion of an additional support needs facility and the future use of auxiliary accommodation for related services on the site.

86. On 01 April 2003, the standing committee agreed to recommend to the council that the taskforce report back with costs on a new build at Clickimin. On 04 April 2003 the council approved the recommendation from the standing committee to include comparisons for rebuilding on the existing AHS site compared with a cost revision of the previously proposed Clickimin site.

87. However on 16 October 2003 the services committee agreed that the ‘AHS Taskforce concentrate solely on the AHS site at this stage, and only in the event of difficulties should the Clickimin site be considered as the second option.’ From the reports available it is not clear the basis of this decision. However, based on this recommendation, the council decided that the future design and feasibility work should be restricted to the Knab site, unless it proved impracticable on technical, financial or educational grounds.

88. The AHS feasibility report was completed in April 2004 and subsequently presented to members at a seminar on 04 May 2004. The report was a high level study to provide information necessary to consider the future direction of the project. The report stated that ‘it was ascertained there was sufficient land within the site boundaries to potentially construct the school and hostel.’ Based on the decision of the services committee it was therefore not considered necessary to undertake a feasibility study on the possible school site at Clickimin. The approved capital programme at 31 March 2004 included a provision for AHS (including hostel) of £31.7 million over the period 2004/05 to 2009/10. In a report to the council on 19 May 2004 the head of finance estimated the revised cost of the new school and hostel would be £29.45 million and £10 million respectively, a total of £39.45 million over the period 2004/05 to 2013/14.

89. Although the council approved the decision to proceed in 2004 to build the school on the Knab site, the project has continued to be deferred over the last 5 years including decisions to defer by the current elected members. In response to growing public opinion the project was again put on hold in June 2009**,** pending the outcome of an independent review which was approved by members at the services committee on 18 June 2009.

The results of this review were presented to the services committee on 3 September 2009 where members recommended that the decision to proceed on the Knab site be reversed and the council proceed to purchase Lower Staney Hill, the Clickimin site, 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. This decision was formally approved by council on 16 September 2009. The budget for the project remains at £49.0 million despite the review indicating that building on the Lower Staney Hill site is likely to cost the council more. A number of independent bodies fed into this review process.

90. As part of the independent review CRGP limited were commissioned by the council to assess various costing aspects related to the construction of the new school. The report noted at the outset that the level of information available for assessment was considerably more for the Knab Road site given the stage at which the site had been progressed. The Clickimin site on the other hand, was previously discounted therefore does not benefit from a building design, planning approval or investigative information. The report concluded that in monetary terms, the effect of relocating from the existing site to the Clickimin site would be at least an additional £6.08 million.

91. Architect and Design Scotland (A+DS) were asked to undertake a review to inform the work currently being carried out on behalf of the council to establish the merits of the current proposals before the project proceeds to the next stage. A+DS acknowledged the review took place when the designs were at an advanced stage and the comments would have been better made whilst they were still being developed at outline design stage. However, they concluded the designs require significant amendments if a successful result is to be achieved.

92. Shetland Architectural Society concluded that the 'Blueprint for Education' be finalised before completing the design of the new school as there is a high risk that planning for future service needs is based on information which may later prove to be inaccurate. They also note that the current requirement to design for 1,000 pupils is in excess of the projections for either the status quo or the curriculum for excellence.

93. Zurich Management Services Limited facilitated a risk evaluation process for the AHS project. The risk evaluation process was carried out using the council's own risk management methodology. This exercise resulted in a total of 29 risks being identified. It is of concern that a number of risk categories including political, professional, competitive and economic and financial have a residual risk rating of 25. Within the risk matrix this scoring equates to the risk being almost certain to happen and that the severity of the risk will be catastrophic. The Clickimin site was assessed to be significantly riskier than the Knab site, scoring 304 versus 228. Also, the Clickimin site was judged to have considerably more risks in the highest risk category – catastrophic/almost certain; 5 Risks were in this category for the Clickimin site versus 3 for the Knab site.

94. During discussions at the services committee on 03 September 2009 some members expressed concern they did not have all the information available to them in order to make an informed decision. In particular concerns were raised in relation to ownership of the land, site plans, design, surveys, consultations and life cycle costs. There were a range of unknown factors and members accepted they had a duty to ensure all the relevant information was available to them before they could make a decision. However there was little dissent amongst members that the Clickimin site was the preferred

site for the replacement school. Indeed at the full council meeting on 16 September 2009 councillors voted to proceed with the Clickimin site.

95. It is of concern that this capital project has been considered by the council for more than 18 years and as yet work has still to commence. Also of concern is the fact that at no time have councillors been provided with comprehensive option appraisal which includes costed project plans to enable them to compare the full costs and benefits of the two proposed sites. To date the council has incurred direct expenditure of £5.54 million on the proposed build on the Knab site. Of this, £3.07 million has been capitalised and included within the asset register. As noted at paragraph 44 the decision to now reject the Knab site and vote in favour of the Clickimin site will result in the capitalised cost of £3.07 million being written off as a revenue expense in the 2009/10 financial statements. In addition the council is still not clear what the total costs of building the new school on the Clickimin site will be or its timescale to completion. As a result its capital programme cannot be properly costed. It should now be a priority for the council to provide full comprehensive costings and a comprehensive project plan for completion of this project.

96. In addition to these direct costs the council has incurred additional maintenance costs on the existing Anderson High School that could have been avoided or at the very least minimised had a decision been made earlier to proceed with the new build. Between 2004/05 to 2006/07 the council has capitalised in excess of £1.2 million of maintenance costs. Officers have advised that additional capital and revenue costs in respect of repairs and maintenance will have been incurred however without additional work being undertaken the council has not been able to quantify this value. We intend to examine the Anderson High School project in greater detail during the 2009/10 audit.

97. **Mid Yell Junior High School**: A formal notice to proceed to construction has been issued to the contractor who is proposing to commence works on site during September 2009. It is expected that the project will be complete by October 2010. The estimated cost has increased from £8.5 million to £8.75 million following a decision by the council on 1 July 2009 to expand the design to offer greater storage capacity and to enlarge accommodation for music and additional support for learning.

98. **Mareel Cinema and Music Venue**: Over £1.1 million was spent prior to the Mareel project actually starting. Project management has now transferred to Shetland Arts who have secured £12.1 million funding for the project, £5.19 million of which has been provided by the council. The contractor has now been appointed and site set up has commenced. The venue is due to open in early 2011.

99. Going forward, the council needs to ensure that the best practice methodology is fully implemented for all capital projects.

Key Risk Area 8

Treasury management

100. The current economic climate means interest rates on borrowing and investments are low. The council does not have any borrowings but with large reserves the main impact has been the continuing reduction of investment income from £12.97 million in 2007/08 to £11.51 million in 2008/09. (£14.8 million in 2006/07) As yet there has been no direct impact on service provision within the council. The net worth of the council has reduced from £575.52 million in 2007/08 to £505.60 million in 2008/09. This is mainly due to the reduction in long term investments by £41.38 million and an increase in the pension liability of £40.87 million.

101. In order to limit its exposure to investment risk the council will only deposit money with organisations that have at least a –AA long term Fitch IBCA rating, the council's own bank or any other local authority. The council also has a policy where it will not lend more than £3.0 million of its surpluses to any single organisation at any one time, with the exception of the council's own bank.

102. On 3 December 2008 a report was presented to the council entitled, Long Term Financial Planning: Impact of World Financial Crisis. The paper concluded the council should await the calculation of the balance sheet value of the reserves at 31 March 2009 before reconsidering its spending plans and policy targets for the use of reserves, and if a change of course was necessary it should be phased in over time to moderate its effects on the wider Shetland economy. The unallocated balance on council reserves at 31 March 2009 is £280.41 million, well above the minimum threshold amount of £250 million.

103. The council's budget strategy for 2010/11 and beyond was presented to members in August 2009. This report concluded that the £250 million reserve floor policy should again be reaffirmed for 2010/11 and that a target for the use of reserves in 2010/11 should be set at £2.0 million for general fund expenditure, £7.8 million for reserve fund expenditure and £15.0 million for the capital programme. This is in line with the council's current policy targets for the use of reserves.

104. In September 2009 a report was presented to the services committee by the Shetland Charitable Trust Funded Bodies Review Group. The review group was established in May 2008 to help the trust meet its three year budget strategy, including the aim to make a permanent reduction in expenditure of at least £1 million per annum. As the trust relies heavily on investment income it is facing financial difficulties and is struggling to meet its policy of self-sustainability in the current economic climate. The review group has therefore made a number of proposals to transfer the funding of services from the SCT to the council. The current budget strategy does not include these costs; therefore these proposals will have significant financial implications for the council. The council will therefore need to review its current spending plans in order to remain within its current financial strategy.

Key Risk Area 9

Pension fund

105. The council is responsible for the management and administration of Shetland Islands Council Pension Fund (the pension fund). The pension fund is a pool into which employees' and employers' contributions and income from investments are paid and from which pensions and other lump sum benefits are paid out in accordance with the provisions of the Local Government Pension Scheme (Scotland) regulations. The council is trustee for the pension fund covering 3,325 members, including 375 who are members of other admitted bodies and 12 who are members of a scheduled body. These figures do not include teachers, who are covered by the Scottish Public Pensions Agency.

106. The council purchased Shetland Towage Limited in February 2006 from SCT with the aim of streamlining operations and generating efficiencies. Approximately 50 staff transferred into the pension fund at an estimated cost of £4.0 million. In his report to council on 19 August, the head of finance reported that this contribution to the pension fund was not made during 2008/09 and had been deferred to 2009/10. Following an independent actuarial valuation, the estimated contribution has now increased to £8.3 million, more than double the original estimate. As a result, members have requested payment is delayed until an updated report is submitted by the head of finance.

107. The investment assets for the fund are under the management of external fund managers. Over the year, net assets of the fund decreased on a market value basis by approximately £41.66 million to £158.10 million at 31 March 2009, mainly due to the global economic downturn. The dynamic nature of the current market does not lend itself to a reliable long term estimate of the value of the fund.

108. The trend over the last few years is indicated by the following table:

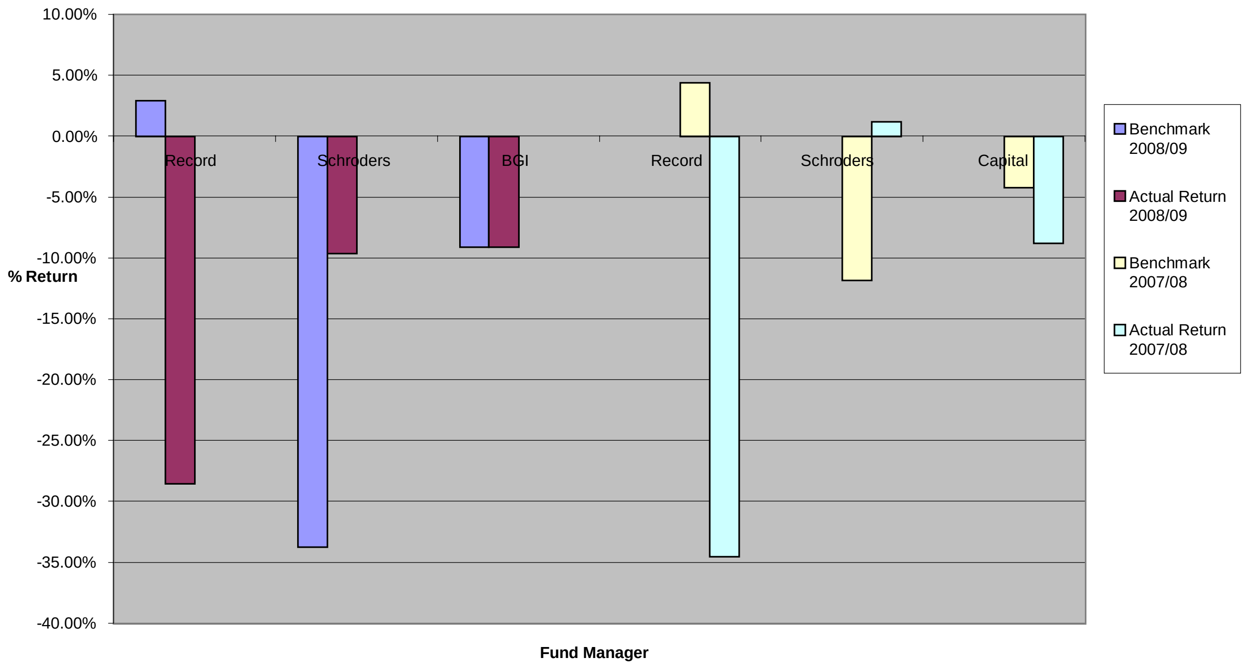
Exhibit 4
Pension Fund Investments

	31/03/06	31/03/07	31/03/08	31/03/09
	£m	£m	£m	£m
Shetland Islands Pension Fund	191.20	211.72	199.76	158.10

109. In 2008/09, there was a mixture of returns achieved by the various fund managers. In one case the benchmark return was met, in one case it was missed by 31.4% and in one case it was exceeded by 24.1%. Exhibit 5 shows the fund performance in 2008/09 compared with performance in 2007/08.

Exhibit 5

Shetland Islands Pension Fund – fund and benchmark return 2007/08 and 2008/09



110. The long term impact of these fluctuations will be monitored on an ongoing basis by the council. The effect on the asset values of the pension fund and the future outlook for employers' contributions was assessed at the triennial valuation of the pension fund.

111. The last actuarial valuation of the fund as at 31 March 2008 was reported in March 2009. Factors such as the volatile stock markets and increasing life expectancy have resulted in the funding level, calculated as the ratio of fund assets to past service liabilities, falling from 99% at 31 March 2005 to 88% at 31 March 2008, see exhibit 6. The actuary is required to make a three-year assessment of the contributions that should be paid by the employing authorities from 1 April 2009 to maintain the solvency of the fund. The common rate payable by each employing authority for the period 1 April 2009 to 31 March 2012 is 18.9% of pensionable pay, before allowing for any individual adjustments.

Exhibit 6

Funding Position

Date	31Mar2005	31Mar2008
	Actual	Actual
Assets	149.55	199.76
Liabilities	(151.78)	(225.75)
Surplus/(Deficit)	(2.23)	(25.99)
Funding Level	99%	88%

Financial planning

112. The council continues to face difficult financial pressures in 2009/10. As well as increasing demands from the big spending area of community care, there is significant pressure on the planning function as major developments are taken forward. The implementation of the single status agreement will also increase the annual pay bill by approximately £4.0 million.

113. The council is party to the Concordat with the Scottish Government which, amongst other things, means that council tax will not be increased in the current year. The council has therefore had to take a number of steps to balance its budget. The chief executive and executive management team met with heads of service in December 2008 to identify where budget estimates could be reduced and be made more realistic. As a result of these discussions, the 2009/10 budget was set in February 2009 with a proposed transfer of £30.7 million from reserves; £3.0 million to meet general fund expenditure, £7.7 to meet reserve fund expenditure and £20.0 million to meet capital expenditure. This is in line with the council's current financial strategy.

114. As noted above, the decision by members in September 2009 to accept the proposals of the Shetland Charitable Trust Funded Bodies Review Group will result in additional costs to the council estimated at an additional £1.27 million per annum. As these additional costs are not currently budgeted for the council will need to review its spending plans and identify efficiency savings if it wishes to remain within its current financial strategy.

115. Education and Social Care Services is the largest department within the council, accounting for over half of the annual budget. The department has to manage competing financial pressures between the two services which are both demand led and face a number of challenges to ensure the existing service provision can be provided within budget. Despite these financial pressures the department has underspent over recent years mainly due to vacancies within the department.

116. There is increasing demand for all existing home based care service provision and this trend is expected to continue for the foreseeable future. As demand for services increases, the council need to be more creative in the way services are provided. This includes targeting resources on high priority areas, ensuring care assessments are based on need and not availability, and working more closely and effectively with partners, i.e. the voluntary sector.

117. If services are to be developed to meet the anticipated levels of need in future years, significant additional financial investment and recurring revenue expenditure will be required. The council needs to ensure budgets and service priorities have been fully reviewed to reflect changing service demands.

Key Risk Area 9

118. Elected members face a number of difficult decisions to ensure the council remain within their current financial strategy. At the same time officers play a vital part in ensuring members have the information and knowledge to make these decisions.

Key Risk Area 10

Budgetary Control

119. Despite the overall financial pressures, a pattern of under-spending of a number of approved budgets has emerged in recent years. Budgetary control reports for 2009/10 show that this pattern is continuing in the current year. The chief executive is currently working with heads of service to develop processes to promote efficiencies and the early declaration of under-spends.

120. For the council to maintain its reserves at £250 million, whilst ensuring sustainability and quality of services, a comprehensive policy led approach to budgeting is required. This would demonstrate which of the council's objectives could be delivered within the resources available each year. It would provide the information needed by the council to prioritise its objectives if the council's reserves were at risk of falling below the target level in the longer term. Although there has been some improvement in the council's budget setting processes, there continues to be a risk that budgets are incremental and budget savings are identified by top slicing without a review of overall priorities and spending needs of the council.

Key Risk Area 9

121. Revenue management accounts are presented to the Executive Management Team (EMT) on a monthly basis to enable management to monitor the council's overall financial position. The financial regulations say that the head of finance should make suitable reports and recommendations to the council as is deemed necessary. To meet this duty, revenue budget monitoring reports should be presented to members on a quarterly basis. However in 2008/09 only one revenue budget monitoring report, covering the period 1 April 2008 to 31 August 2008 was presented for consideration. It is of some concern members were unaware of this issue until it was raised in our internal key financial controls assurance report in May 2009.

Key Risk Area 11

122. Audit Scotland would expect a best practice council to present their unaudited accounts to members prior to or shortly after the statutory submission deadline of 30 June to the Controller of Audit. Although the unaudited financial statements were not presented to members prior to this date the head of finance advised us that they would be presented to members in August 2009 however this did not take place. Although a provisional outturn report for year ending 31 March 2009 was presented in July 2009 there is a risk that members are not being provided with appropriate information on a regular basis to allow them to fully carry out their role in scrutinising the financial performance of the council.

Key Risk Area 11

Future Capital Programme

Capital programme

123. The current strategy for the general fund capital programme is to limit the draw on reserves to £20.0 million per annum. However, as reported at paragraph 74 the approved draw will decrease to £15.0 million per annum from 2010/11 going forward. However in the same report, the head of finance concluded that in view of the recently established general capital grant, and the continuing pattern of specific grants and capital receipts, it was considered prudent to allow for gross spending of up to £20.0 million on projects next year, and for the remaining years up to 2016. This will allow the council to remain within the financial strategy to fund £15million from reserves, with the remainder being funded from the general capital grant, specific capital grants, and capital receipts.

124. The council's capital programme for 2009/10 was presented to the council in February 2009. This comprises a prioritised list of capital projects of £19.91 million for the general fund, £2.60 million for the HRA and £11.37 million for the Harbour account. In September 2009 it was reported that slippage of £1.28 million has been identified on general fund expenditure to 2010/11, £0.33 million of this has been re-allocated to existing general fund projects.

125. The council has reported that its capital programme includes projects of £231.28 million to be completed or commenced between 2009/10 and 2013/14. As part of the programme, funding required to complete projects scheduled for 2009/10 and 2010/11 totals £88.0 million. These figures do not include projections for HRA or Harbour account expenditure, nor do they include the currently estimated £49.0 million to build the new Anderson High School on the new site. The capital programme is continues to be heavily oversubscribed and as a result of continued slippage there is a risk that projects may not be delivered and corporate priorities not achieved.

Key Risk Area 12

Capital prioritisation

126. The 2008/09 capital programme was not approved until February 2008. The council acknowledged that the current timetable for approval needs to be improved which resulted in the assistant chief executive establishing a Finance Working Group consisting of chairs, vice chairs and spokespersons of the three principal committees to, amongst other things, consider the capital programme in terms of planning, prioritisation and slippage. It was also proposed that the working group take a lead role in reconciling competing projects, which are now approved by principal committees, at a corporate level.

127. In addition, senior council officers attended a two day event in August 2009 to debate the council's approach to capital spending. Following this it is the intention to draft a realistic five year capital plan concentrating on high priority developments to be put before members for consideration. It is hoped that with this approach spending will be much more closely aligned with budgets than in the past.

128. If adopted, the head of finance has recommended that the council move away from a one year spending target of £20 million, to a five year spending target of £100 million allowing for greater flexibility around annual spending.

Key Risk Area 12

School Estate

129. The council are committed to producing a model for education by 2009 that considers the educational and financial viability for schools and communities. It is anticipated that significant capital investment will be required to bring some schools and facilities up to a modern standard.

130. At the services committee in January 2008 a report was presented entitled, "Developing a "Blueprint" for the Education Service". The committee agreed to the establishment of the working group to undertake the 'blueprint' review. It was further decided to have sub-groups to look at quality education and transitions at three stages: Pre-School/Primary, Secondary/Further and for pupils with Additional Support Needs. In order to inform the direction of the blueprint, a programme of consultation was developed to seek the community of Shetland's views on the issues. The results of the consultation exercise, along with any key messages, were presented to a special services committee on 12 February 2009.

131. By taking the results of the consultation into account, the council's broad educational mission is to develop principles based on equality, entitlement, access and quality of delivery to take forward education in Shetland over the next ten years within budget. Action plan areas and a timetable were approved at Services Committee on 12 March 2009. The timetable considers the main activities taking place over a two year period. Updates are provided at each cycle of the services committee detailing progress made on the development of these action plans.

132. There are a number of schools that could potentially be identified for closure as a means of rationalising the school estate. Some schools are easier than others to identify and it is likely that in some schools a natural point for closure can be identified. Both Mid Yell and Anderson high school have been designed above the current school role to accommodate any future transfers. This is likely to be progressed on a five to ten year timescale on the assumption that Anderson High School is also progressed within this timescale.

Key Risk Area 10

Housing Supply

133. The housing supply issue in Shetland is worsening with numbers waiting for social housing continuing to increase with approximately 1,000 people now on the waiting list. Right to buy cases are diminishing the housing stock and there are increasing homelessness presentations. The council

made the policy decision that the housing repairs and renewals reserve would be dedicated to achieving increases in housing stock, although to date this has not happened. However, the council has reported a deficit of £0.26 million on its Housing Revenue Account for 2008/09 which has to be met from the housing repairs and renewals reserve.

134. The head of finance has recommended that the HRA strategy going forward should be to minimise the use of reserves to support revenue spending, thereby maximising the extent to which reserves can contribute to the additional housing stock programme. A programme of £20 million over the next five years has been recommended, however, this figure will be revised as and when new information becomes available.

Key Risk Area 13

Asset Management

135. Effective management of council assets helps the council achieve its objectives and get best value from its investment in property. Effective asset management benefits service delivery by making council buildings work better for staff and service users now and in the future. It also reduces the opportunity cost of money locked up in surplus property and reduces the council's carbon footprint.

136. In 2009, we published *Asset Management in Councils.* Our study found that strategic asset management was not well developed in most councils. For Scottish councils as a whole, over a quarter of all properties were in poor condition and slightly less than that were not suitable for the services being delivered from them. It was highlighted in the report that Shetland Islands Council was one of five councils who did not know the suitability ratings for more than 20 per cent of their buildings.

137. The report was noted by the audit and scrutiny committee on 17 June 2009 where members requested additional information on the areas where the council was reported as performing poorly. The report has been noted by the new chief executive who recognises the importance of proper asset management. As a result all relevant matters have been discussed with the EMT and senior councillors. It is anticipated the new head of asset and strategy will progress this issue as part of their remit.

138. The council had plans in place to complete a review of the non housing estate by the end of March 2008. As yet the council has still to complete this review and it is unlikely to be completed prior to March 2010 due to staffing issues. There is a risk that until the estate management plan is in place, the assets of the council are not being utilised in the most effective way.

139. Work has been progressing to implement a Computer Aided Management System (CAMS) to measure asset management performance. The information is now available for testing and it is expected that the system will go live by the end of December 2009.

Key risk area 14

Procurement

140. Local authorities spend significant sums of money annually on purchasing goods and services and as part of the efficient government initiative, the Scottish Government anticipated that scope existed for significant financial savings through improved procurement procedures and practices. The McClelland report on procurement published in March 2006 confirmed significant savings were possible but concluded public sector procurement processes still had weaknesses in resources, skills, organisational structures and practices.

141. In response to the McClelland report the Scottish Government introduced the Public Procurement Reform Programme (the Programme) in April 2006. In July 2009, Audit Scotland reported the extent to which the Programme had progressed nationally. This report concluded that while some significant steps had been made, more work was required before the Programme could achieve its full potential.

- there was no systematic basis for reporting savings directly attributable to the Programme
- savings from collaborative contracts are being achieved more slowly than expected
- there are wide variations in the quality of purchasing data, practice and skill levels.

142. Audit Scotland recently surveyed Scottish local authorities to establish the nature of information held by councils on procurement processes. Questions also sought information on some key procurement statistics as well as establishing if individual councils had plans to implement the key recommendations from the McClelland report. The survey found that procurement strategies have been implemented in almost all councils and most of these have been approved by members and / or the management team, however, most councils' have contracts in place with less than 10% of their suppliers. The survey also found that a number of councils are not yet making full use of the Public Contracts Scotland Portal. This suggests that there is the potential to make further savings from procurement.

143. The council approved its procurement strategy in July 2007 and joined Scotland Excel in October 2008. The conditions of membership are such that procuring officers would require to have a sound business case for the procurement of goods, work and services not to be sourced via Scotland Excel. One such example where the council has agreed with Scotland Excel that it will not be pursuing national contracts is the purchase of local food.

144. Despite these positive steps to improve procurement activity the council acknowledges the procurement policy requires to be further developed to release the potential for significant savings and to fully incorporate the aims of the corporate plan.

145. It is also recognised that in order to improve the procurement methodology and allow full participation in national contracts it will be necessary to establish a corporate procurement service. This was considered as part of the assistant chief executive's review of the Capital Programme Service and was recommended to the council on 1 July 2009. A restructuring of executive services is currently underway, which includes a new head of asset and strategy to deal with capital procurement and to oversee the proposed £100 million capital programme for the next five years.

Key risk area 15

Managing People

146. A formal single status offer was developed, incorporating the feedback from staff, and sent to the relevant unions in February 2009 for collective agreement. After performing their own equalities reviews each of the 3 unions balloted their members which resulted in an overall 91% acceptance level. Detailed work is now commencing on implementing the agreement.

147. Three ring-fenced staff groups were not included in the offer due to particular aspects of some historic terms and conditions that still present specific challenges to resolve. These are:

- port operations sea staff and associated posts which have proven difficult to fully assimilate due to working practices developed to suit the nature of the industry. Investigation of the options and implications arising from new vessels, and potential changes to service requirements, continue to be under discussion
- early years workers posts which have proven difficult to assimilate to the new system due to a locally negotiated arrangement put in place to alleviate a potential pay dispute which does not meet equalities tests under the new system. Various options will be a particular focus of the detailed consultation with staff as part of the Blueprint for Education
- progress with evaluation of economic development staff has been delayed due to uncertainty over restructuring and staff transfers which are still being completed.

Key risk area 16

148. Employee development strategy phase 1 priorities have now been agreed. These include: updating job profiles and person specifications in line with job evaluation re-designs (currently underway), conducting a skills audit and training needs analysis to identify gaps in skills and qualifications (to be completed by end December 2009), producing individual training plans for the period to March 2012, reviewing career grades linking progression to competencies (currently underway), and developing an electronic corporate training records management system (a project team is taking this forward now).

Overlapping this is the ongoing development of a competencies framework and further development of job family tools.

149. A workforce development strategy for the education and social care department was presented to the services committee in May 2009. The strategy assists the department in describing the skills, knowledge and competencies that staff will need, now and in the future. It also provides a focus for training and development opportunities for staff.

150. A promoting attendance strategy was also presented to the services committee in May 2009. The aim of the strategy is to initiate a change in culture, to challenge acceptance of poor attendance and to improve SPIs through a programme of targeted initiatives. A progress report was presented to the audit and scrutiny committee on 2 September 2009. This highlighted the 2008/09 SPIs and quarter 1 information for 2009/10 shows an improvement in the overall absence figures. However the data still shows that 12,182 days have been lost due to sickness absence in the first quarter of 2009. It is anticipated that this will have significant impact on costs, in terms of replacement cover, and staff morale.

151. The annual accounts include a provision of £0.05 million to cover eleven equal pay cases outstanding at the end of March 2009. This has reduced from £0.21 million in 2007/08 as an additional sixteen employees accepted offers throughout the year. The implementation of single status should help reduce the risk of further claims.

ICT

152. The council makes good use of ICT to support and deliver services. It has an ICT strategy covering the period 2007-2012 and has developed an ICT infrastructure capital budget from 2009 through to 2014. In our 2008/09 SARA we reported the council did not have an overarching information strategy in place to provide direction and a consistent approach for information sharing. Following this, the council developed a project initiation document to scope an information management project. It identified that in order to inform the projects and priorities included in the ICT strategy, a clear understanding of all service information management requirements for the next five years is necessary. The main objective of the project is to deliver a comprehensive information management strategy, to be incorporated within the overall ICT strategy.

153. The council has corporate policies in place with regard to fulfilling its legal and statutory responsibility for data protection and freedom of information. In addition there is an Information Security Policy which was updated and issued in July 2009. The policy has been amended to provide more comprehensive guidance necessary to draw attention to the regulatory and legislative demands that apply to the secure storage and processing of information, including sensitive information.

Data handling and security

154. Data handling and security has received increased public and media attention recently as a result of a number of national incidents relating to lost data. The council shares data with a number of organisations such as the Department for Work and Pensions and other government departments. Information security is now a service delivery issue where a significant failure of controls could lead to loss of stakeholder confidence and opt out from services, higher compliance costs due to enforcement action, withdrawal of third party services such as payment card processing and legal fees relating to civil and criminal litigation.

155. The YourBusiness@Risk survey was repeated during 2008/09 and it was concluded from the profile of results that a good level of awareness was evident across the identified areas. However, a number of other areas such as password storage and equipment loss needed to be addressed to help improve the overall staff awareness of information security. It was agreed with the ICT unit manager that the outcomes from the survey will be communicated to staff and that the risk areas identified will be addressed clearly through the ICT management team.

Shared Services

156. The Accounts Commission commented on the lack of progress in developing shared services in its *Overview of the local authority audits 2008.* They recommended that councils should give this high priority in the light of financial pressures and the drive for efficiency.

157. The council is participating in the Hub initiative together with a number of other local authority organisations within the Highlands and Islands region. The Hub initiative is part of the Scottish Futures Trust and aims to establish a Northern Territory Programme Board to help deliver community infrastructure projects between partners. It is intended that the board will contract a private sector development partner to help develop shared community infrastructure projects delivering efficiencies in procurement, tendering and construction.

Outlook

158. Clearly we are in a period of reduced economic growth with big implications for the council's resources and the demand for services. The council needs to remain alert to the impact of the recession on the community it serves and what that means for its own objectives and services. At the same time as the council tries to support its local economy and provide best value services, it is likely to face a reduction in resources.

Governance and accountability

Introduction

159. We believe that an effective council is committed to high standards of probity and can demonstrate high standards of governance and accountability. It has effective political and managerial structures and processes to govern decision-making and the exercise of authority within the organisation, supported by mature and effective relationships between members and officers. An effective council is committed to public performance reporting as a key element of public accountability. It clearly sets out service standards which reflect the needs of local people and other stakeholders, and is balanced in its presentation of the council's strengths, weaknesses and challenges for the future.

Structure and policies

160. Corporate governance is about direction and control of organisations. Councils are large complex organisations and so good governance is critically important. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account and support the modernisation agenda.

161. The Audit and Scrutiny Committee's remit includes risk management and the associated control environment, scrutiny of the council's financial and non-financial performance, and to oversee the financial reporting process. The committee also has a wider role in terms of promoting, monitoring and developing continuous improvement. The committee is well attended and in overall terms its remit and working practices are in accordance with the good practice principles. For example, the committee:

- is a formally constituted committee with clear terms of reference and usually meets in public
- membership is in line with the geographical areas of the islands and there is regular attendance by appropriate senior officers of the council
- considers internal and external audit plans and respective annual reports
- reviews the audit certificate and considers matters arising from the audit of the annual accounts.

162. Officers play a vital part in ensuring that members have the capacity and knowledge to facilitate the decision making process. There are currently 22 independent councillors representing the people of Shetland. Elected members need to ensure that the council fulfils its statutory duty to secure best value. They need to be supported in formulating priorities and taking decisions on service delivery options on the basis of sound and comprehensive information.

163. A new chief executive was appointed to the council in June 2009 following the resignation of the previous chief executive in January 2009. He believes improvements in communication can be made between council officers and elected members. With this in mind, informal meetings are to be held with the chief executive, executive directors and committee chairpersons once per cycle to ensure that both groups are working cooperatively.

164. Notwithstanding this, to date councillors have yet to demonstrate they are able to collectively take the difficult decisions required to reduce the current draw on reserves in line with the agreed financial strategy. There is a risk elected members do not address the difficult financial choices required to ensure continued service delivery and progress on the capital programme within the agreed financial strategy. This may result in the council not delivering its corporate plan.

Key risk area 10

165. A discussion paper on governance was presented to the audit and scrutiny committee in June 2009. As a result of the issues raised, it was agreed a consultation exercise be carried out with staff, community councils and the public, in order to get suggestions as to how the governance of the council could be improved. It was recommended that the exercise commence following the appointment of the new chief executive.

166. The chief executive gave a verbal update on the governance review to the audit and scrutiny committee on 2 September 2009. He explained that although he considered the current structure to be fairly good, there were key areas that needed to be addressed, including housing, asset management and procurement. He also explained that it was premature to introduce broader structural changes until he had been in post long enough to determine how the council operated under his management.

167. In terms of the operation of the management structure, the chief executive has already implemented a number of changes, including weekly meetings with the executive team and the introduction of a leadership forum where heads of service meet with the executive team on a regular basis. These are further discussed at paragraphs 200 and 201 below.

168. Roles and relationships

169. The Accounts Commission recommends councils give priority to the continuous professional development of its members. The council has developed role profiles for all council members. Training was provided to the planning board and audit and scrutiny committee during the year, both of which were well attended by relevant members. There are currently no personal development plans in place, nor are there any formal mechanisms to monitor the impact of training, however, human resources has reviewed members' training and are due to commence a refreshed training needs analysis.

170. The creation of multi-member wards has required new ways of working to support efficient representation and sharing of the workload. There is no formal protocol for multi-member ward working, but with one member from each ward being appointed to committees, it has meant that workload has been split by to promote better understanding in specific areas.

171. Elected members represent the council on a number of arms length organisations, with potential for conflicts of interest. A review of member involvement in arms length organisations has been undertaken through the legal and administration service. The main aim was to identify the bodies that actually require member involvement in their organisation. Where it is decided continued involvement in arms length organisations is warranted, the council has pursued dispensations as appropriate, to maximise the capacity of members to engage in any necessary representative role without compromising obligations under the Councillors' Code of Conduct. The council must ensure members are clear about their responsibilities in these organisations and avoid any potential conflict of interest.

172. An example where there is a possible conflict of interest is with members in their role as trustees on the SCT. As reported above, in February 2009 the council's elected members approved a recommendation from the chief executive for the results of the SCT to be requested from the trust for inclusion in the council's group accounts. In March 2009 the same councillors acting in their capacity as trustees of the SCT voted against providing the information required by the council to facilitate the consolidation of the trust's results into the group accounts. In this case the councillors took a decision in their role as trustees which has seen them act against the recommendation approved by them as elected members of the council. The structure of the SCT is currently under review.

173. In July 2009 the head of legal and administration submitted a report to members on the 'Viking Energy Limited windfarm consent application – resolving conflicts of interest'. The report concludes that an irreconcilable conflict arises for individual councillors in the handling of the Viking Energy Windfarm Consent application. It further recommends the council should agree there will not be a formal meeting of the council nor a determination by councillors in connection with the consent. Instead, it is proposing holding one or more hearings where members can, in line with the Councillors Code of Conduct, "advocate" on behalf of ward interests in a way that does not compromise their position as councillors or their position as charity trustees.

174. At the meeting members agreed an extended public consultation exercise should take place, including a number of public sessions. The consultation period has been extended from 30 September 2009 to 13 November 2009 to allow these public sessions to take place. The head of legal and administration has been given delegated authority to organise the meetings at suitable locations across Shetland. A response to the application will then be subject to a full debate by the council.

Internal Audit

175. Internal audit provides an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. We carry out an annual review of the council's internal audit arrangements against CIPFA's revised Code of Practice for Internal Audit in Local Government 2006. We found the function continues to deliver quality work in accordance with a risk based framework. We were able to place specific reliance on the sections work on creditors, debtors, payroll and the SPIs. During 2008/09 internal audit successfully retained its ISO 9001:2000 quality accreditation standard.

176. For 2008/09 internal audit achieved 88% of their audit plan, this compares to 94% completion in 2007/08. The reduction in performance against the audit plan was due to a key member of staff being absent during the last two months of the financial year and three audits taking longer than estimated due to the number of issues identified.

177. Due to lack of progress in implementing a number of internal audit recommendations in the schools service, the audit and scrutiny committee received a progress report in September 2009. The report highlighted the three main areas of concern were disclosures, contracts and school funds. There are currently no disclosures outstanding and work will be carried out to ensure this continues. However, schools service management is still in the process of addressing the key issues in relation to contracts and school funds.

178. The transport audit identified a significant number of key and other audit issues including contractual, disclosure, financial and procedural matters, although positive steps have been taken by the department to address these various issues.

Partnership Working

179. The community plan has been endorsed by the council and was formally adopted by all partners in 2006. It contains clear priorities and explicit targets which are to be achieved by the council and its partners. Sustaining Shetland is a monitoring mechanism for a set of indicators of the quality of life in Shetland. It is regularly monitored and annual reports are presented to the community planning board and the council. This demonstrates the council has sound arrangements in place for monitoring and assessing the agreed outcomes.

180. The Single Outcome Agreement (SOA) for 2009/10 has been developed by Shetland community planning partners and has been circulated to members, senior officers and partners. It was officially signed by the Minster for Enterprise, Energy and Tourism on 13 August 2009. The SOA is a key milestone for effective partnership working. It sets out how key national and local outcomes for individuals, families and communities are going to be achieved.

181. The community planning partnership includes membership from council members, NHS board members, Shetland Charitable Trustees, Police and Fire boards, ASCC executive, strategic group chairs and the councils executive management team. The community planning partnership meets twice yearly as the strategic discussion forum for community planning issues. The most recent meeting was held in April 2009.

182. A community planning delivery group has also been established consisting of senior management and members from local community planning partners. The purpose of the group is to provide leadership and facilitation to community planning in Shetland, through the adoption and overall monitoring of arrangements. The group assigned 'champions' to take forward each of the six national outcome areas from the single outcome agreement. The structure of the community planning delivery group ensures focus on the delivery of the single outcome agreement.

183. As well as monitoring overall progress, it has been agreed that the following priorities will be 'championed' throughout the year by key representatives of partner agencies:

- work on a co-ordinated, joined up and comprehensive response in Shetland to the economic and financial downturn across all community planning partners
- work with all partners to make available high quality broadband and telecommunications throughout Shetland
- promote healthier lifestyles to improve health and well being and reduce avoidable deaths, targeting the key issue of alcohol
- develop a cross agency approach to using less carbon and using energy better
- work with partners to sustain and regenerate our most disadvantaged communities.

184. These new priorities reflect the themes that emerged from the first meeting of the community planning partnership in October 2008. Findings and progress will be reported back to the partnership throughout the year.

185. The council and NHS Shetland continue to work well together to meet shared priorities for health and care services that meet national standards and are appropriate for the Shetland community. Community Care Plans for Shetland have been prepared jointly by the two bodies since 1992.

186. A community health and care partnership agreement (CHCP) 2009-2012 was approved by the services committee on 7 May 2009. The gross outturn in 2009/10 is expected to be approximately £35 million with the funding stream from the council accounting for £19 million of this total. The CHCP Agreement contains the joint management and financial framework that underpins the CHCP arrangements and sets out Shetland's community care plans under a number of headings including carers, learning disabilities, mental health, etc. The agreement will be submitted to the Scottish Government together with the performance information required for 2008/2009.

Community engagement

187. The council's service plans have a section which outlines any recent or future consultation and engagement with customers. This enables services to build up an understanding of customers' needs, what they expect and how services can be improved.

188. The council also operates good practice guidelines for consulting and engaging with communities which were developed in partnership with the NHS and Shetland Enterprise. This is a toolkit which is designed as a reference and learning source for those planning and carrying out activities to engage with the public in planning, delivering and evaluating services across Shetland.

189. "Your Voice" is Shetland's twice yearly citizens' panel which was established in 2004 and consists of 600 people representative of the Shetland population. The survey results provide statistical and qualitative data which feel into the process of planning and delivering services. The council are currently looking to refresh the panel and are considering alternative methods of collecting the data to improve the response rate and ensure it is efficient.

190. Industry panels have been established to engage with local business on their service needs and local service delivery groups have also been established regionally to service delivery arrangements.

Public performance reporting

191. The council produces an annual performance report in the form of a calendar which is distributed to council offices and public buildings where members of the public can obtain copies. Information is easily obtainable, indicates both good performance and areas where improvement is required, and shows recognisable outcomes and targets. It is also forward looking detailing developments the council is planning in the future.

Governance and internal control

192. A Statement on the System of Internal Financial Control (SSIFC) for the council and its group was included within the financial statements. The conclusion of internal audit, reporting to the audit and scrutiny committee on 2008/09, was that the council's system of internal control was adequate and effective to provide reasonable assurance that the assets were safeguarded, waste or inefficiency was avoided, reliable financial information was produced and that value for money was continuously sought.

193. In accordance with the Code of Practice on Local Authority Accounting, the Statement reflects the internal control environment for the group position. The head of finance concluded that he was satisfied that reasonable assurance could be placed on the adequacy and effectiveness of the systems of internal control operated by the council and its associates.

194. CIPFA guidance Delivering Good Governance in Local Government recommends that the review of effectiveness of internal control should be reported in an Annual Governance Statement. In Scotland this requirement is voluntary. As in previous years the council's financial statements include a Statement on the System of Internal Financial Control. In accordance with best practice the council intend to include an annual governance statement in the 2009/10 financial statements.

Outlook

195. Partnership working is critical to the council's success and achievements of it SOA commitments. We are developing our approach to the audit of partnerships through the new approach to best value. In future, we shall increasingly be looking at the contribution of partners, as well as the council's own contribution, to the delivery of outcomes.

Performance management and improvement

Introduction

196. We believe that an effective council has a clear and ambitious vision for what it wants to achieve for its locality and communities to secure high quality services and effective outcomes for local people. The vision is effectively promoted by the member and officer leadership of the council and supported by staff and partners. It is backed up by clear plans and strategies to secure improvement, with resources aligned to support their delivery. An effective council has a performance management culture which is embedded throughout the organisation. The council's performance management framework is comprehensive and integrated with service planning and delivery. The council is able to demonstrate significantly improved outcomes for citizens and more effective and efficient services because of its performance management arrangements.

Vision and Strategic Direction

197. The current corporate plan was approved by the council in 2008. This is the key mechanism for driving improvement and change and sets out the council's priority areas for 2008-2011. Its principal aim is to ensure what the council intends to do will contribute to improving Shetland's sustainability. The plan is structured to reflect three themes: a sustainable economy; a sustainable society; and a sustainable environment and transport.

198. A total of 8 targets and priorities were developed by the Community Planning Board (CPB), now the community planning partnership, as a way of setting some long-term aspirations for Shetland. The council, as a lead member, agreed to help achieve and support these aspirations and these targets and priorities are included within the council's corporate plan. The targets and priorities are aligned with the national outcomes set out in the Scottish Government's 'Concordat'. The council and its partners therefore have a clear vision for the future of the islands.

199. The SOA sets out the council's contribution to the government's 15 key national outcomes as set out in the concordat. It also reflects established corporate and community planning commitments in the corporate plan. In this way progress at a national level is supported by outcomes at a local level.

200. The general quality of working relationships between officers and members can influence the impact and efficacy of the council and its services. Problems will arise if there is not a clear and common understanding of the councils priorities, members' strategic role and the limitations that should be set on their involvement in detailed operational management issues. If senior managers do not respect

political direction and do not balance their professional advice with being responsive to the policy priorities of the council administration, there will be difficulties in these relationships. At the time of writing this report we have become aware of some high profile relationship issues involving the new chief executive and members. There is a risk that these issues will adversely impact on the council's reputation and governance and accountability arrangements going forward.

Performance management

201. Since his appointment in June 2009 the chief executive has re-instated the weekly EMT meetings and these now take place every Tuesday. Each month a performance management item is included on the agenda for discussion by the EMT. A report was presented in August 2009 which aligns the monitoring arrangements for the SOA, corporate plan and sustaining Shetland. The EMT will then monitor these documents on a quarterly cycle.

202. The chief executive has also set up a leadership team which consists of all heads of service. The purpose of the group is to help communication and introduce peer support and challenge to the management team. The team meets every 6 weeks, with a theme being chosen and guest speakers to focus the meeting. So far there have been presentations on best value 2 and the capital programme / finance strategy.

Overview of performance in 2008/09

203. A corporate plan progress report was presented to the council in May 2009 which gave an update on progress for the 2008/09 financial year. An update is expected to be provided to the Scottish Government in September 2009. A detailed report on SOA progress will be provided in October 2009.

204. Performance against the main sustainability themes was summarised by the council in their progress report. The council provided the following update:

- ***Sustainable Economy*** *– Despite the very difficult world economic conditions through 2008-09, the Shetland economy has avoided the worst effects, at least so far. Unemployment levels are still very low compared to national levels, although they have risen somewhat during the latter part of 2008. Business start-up rates have increased from the previous year and while concerns remain around the fragility of traditional sectors a number of important investments have been made.*
- ***Sustainable Society*** *– The council continues to deliver a wide range of very high quality services. This is confirmed by a wide range of favourable inspections in schools, social care, housing, adult learning and other areas. Long term planning across services has been a key activity and extensive consultation and development work has been progressed around the*

blueprint for education, new build schools, long term community care services and the provision of affordable housing.

- ***Sustainable Environment and Transport*** *– Shetland continues to enjoy an enviable natural environment, and continues to seek to deal with the challenges a remote and scattered population gives in transport. Funding challenges for the provision of fixed links are a significant issue in internal transport provision, however development of the Shetland Transport Strategy action plan has progressed a number of other areas. Solid progress continues to be made on the sustainable use of resources by the council and preparations for significant planning activity have been progressed.*
- ***Sustainable Organisation*** *– Progress continues to be made on efficiency measures, including procurement, reductions in sickness absence and reductions to bureaucracy; however sufficiently integrated partnership working to create actual savings has made limited progress.*

205. We have not undertaken a review of the above assertions as part of our annual audit work.

206. The quality and frequency of public performance reporting currently varies across community planning partners. With the move towards a shared approach, focusing on common outcomes, there is scope for performance reporting to be more joined up between partners. This will be considered by partners from 2009 onwards.

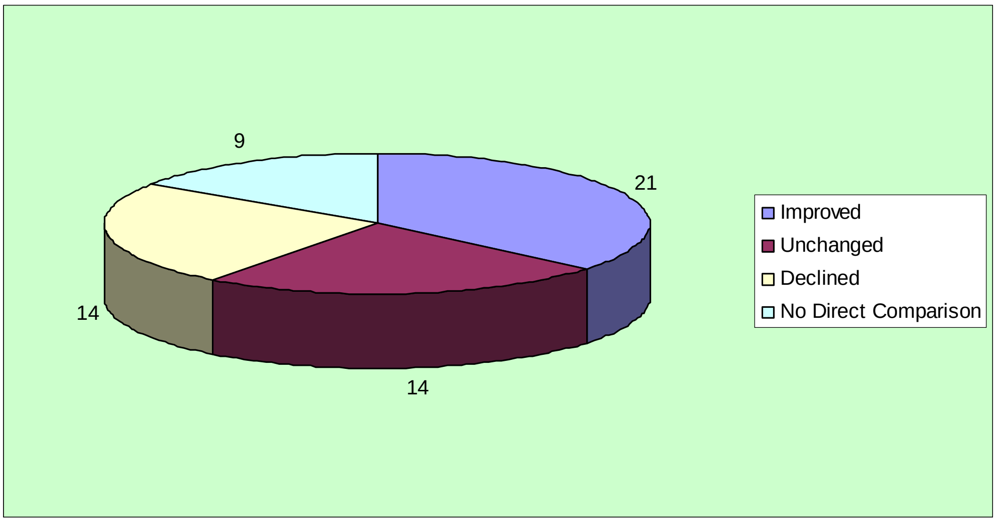
Key risk area 17

Statutory performance indicators

207. One of the ways of measuring council performance is through the statutory performance indicators (SPIs). With regard to 2008/09, a total of 58 SPIs were required. These were published by 30 September 2009 and will be submitted to the council's audit and scrutiny Committee. SPIs provide a consistent form of measurement for councils to review their performance over time and to make comparisons with other councils. In overall terms, Exhibit 7 confirms that the council has made improvement in a number of areas.

Exhibit 7

Improvements demonstrated by SPIs (Total 57 indicators)



208. Each year we review the reliability of the council's arrangements to prepare SPIs. The timeliness of working papers provided to support the SPIs continued to vary and we will continue to work with the council to improve the overall arrangements.

209. The council did not report on 3 indicators in 2008/09; ASW1 - community care assessments, BA2 and BA3 – benefits administration. The council did not report on ASW1 due to the complexities in collating the data required for the SPI. BA1 and BA2 were not reported on following guidance issued by Audit Scotland which stated that the information was not required for 2008/09. All other indicators were classed as reliable. Particular areas of improvement include:

- care staff in local authority residential homes, who have appropriate qualifications for the level of post held (up 18.5%)
- *the number and proportion of street light failures completed within 7 days(up 21.6%)*
- average time to re-let houses which are not low demand (down 15 days)

210. The following indicators are examples of where the council's performance has declined:

- percentage of inspections undertaken within time in high risk premises (down 16.3%)
- average time to re-let low demand houses (up 22 days)
- average time to sell houses (up 7 weeks)

Progress on delivery of the council's best value improvement plan

211. A Best Value and Community Planning audit of the council was completed in 2005. A progress report was issued in January 2007 which outlined the steps taken by the council during 2005/06 and the extent to which the objectives of the Improvement Plan had been achieved. This report concluded that the council had made a start in addressing the issues raised, but that a number of initiatives were relatively recent and consequently not fully embedded and had not yet had an impact in terms of improved service delivery or outcomes.

212. Since January 2007 the council has continued to address and monitor the risks arising from the BV follow up report some of which are highlighted below and referred to in more detail elsewhere in this report:

- the targets and priorities of the community plan are now included within the council's corporate plan and have been aligned with the SOA
- the council has a capital programme prioritisation system in place
- continued improvement within the council's performance management framework
- a procurement strategy has been approved and the council joined Scotland Excel in October 2008.

Equality and Diversity

213. The council is aiming to ensure that all of its activities comply with best practice in the field of equality and diversity. The Race Equality Scheme was reviewed in 2008 as part of a three year review cycle. This scheme covers both recruitment and employment practices, and access to all council services. An annual report is produced and normally published in November each year.

214. In 2008, we published a national study examining how councils responded to their race equality duty, *The impact of the race equality duty on council services.* This study found all councils have developed policies and processes on race equality. A number of initiatives are in place to meet the diverse needs of local communities, such as the provision of interpretation and translation services, and information packs for recent migrants. However, councils lack information about minority ethnic communities, their needs and experiences. Councils are also unable to show how race equality is routinely built into the design and delivery of services.

215. Our national report was considered by the audit and scrutiny committee on 6 May 2009 and was raised with the chief executive for consideration by the EMT. From discussions with the performance management coordinator it was confirmed any relevant findings will be incorporated into the existing race equality scheme action plan.

Efficiency

216. The council’s approach to the efficiency agenda is set out in the council’s medium term budget strategy, approved on 10 September 2008. This highlights the council’s main efficiency policy objective – to eliminate the annual draw on financial reserves to support general fund revenue expenditure by 2012/13.

217. The council’s annual efficiency statement was submitted to COSLA in August 2009. This shows that the council achieved totals efficiencies of £0.68 million in 2008/09, an estimated £0.44 million of which is in respect of procurement efficiencies arising mainly from joining Scotland Excel in October 2008.

218. The council has also joined the National Recruitment Portal. As a result much more recruitment activity is being carried out online and the amount of national posts being advertised through newspapers has reduced.

219. Other key areas that the council will be focusing on in 2009/10 are:

- efficiencies generated from improvements in procurement polices
- a reduction in energy usage across council services
- efficiency savings in the amount of fuel being used across the council.

220. Tackling climate change and making the best use of resources require the efficient use of energy. In 2008, we published a national report on this subject: Improving Energy Efficiency. Our report concluded the public sector in Scotland has made progress in using energy more efficiently, recording a 5% decrease in energy consumption in councils for the three years to March 2007. However, the amount spent on energy, over the same period, increased by 47% due to price increases. Public bodies are recommended to develop and implement robust energy strategies and to encourage the necessary changes to culture and behaviour.

221. The council established an energy unit in 1995 to identify, develop and implement practical and cost effective energy conservation measures. The unit published the Shetland Energy Plan in 1998, which set out to encourage a more strategic and co-ordinated approach to energy management in Shetland. The objectives in the plan were broadly to reduce reliance on oil, maximise the use of local resources - including renewable technologies - and promote energy efficiency and sustainability. The mechanisms for achieving the plan's objectives are summarised in an action plan which draws together existing strategies such as the Home Energy Conservation Act Report and promotes initiatives including the Lerwick District Heating Scheme.

Risk Management

222. Risk is the threat that an event, action or inaction will adversely affect an organisation's ability to achieve its objectives. Risk management is the process of identifying, evaluating and controlling risks. Risk management supports decision making and contributes to performance.

223. A risk management strategy for 2009-2014 was presented to the Audit Committee for approval on 17 June 2009. The new strategy is to replace the existing risk management policy which the council considers to be out of date to meet the demands of modern government. The strategy highlights the various elements across departments and partner agencies which will fully embed the risk management process within everyday working practices.

224. Safety and risk staff will be mainly responsible for implementing the risk management strategy, however, heads of service will be involved through the Risk Management Board (RMB). The RMB is responsible through the EMT for monitoring and directing the control of strategic and corporate risks.

225. Following the risk management strategy, a risk management development plan was presented to the audit and scrutiny committee on 2 September 2009. This details how the council will address twelve points outlined in the CIPFA self assessment checklist for risk management. An action plan has been prepared and the safety and risk manager estimates the council is currently 75% compliant. Progress reports will be provided as and when appropriate.

226. The council's strategic risk register focuses on those areas of risk that can disrupt the strategic planning of the council and/or would have a long term impact on the Shetland community. The board is currently in the process of reviewing the strategic risk register. The initial deadline for the review has now passed due to resource issues and a revised timescale for completion is yet to be established. A risk register is in place for the SCT and work with other trusts will commence now the risk management strategy has been approved.

Key risk area 18

227. The CHP risk register has been reviewed during 2008/09 and is reported quarterly to the CHP committee. The CHP risk register links with both the council and NHS Shetland corporate risk assessment frameworks. It is proposed that the CHP risk register is included in six monthly update reports to the council's services committee.

228. We published a report on *Improving civil contingencies planning* in August 2009. The report found that key organisations are working well together to plan for dealing with emergencies, however, there is still more they could do to improve their arrangements.

229. Senior representatives of Shetland Islands Council, NHS Shetland, the emergency services, the public utilities, transport services, voluntary sector and the Scottish government recently met to discuss emergency planning and business continuity. At this meeting it was concluded that Shetland Islands are well equipped to deal with an emergency as the public services are all willing to work together.

230. The council has contracted with an external provider to achieve an in-depth process to ensure business continuity plans are created, tested and kept up to date. The methodology incorporates the relevant British Standards and builds on the understanding of business continuity across services so future management will be internalised. These plans will be entered into the risk management database and will become a regular item on the risk management board agenda. All service plan authors attended training on business continuity management and have prepared business continuity plans. These were tested at the recent multi-agency meeting and amended as necessary.

National studies

231. A number of our national studies have been discussed throughout this report. Some reports are of particular interest as the council continues to develop in a number of areas, including, procurement as discussed at paragraphs 140-145, asset management as discussed at paragraphs 135-139 and improving energy efficiency as discussed at paragraphs 62-64.

232. The following reports are directly linked to the priorities that the planning partners identified for 2008/09:

- Overview of drug and alcohol services
- Mental health overview.

Overview of drug and alcohol services

233. A report on drug and alcohol services in Scotland was published in March 2009. This report highlighted that a coordinated effort is needed to ensure services meet local needs and are delivered to consistent standards nationally.

234. The council and its partners are committed to promoting healthier lifestyles to improve the health and well being of the community and reduce avoidable deaths, targeting the key issue of alcohol. The director of public health - NHS Shetland, the chair of the NHS board and the chief executive – Shetland islands council have been assigned as champions to take this issue forward in 2009/10.

Mental health overview

235. The overview of mental health services was published in May 2009. This concluded that mental health problems cause considerable poor health in Scotland and much has been done to move services from institutions into the community. However, there now needs to be a better understanding of the care people receive and how resources to support this are best used.

236. The CHCP agreement between the council and NHS Shetland which was approved by the services committee on 7 May 2009 sets out Shetland's community care plans under a number of headings, including mental health. One of the priorities for 2009/10, amongst other things, is to implement streamlined mental health arrangements.

Outlook

237. We have already mentioned the importance of developing the governance aspects of the SOA; the performance management aspects are also important. The long term and complex nature of many of the outcome targets, pose many challenges for performance management. For example, how can the council tell if its resources are making a difference? We recognise the challenges and whilst we have no plans to audit the outcome progress reports in 2010/11, we will pay attention to the systems the council has in place to monitor progress and take remedial action.

238. We are currently developing our approach to best value 2 by working with five pathfinder councils. From April 2010, we shall be rolling out the new approach to all Scottish councils. The timing of Shetland Islands Council's best value audit will be determined by a risk assessment. We will report the risk assessment in March 2010.

239. The risk assessment will be carried out in conjunction with other scrutiny bodies. That means that not only will it determine the timing and scope of the best value 2 audit of Shetland Islands Council, but it will also identify the timing and scope of other scrutiny work. Along with the other bodies, we intend to publish a scrutiny plan for each council covering all scrutiny activity over a three year period.

Appendix A

External audit reports and audit opinions issued for 2008/09

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan	28/01/2009	06/05/2009
Strategic Audit Risk Analysis	30/03/2009	06/05/2009
Internal key financial controls assurance report	13/05/2009	17/06/2009
Statutory performance indicators	28/08/2009	07/10/2009
Report on financial statements to those charged with governance	18/09/2009	24/09/2009
Audit opinion on the 2008/09 financial statements	30/09/2009	09/12/2009 (FULL COUNCIL)

Appendix B: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	10 34	**Group Accounts** In 2008/09 the council did not include the results of the charitable trust in the group accounts. Audit disagrees with this accounting treatment. ***Risk: the council may continue to receive a qualified audit opinion.***	There are ongoing discussions between Audit Scotland and the chief executive regarding the issue.	Chief Executive	Ongoing
2	11 39	**Financial instruments** The council did not apply the effective interest rate method to the relevant financial assets. ***Risk: the council may continue to receive a qualified audit opinion.***	The head of finance will ensure that this issue is addressed in 2009/10.	Head of Finance	March 2010
3	16 40 43 49 64	**Financial Statements** Procedures are not adequate to ensure financial statements are prepared and presented in accordance with the SORP. Specifically, in 2008/09 recurring issues were raised in respect of fixed assets and investments. ***Risk: the financial statements do not present fairly the result of council activities.***	The council will review the procedures for preparing the 2009/10 financial statements. Issues raised throughout the 2008/09 financial statements audit should be considered and adjusted for accordingly. Specific areas for early consideration include: ▪ fixed assets ▪ investments ▪ carbon trading scheme	Head of Finance	March 2010

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
4	50 55	**Housing Benefit** The council needs to address the findings from the benefits review to ensure continuous improvement is achieved. This includes updating of the anti-fraud documents. ***Risk: there is a risk issues are not addressed per the agreed timetable.***	A detailed action plan has been prepared in response to the findings in the report. The anti fraud documents will be updated over the coming months.	Benefits Manager	October 2009
5	60	**IFRS Adoption** The council has made little progress in preparing for the implementation of IFRS by 2010/11. Key milestones in the outline project plan have been missed. ***Risk: if key deadlines are not met the authority will be unable to achieve the introduction of IFRS by 2010/11.***	The council will identify a lead officer within finance for IFRS implementation. Key deadlines will be agreed to enable the implementation of IFRS by 2010/11. Finance staff will be provided with the appropriate training.	Head of Finance	October 2009
6	73	**Significant Trading Operations** The council's two significant trading operations made a deficit in 2008/09 due to single status back pay. As single status costs are now a recurring annual expense, the council should review their charges to ensure they are sufficient to cover the additional costs going forward. ***Risk: if the operations continue to make a deficit they will fail to meet the statutory break even target over a three year period.***	Charges will be reviewed to ensure that they are sufficient to cover the additional costs of single status going forward.	Head of Finance	October 2009

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
7	75	**Revenue Budgets** As well as ongoing financial pressures, particularly from education and social care services, the council faces the ongoing challenges to ensure that the council remain within their current financial strategy. ***Risk: reserve balances will be used to support general fund expenditure. The target balance of £250 million may not be achieved and maintained.***	The council will monitor general fund expenditure to ensure that financial targets are met. The council will review budget allocations as part of the 2010/11 budget setting process.	Head of Finance	Ongoing
8	99	**Capital Project Management** A best practice methodology for future project management was prepared and was approved by the audit and scrutiny committee on 6 May 2009. However, it was noted that there was still some more work to be carried out in terms of development of the methodology. ***Risk: without a clear project brief additional expenditure will be incurred and projects will be deferred.***	The council will implement the revised methodology on all future capital projects.	Chief Executive	Ongoing
9	104 117 120	**Budget setting process** The council should undertake a review of budget allocation to ensure that these are properly matched to service need. It is likely there will be additional budget pressures resulting from any transfer of services from the SCT to the council. ***Risk: without a full review the budget allocated to service departments will not reflect current service provision.***	The Chief Executive is currently working with Heads of Service to develop processes to promote efficiencies and the early declaration of under-spends. The council will continue to review budget allocations as part of the 2010/11 budget setting process.	Chief Executive	January 2010

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
10	118 132 164	**Decision making** Elected members need to address the difficult decisions to ensure that the council remain within current financial constraints. ***Risk: there is a risk that elected members do not address the difficult financial choices required to deliver services or the proposed capital programme within the agreed financial strategy.***	The council will continue to review budget allocations as part of the 2010/11 budget setting process. The council will progress the development of a 5 year capital plan which supports corporate aims and objectives. This will be presented to members for consideration.	Chief Executive	Ongoing
11	121 122	**Revenue Budget Monitoring** During 2008/09 it was identified that only one revenue budget monitoring report was presented to members for consideration. It was also noted that the unaudited financial statements were not presented to members prior to them being submitted to the Controller of Audit. ***Risk: without adequate information, members are not in a position to make the difficult decisions which necessary to ensure that the council remains within its current financial strategy.***	Revenue budget monitoring reports will be presented to the full council on a quarterly basis. Unaudited financial statements will be presented to members prior to them being submitted to the controller of audit.	Head of Finance	Ongoing

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
12	125 128	**Capital Programme** The capital programme is heavily over-subscribed. Projects to be completed or commenced before 2013/14 amounts to £231.28 million. This is before the inclusion of Anderson High School at an estimated cost of £49.0 million. ***Risk: the capital programme may slip or may not be delivered and corporate priorities not achieved.***	A finance working group has been established to look at the longer term considerations of the council's capital programme. The finance working group will take a lead role in reconciling competing projects at a corporate level. The chief executive, along with senior council officers, is in the process of drafting a five year capital plan focusing on high priority projects. This will be presented to members in due course.	Chief Executive	Ongoing
13	134	**HRA Budget** Financial pressures in the HRA have resulted in a deficit in 2008/09 which has to be met from the HRA reserves. ***Risk: HRA reserves will continue to be used to cover in year deficits and therefore reduce support for future revenue or capital expenditure.*** ***This could impact on compliance with the SHQS standard by 2015.***	The HRA strategy going forward is to minimise the use of reserves to support revenue spending, thereby maximising the extent to which reserves can contribute to the additional housing stock programme. The council will monitor HRA expenditure to ensure that overspends are managed and financial targets are met.	Head of Finance	Ongoing
14	139	**Effective management of assets** Despite target dates being passed, the council has yet to consolidate the estates and maintenance records or review the non housing estate. ***Risk: there is a risk that the assets of the council are not utilised in the most effective way.***	The council will progress implementation by March 2010.	Chief Executive	March 2010

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
15	145	**Procurement** The council does not have a dedicated corporate procurement service. ***Risk: there is a risk the council will not maximise potential savings from efficiencies in procurement.***	The proposed new head of asset and strategy will lead on capital procurement.	Chief Executive	Ongoing
16	147	**Single status** The council have still to include a number of staff groups within the single status agreement. ***Risk: there is a risk the council is not addressing inequalities in pay scales for all council employees.***	The council recognises the need to progress single status for all council employees	Head of Organisational Development	March 2010
17	206	**Performance reporting** Performance reporting currently varies across community planning partners. With the move towards a shared approach, focusing on common outcomes, there is scope for performance reporting to be more joined up between partners. ***Risk: there is a risk of a fragmented approach between partners.***	This will be considered by partners from 2009 onwards.	Head of Organisational Development	March 2010
18	226	**Risk Management** The council is in the process of reviewing and updating the strategic and departmental risk registers to reflect the council's 8 priorities identified with the corporate plan and service specific issues respectively. ***Risk: there is a risk that until the risk registers are updated the council may not identify an imminent risk facing the council.***	Work is ongoing in both of these areas and it is anticipated that all risk registers will be updated and entered onto the database by December 2009.	Risk manager	December 2009