

**A report by the Controller of Audit to the Accounts Commission under Section 102(1) of the Local Government (Scotland) Act 1973**

**Shetland Islands Council: Annual Audit 2007/08**

**Introduction**

1. The external auditors have completed their 2007/08 audit of Shetland Islands Council and I have received the audited accounts for the year ended 31 March 2008 and their report on the year's audit.
2. The auditors qualified their opinion on the accounts due to a disagreement about accounting treatment. This is the third consecutive year that the Council has received a qualified audit opinion on this matter.

**Qualified audit opinion**

3. *The Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice* (the SORP) requires councils to prepare group accounts where they have interests in entities meeting the definitions of subsidiaries, associates and joint ventures. Group financial statements are required to present fairly a full picture of the council's activity and financial position.
4. Shetland Islands Council's group accounts for financial year 2007/08 did not include the Shetland Development Trust (SDT) and the Shetland Charitable Trust (SCT), and their related subsidiaries. In the auditors' opinion, the substance of the Council's relationship with these bodies represents a significant interest and their omission results in a material mis-statement of the group accounts. The auditors qualified their opinion on the accounts accordingly.
5. The full text of the audit certificate is set out in Appendix A.

**Basis for the auditors' view**

6. The auditors are of the opinion that the following factors are all relevant in determining the entities to be included in the Council's group accounts and support the inclusion of SDT and SCT:
  - SCT provides 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
  - Council representation on the trusts changed after the May 2007 local authority elections with all 22 councillors now sitting as trustees on both bodies. This link between Council membership and representation on the trusts is an indication of 'influence and common interest'
  - Since 2004 SDT has required the approval of the Council for any investment which exceeds £0.25 million and is another clear indication of 'influence and control'.

**The position at the Council**

7. In January 2008 a revised structure for SDT was proposed by the chief executive for the re-establishment of a development committee within the

Council to deal with all matters related to economic development. SDT would retain a minimal number of financial related staff to monitor and manage its ongoing investments.

8. On the basis of the proposed new structure, legal advice recommended that the results of SDT should be included in the group accounts. In March 2008, SDT was directly placed within the Council's governance structures and the Council has stated that the results of SDT are to be included in the group accounts for financial year 2008/09. The Council took the view that neither trust should be included within the 2007/08 financial statements.
9. In 2008/09 there have also been some operational and managerial changes within SCT, including the appointment of a trust general manager to replace the Council's chief executive. While the impact of these changes will be reviewed by the auditors in forming an opinion on the appropriate accounting treatment of SCT in the Council's 2008/09 group accounts, they are likely to remain of the view that, to comply with the SORP, SCT should be included. The Council has explained to the auditors that the trust is concerned that its charitable status may be affected if the trust was to provide accounts to the Council for group consolidation purposes. The Council has explained that the trust is having discussions with the charities regulator (Office of the Scottish Charity Regulator) on these concerns.

### **Conclusion**

10. The purpose of my report is to bring the Accounts Commission's attention to the fact that, for the third consecutive year, the auditors have qualified the accounts of Shetland Islands Council because of a disagreement about accounting treatment in the Council's group accounts.
11. The results of the Shetland Development Trust are to be included in the group accounts for 2008/09. The position on the Shetland Charitable Trust will be the subject of further consideration by the Council in 2008/09. Unless the position is resolved, there is a risk that the auditors will again qualify the Council's accounts in 2008/09.

**CAROLINE GARDNER**  
**CONTROLLER OF AUDIT**  
**9 December 2008**

**Independent auditor's report to the members of Shetland Islands Council and the Accounts Commission for Scotland**

I certify that I have audited the financial statements of Shetland Islands Council and its group for the year ended 31 March 2008 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Income and Expenditure Account, Statement of Movement on the General Fund Balance, Statement of Total Recognised Gains and Losses, Balance Sheet and Cash-Flow Statement, the Housing Revenue Account, Statement of Movement on the Housing Revenue Account Balance, the Council Tax Income Account, the Non-Domestic Rate Income Account, the Pension Fund Account, and the related notes and the Statement of Accounting Policies, together with the Group Accounts. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to the parties to whom it is addressed in accordance with the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

**Respective responsibilities of the Head of Finance and auditor**

The Head of Finance's responsibilities for preparing the financial statements in accordance with applicable laws and regulations and the Code of Practice on Local Authority Accounting in the United Kingdom 2007 - A Statement of Recommended Practice (the 2007 SORP) are set out in the Statement of Responsibilities for the financial statements.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission.

I report my opinion as to whether the financial statements present fairly, in accordance with relevant legal and regulatory requirements and the 2007 SORP the financial position of the local authority and its group and its income and expenditure for the year, and have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

I also report to you, if in my opinion, the local authority has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the Statement on the System of Internal Financial Control reflects compliance with the SORP, and I report if, in my opinion, it does not. I am not required to consider whether this statement covers all risk and controls, or form an opinion on the effectiveness of the local authority's corporate governance procedures or its risk and control procedures.

I read the other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information

comprises only the Explanatory Foreword. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

### **Basis of audit opinion**

I conducted my audit in accordance with Part VII of the Local Government (Scotland) Act 1973 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Accounts Commission. My audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Head of Finance in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the local authority's and its group circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

### **Qualified opinion arising from disagreement about accounting treatment**

The 2007 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 fairly a full picture of the authority's activity and financial position.

The Council's group accounts do not include the Shetland Development Trust and the Shetland Charitable Trust, and their related subsidiaries. In my opinion, the substance of the Council's relationship with both of these bodies represents a significant interest and their omission results in a material mis-statement of the group accounts.

In March 2008, the Council obtained legal advice which recommends that the results of the Shetland Development Trust should be included in the group accounts, whilst the position of the Shetland Charitable Trust required further consideration. Despite this advice, for 2007/08 the Council has not included either of the trusts in the group accounts.

Based on prior year financial statements, I estimate that these bodies would contribute:

- a deficit position of approximately £3 million to the Group Income and Expenditure Account (resulting from income of £13 million and expenditure of £16 million);
- net assets of approximately £277 million to the Group Balance Sheet (resulting from fixed assets of £29 million, investments and loans of £232 million, net current assets of £18 million and long term liabilities of £2 million).

Except for the omission of these amounts from the group accounts, in my opinion the financial statements:

- present fairly, in accordance with relevant legal and regulatory requirements and the 2007 SORP, the financial position of Shetland Islands Council and its group as at 31 March 2008 and its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

*Fiona Mitchell-Knight FCA  
Assistant Director of Audit (Local Government)  
Audit Scotland  
7<sup>th</sup> Floor Plaza Tower  
East Kilbride, G74 1LW*

30 September 2008

## **AGENDA ITEM 2 (APPENDIX 3)**

### ACCOUNTS COMMISSION FOR SCOTLAND

### SHETLAND ISLANDS COUNCIL

### ANNUAL AUDIT 2007/08

### FINDINGS

The Accounts Commission has considered the report by the Controller of Audit under Section 102(1) of the Local Government (Scotland) Act 1973 on the 2007/08 Annual Audit of Shetland Islands Council.

The Commission notes with great concern that for the third consecutive year the Council has received a qualified audit opinion, as the auditors have determined that the substance of the Council's relationship with the Shetland Development Trust and the Shetland Charitable Trust represents a significant interest and that, accordingly, their omission from the Council's group accounts results in a material mis-statement of those accounts.

The Commission expects the Council to take all appropriate action without further delay to resolve this situation during the 2008/09 financial year.