

Shetland Islands Council

Annual report on the 2012/13 audit



Prepared for Members of Shetland Islands Council and the Controller of Audit
October 2013

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

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Key messages

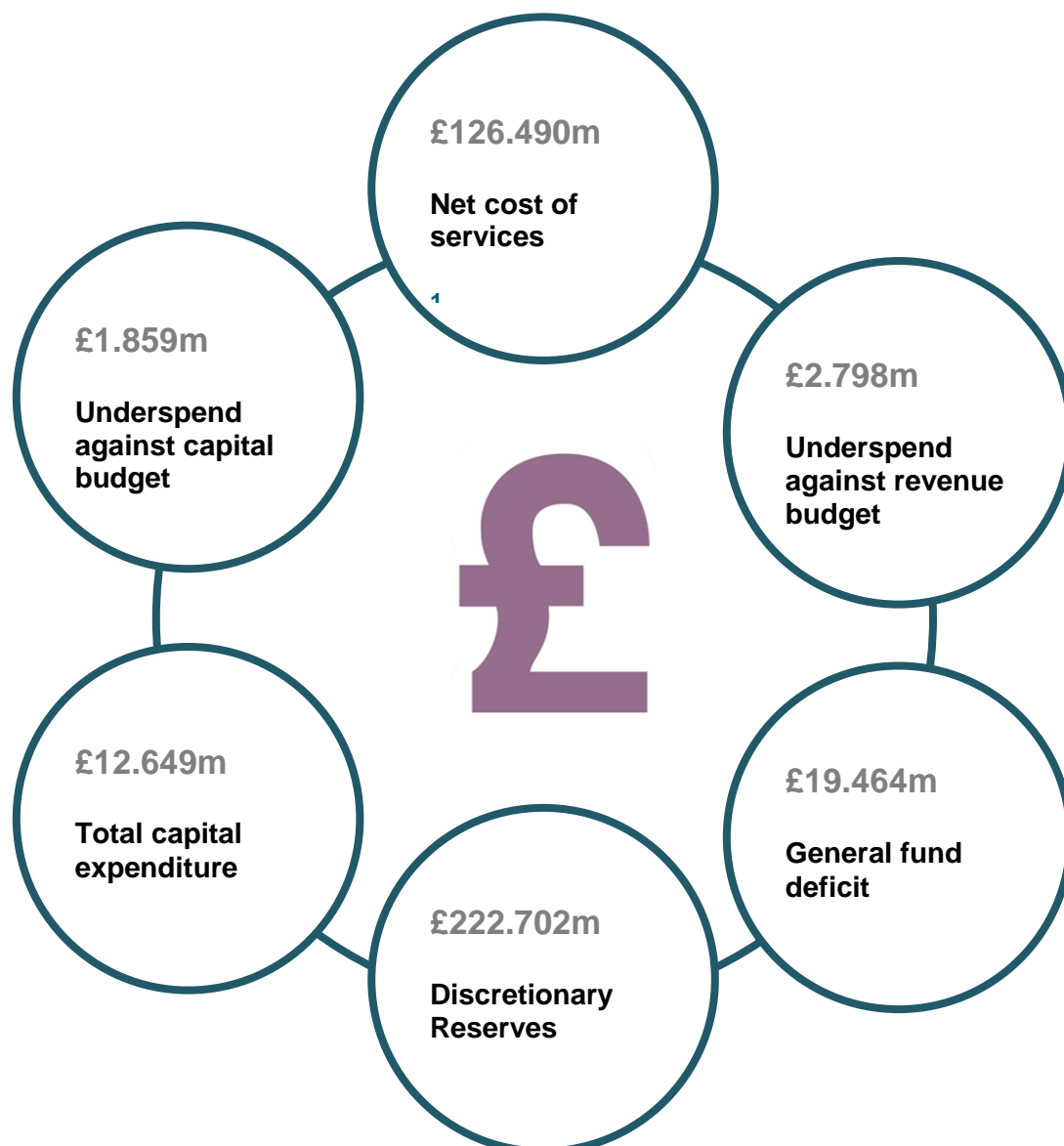
2012/13 key facts

This report summarises the findings from our 2012/13 audit of Shetland Islands Council. As part of the audit we assessed the key financial and strategic risks being faced by the council. We audited the financial statements and reviewed the council's financial position and aspects of governance, best value, the use of resources and performance.

Financial Statements

We have given an unqualified opinion on the financial statements of the council and its group for 2012/13. In our opinion, they give a true and fair view of the financial transactions for the year to 31 March 2013 and the financial position at that date.

Financial position



Governance and accountability

Overall, the council's governance arrangements in 2012/13 were satisfactory although internal audit highlighted significant non-compliance with Standing Orders for Tenders and Contracts and Small Contract procedures. A management action plan was agreed to address this issue. No other significant weaknesses in the accounting and internal control systems were identified during the audit.

The council has continued its good progress in improving its governance arrangements and has an agreed strategy within the Corporate Plan to deliver further improvement.

All departmental risk registers have been updated and the council is working towards finalising the corporate risk register later this year

Performance and best value

In January 2013, the Accounts Commission Statutory follow-up report found that *'The council has made good progress on its improvement agenda, but needs to ensure that the wide ranging and ambitious improvement plans are prioritised and managed in a sustainable way so that it has the capacity to deliver on its objectives.'*

The council has agreed an ambitious and challenging Change Programme that requires to be effectively managed to ensure key changes and service priorities are delivered within the limits of its medium term financial strategy.

Outlook

Scotland's public bodies will continue to face increasing demand and cost pressures for their services in the foreseeable future. As with other councils, Shetland Islands Council will have to review its priorities and make difficult decisions regarding the provision of services in order to balance budgets in future years. The council has specific challenges in addressing the erosion of its reserve balance over recent years. The council has developed a Medium Term Financial Plan (MTFP) to help ensure delivery of its core objectives and to maintain a minimum reserve balance of £150 million by 2017/18. The MTFP requires the council to make savings of £23 million over the next 4 years. We will continue to monitor the council's progress in this area.

There are still uncertainties over the impact of the implementation of the Universal Credit on councils' services and resources, and a period of ongoing change lies ahead due to the integration of health and social care and the implementation of the reformed police and fire services. The co-operation and assistance given to us by officers during the audit is gratefully acknowledged.

Introduction

1. This report is the summary of our findings arising from the 2012/13 audit of Shetland Islands Council. The purpose of the annual audit report is to summarise the auditor's opinions (i.e. on the financial statements) and conclusions, and to report any significant issues arising. The report is divided into sections which reflect the public sector audit model.
2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of the council.
3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that the council understands its risks and has arrangements in place to manage these risks. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.
4. This report is addressed to members and the Controller of Audit. Reports should be available to the other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
5. This report will be published on our website after consideration by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.
6. The management of the council is responsible for preparing financial statements which show a true and fair view and for implementing appropriate internal control systems. The auditor is responsible for auditing and expressing an opinion on the financial statements. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
8. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.
9. Auditors review and report on, as appropriate, other information published with the financial statements, including the annual governance statement and the remuneration report. Auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

10. We have given an unqualified opinion that the financial statements of Shetland Islands Council for 2012/13 give a true and fair view of the state of affairs of the council and its group as at 31 March 2013 and of the income and expenditure for the year then ended.

Legality

11. Through our planned audit work we consider the legality of the council's financial transactions. In addition, the Executive Manager - Finance has confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the council's corporate management team, the financial transactions of the council were in accordance with relevant legislation and regulations. There are no legality issues arising from our audit which require to be brought to members' attention.

Going concern and group accounts

12. The council has prepared the financial statements on the assumption that both the council and its group can continue to operate as a going concern in future.
13. Local authorities are required to prepare group accounts in addition to their own council's accounts where they have a material interest in other organisations. For the purpose of consolidation and incorporation within the group accounts, the council has two subsidiary organisations (Shetland Development Trust and Zetland Transport Partnership) and four associates (Northern Joint Police Board, Highlands and Islands Fire Board, Orkney and Shetland Valuation Joint Board and Shetland Charitable Trust).
14. The overall effect of the inclusion of all of the council's subsidiaries and associates on the group balance sheet is to increase both reserves and net assets by £84.6 million. The group

balance sheet as at 31 March 2013 discloses an excess of assets over liabilities of £541 million (2011/12 £679 million).

15. Police and fire functions transferred to the Scottish Police Authority and the Scottish Fire and Rescue Service on 1 April 2013. The group balance sheet will improve in future years as the council will no longer be required to accrue the pension liabilities of Police and Fire into its group accounts.

Annual Governance Statement

16. As part of our annual audit we review the disclosures made in the Annual Governance Statement, included in the financial statements, and the process for obtaining sufficient assurances to inform the content of the statement.
17. We are satisfied that the disclosures in the Annual Governance Statement are in line with the guidance contained in the CIPFA publication *Delivering Good Governance in Local Government*. Also, we are satisfied with the adequacy of the process put in place to obtain the necessary assurances for the Annual Governance Statement.
18. The Annual Governance Statement refers in outline to a number of areas where improvements are being progressed :
 - the financial governance framework and development of a Medium Term Financial Plan
 - staff policies, including Employee Review and Development Policy, Code of Conduct and Policy of Reporting Concerns at Work
 - project management
 - progress and performance monitoring and reporting arrangements.

Remuneration report

19. We are satisfied that the remuneration report has been prepared in accordance with the relevant legislation. The disclosures within the 2012/13 financial statements include all eligible remuneration for the relevant council officers and elected members under a number of categories including pension benefits.

Accounting issues

20. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 (the 2012 Code). We are satisfied that the council prepared the 2012/13 financial statements in accordance with the 2012 Code.

Accounts submission

21. The council's unaudited financial statements were submitted to the Controller of Audit before the deadline of 30 June 2013. A comprehensive working papers package was also available to our team at that time. This enabled us to conclude the audit and certify the financial

statements prior to the target date of 30 September 2013. The financial statements are now available for presentation to members and publication.

Presentational and monetary adjustments to the unaudited accounts

22. A number of presentational amendments were made at the request of the external audit team. These adjustments were aimed at improving disclosures within the financial statements.
23. Monetary adjustments totalling £0.183 million were made at the request of the external audit team. The effect of the adjustments was to decrease both income and expenditure by £0.183 million. There was no change to the net assets as recorded in the balance sheet. No unadjusted errors were identified.
24. In 2011/12 the Shetland Charitable Trust was treated in the financial statements as a subsidiary of the council. Changes to the Trust's governance arrangements in 2012/13 resulted in a reduction from 21 to 7 councillors who are Trustees, and, in addition, 8 non-councillor trustees were also appointed. This has led to a change in accounting and the SCT is now included as an associate in the council's group accounts. Publicly available financial information for the SCT has been included in the council's group accounts.
25. There was no disclosure of bad debt write-off within the Council Tax Income Account or the Non-Domestic Rate Income Account as these write-offs were charged against the general fund bad debt provision. The Executive Manager - Finance agreed to disclose bad debt write-off within the Council Tax Income Account and the Non-Domestic Rate Income Account.

Pension Costs

26. Shetland Islands Council is a member of the Shetland Islands Council Pension Fund which is a multi-employer defined benefit scheme. In accordance with pension accounting standard IAS19 'Retirement Benefits', the council has recognised its share of the net liabilities for the pension fund in the balance sheet. The valuation as at 31 March 2013, provided by the scheme's actuaries, increased the council's share of the deficit from £104.524 million last year to £129.250 million this year.
27. This increase in pension liabilities of £24.726 million was principally due to the financial assumptions about the cost of pension payments being less favourable than at 31 March 2012. The continuing challenging investment environment and an increase in the inflation rate have led to an increase in the net liability faced by the council. The scale of the movements in the council's pension liability over the last 5 years, arising from the annual valuation, can be seen in exhibit 1 below.

Exhibit 1: Movement in Pension liability 2008/09 - 2012/13

	2008/09	2009/10	2010/11	2011/12	2012/23
	£ million	£ million	£ million	£ million	£ million
Liability	58.979	147.169	91.113	104.524	129.250

Source: Shetland Islands Council audited financial statements

28. It is important to note, however, that this additional liability does not have any immediate impact on the council's financing requirements. The council will continue to make annual contributions to the Pension Fund, through employer contributions, in accordance with triennial valuations carried out by the actuaries.

Equal pay

29. The Equal Pay Act 1970 makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay and are dissatisfied with the council's proposed resolution or compensation can elect to have a case heard before an employment tribunal. Shetland Islands Council has received four claims for compensation.
30. In June 2013 the Supreme Court ruled against Dumfries and Galloway Council in favour of Unison, the local authority workers union, which argued that the terms and conditions of female staff should be in line with male manual workers. The decision of the Supreme Court may have implications for all local authorities in Scotland, including Shetland Islands Council.
31. The council is aware of the potential liability arising from the case, but has not created an additional provision due to the degree of uncertainty surrounding settlement levels. The Council has disclosed an unquantified contingent liability in the financial statements in respect of future unknown equal pay claims.

Asset de-commissioning costs

32. Authorities have an obligation to undertake restoration and aftercare work of landfill when they commence depositing refuse in those sites. It is expected that a provision is recognised under *IAS37 Provisions, contingent liabilities and contingent assets*. It is also appropriate for the council to capitalise such costs within the associated assets and to depreciate over the economic useful lives of the assets.
33. Officers have indicated that the Sellaness facility will need to be decommissioned at the end of its life but the council is currently unable to estimate reliably the costs for a provision as its useful life is difficult to estimate due to the volatility of the oil industry. A reserve fund of £39 million has been set up in the financial statements for this.
34. The original phase of the Gremista Landfill Sites is complete and the second phase will take place in 2013/14 when a provision will be recognised in the financial statements.

Whole of government accounts

35. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. The council submitted the consolidation pack to support its 2012/13 WGA return to the Scottish Government and this has now been audited and the audited return submitted.

Outlook

36. The Charities Accounts (Scotland) regulations 2006, as amended, set out the accounting and auditing requirements for charities registered in Scotland. Irrespective of the size of the charities, a full audit is required, from 2013/14, of all registered charities' accounts where the local authority is the sole trustee.
37. Shetland Islands Council is the sole trustee of three charities: Zetland Educational Trust, Gilbertson Trust and Samuel Mulla Bequest. The council intends to close down Gilbertson Trust and Samuel Mulla Bequest during 2013/14 and transfer the funds to appropriate bodies.
38. A consultation exercise is currently underway in terms of the Local Authority Accounts (Scotland) Regulations. It is likely that for 2013/14, local authorities, if they do not already do so, will require an audit committee or similar to approve the accounts by 30 September 2014.

Financial position

39. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
40. Auditors consider whether audited bodies have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
41. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

42. In 2012/13, as recorded in the comprehensive income and expenditure statement, the council spent £178.725 million on the provision of public services and had an overall deficit on provision of services of £18.531 million. After taking account of statutory adjustments, the overall draw on reserves was £21.407 million, £4.924 million less than budgeted.

Budgetary control

43. The explanatory foreword to the 2012/13 Statement of Accounts reported a general fund revenue account deficit of £20.653 million in the year against a budgeted deficit of £23.940 million. This equates to an underspend of £3.287 million in the year which is attributed to a general reduction in expenditure across services. The main reasons for the service over/underspends are as follows:
 - **Chief Executive & Cost of Democracy:** The £0.039 million overspend was fully attributable to the costs of exit packages.
 - **Children's Services:** The £0.968 million underspend was mainly due to a £0.4 million savings/underspend on Quality Improvement/Schools and a transfer of £0.4 million to capital in relation to works on Sound School and the Halls of Residence which was originally budgeted under revenue.
 - **Community Care Services:** The £0.989 million overspend was due to a combination of shortfalls against budgeted savings across the service.
 - **Corporate Services:** The £1.323 million underspend was due to a combination of vacancies and savings/underspends.

- **Development Services:** The net underspend of £2.021 million was a combination of unbudgeted council-wide savings in some areas, with some slight overspends in other areas.
 - **Infrastructure Services:** The net underspend of £0.428 million was a combination of shortfalls against budgeted savings in Ferries and Fleet Management Unit offset by additional income from waste and burial services and other areas.
 - **Fund Managers Fees:** A £0.141 million overspend occurred in expenditure on fund manager fees.
 - **Harbour Account:** The account was £0.361 million above budgeted surplus. This was as a result of additional cost savings which exceeded the reduced level of income from harbours against the budget.
44. The Housing Revenue Account (HRA) reported an in-year deficit of £2.058 million compared to a budgeted deficit of £1.174 million. The £0.884 million overspend is mainly due to the HRA funding additional capital from current revenue of £0.768 million instead of through borrowing as had originally been planned.
45. There was a £1.983 million underspend on the Capital Account, attributed to slippage on the capital programme. The most significant underspends include Hoofields New Housing (£0.7m), Anderson High School (£0.3m), Terminal Life Extensions (£0.2m), Housing Quality Standards (£0.3m) and Shetland College Phase 3 (£0.2m).

Financial position

46. Exhibit 2 shows the notional level of usable reserves at 31 March 2013 compared to the previous year. The council's usable reserves at 31 March 2013 totalled £222.764 million, a decrease of £16.282 million on the previous year. However, it should be noted that the level of reserves immediately available to the council is, in effect, the amount of cash that is invested, which is shown on the balance sheet as £205.732 million.

Exhibit 2: Usable reserves

Description	31 March 2012	31 March 2013
	£ million	£ million
Total General Funds	3.658	3.604
Total Capital Funds	110.598	103.463
Marine Fund	2.021	1.805
Reserve Fund	57.129	18.219
Repairs & Renewal Funds	63.988	55.222
Reserve Fund - Harbour Contingency	0.000	39.000

Description	31 March 2012	31 March 2013
	£ million	£ million
Other reserve funds	1.652	1.451
Total Other Revenue / Statutory Funds	124.790	115.697
Capital Grants Unapplied	0.596	0.000
Total Usable Reserves	239.642	222.764

Source: Shetland Islands Council 2012/13 financial statements

47. As previously stated, the total draw on reserves during 2012/13 was £4.924 million less than budgeted. The council's MTFP sets out how the council plans to reduce the draw on reserves over the next few years so that, from 2017/18, a minimum reserve balance of £150 million is maintained, with future draws on reserves being funded by investment returns. The reserves held by the council are discussed by members as part of the regular budget monitoring processes. The use of reserves for ring-fenced purposes has been agreed with members.

Housing Revenue Account (HRA)

48. In previous years, the HRA had required to borrow internally for a significant amount of its capital expenditure and the HRA owed the General Fund £38.6 million at 31 March 2013. The Scottish Government has abolished the Housing Support Grant which was used to make interest payments on the debt and was worth £0.8m in 2012/13.
49. The 2013/14 HRA budget requires a £2.5 million draw on reserves to balance the budget, which equates to 25% of the HRA reserve balance. The level of draw on HRA reserves cannot be sustained. We understand the council is in discussions with the Scottish Government and Westminster on this issue and is developing a 30 year business plan ensure the sustainability of the HRA.

Refer to Action Point No.1

Capital investment and performance 2012/13.

50. The 2012/13 financial statements show net capital expenditure of £12.649 million against a budget of £14.508 million which is an underspend of £1.859 million. The draw on the capital fund was £1.359 million, which was £1.983 million less than planned. Exhibit 3 shows the 2012/13 capital expenditure outturn position.

Exhibit 3: 12/13 Capital Expenditure - Outturn Position

	12/13 budget £m	12/13 Outturn £m	Variance £m
General Fund	9.241	8.532	0.709
HRA	5.059	4.011	1.048
Harbour Account	0.208	0.106	0.102
Total	14.508	12.649	1.859

Source: Shetland Islands Council 2012/13 financial statements

51. Capital expenditure was funded as follows:

- capital receipts of £1 million
- government grants of £5.5 million
- draw from reserves of £1.9 million
- capital from current revenue of £3.6 million
- internal loans fund charges of £0.7 million.

Treasury management

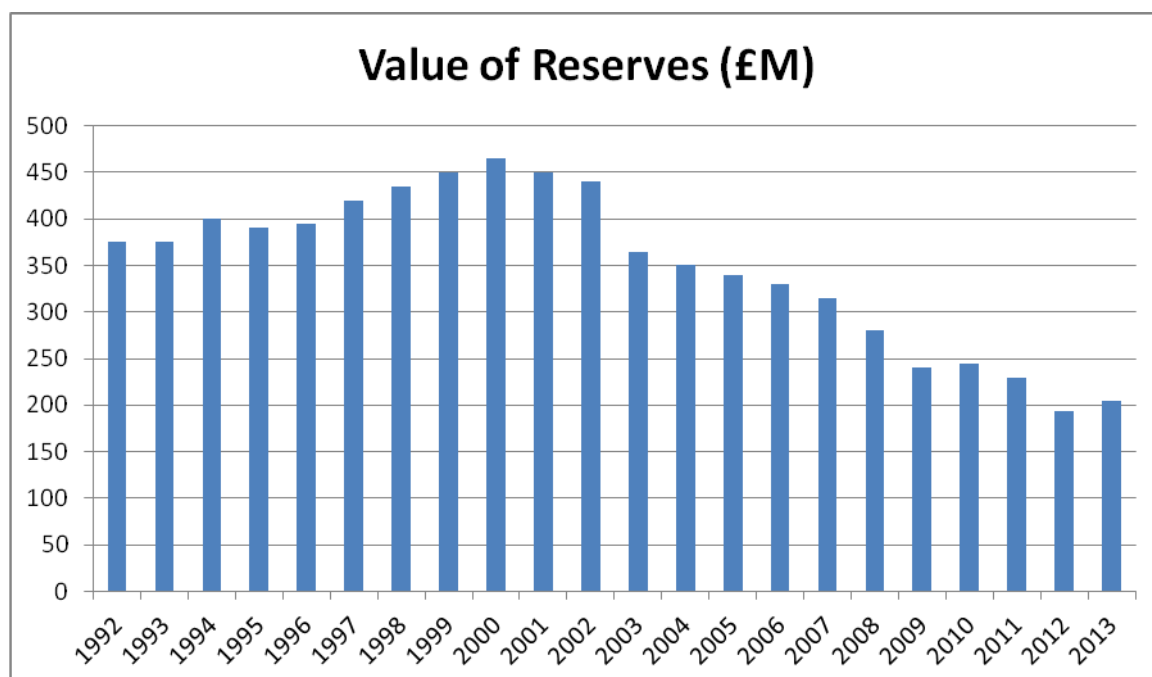
52. The council does not have any borrowings. Funds held for investment by the council at 31 March 2013 were £205.7 million (£193.2 million at 31 March 2012). There were realised gains on investments of £26.5 million at 31 March 2013 (£5.7 million at 31 March 2012).

Financial planning to support priority setting and cost reductions

Savings

53. In recent years the value of the council's usable reserves balance has decreased significantly and, in 2012, the council recognised that it could not continue to meet budget deficits by drawing significantly from its reserves. Exhibit 4 shows how the council's reserve balance has decreased from £465 million (at today's prices) in 2000 to £205 million in 2013.

Exhibit 4: Reserves Balance



Source: Shetland Islands Council MTFP Sept 2012

- 54. In September 2012 the council agreed a 5 year financial plan (the MTFP) to deliver financial sustainability and ensure resources are properly aligned with its objectives and priorities. The MTFP set out total savings targets of £38.360 million and included achieving a minimum reserve balance of £125 million by 2017/18.
- 55. In 2012/13 the council achieved savings totalling £18.6 million. This was £3.3 million more than planned but £21.107 million was still drawn from reserves to meet the funding gap.
- 56. The council agreed an updated MTFP in August 2013, setting a revised total savings target of £23 million over the next four years as detailed in the Exhibit 5. The revised plan amended the projected minimum reserve balance at 2017/18 from £125 million to £150 million.

Exhibit 5: Planned Savings

Description	2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m
Planned Savings	12.526	6.539	2.223	1.720	0.000	0.000

Source: Shetland Islands Council MTFP 2013-2018

- 57. Many of the more readily achievable savings have already been made and it will be a significant challenge for the council to identify recurring savings going forward. There are difficult decisions ahead about prioritising services and allocating resources.

Refer Action Point No. 2

Procurement

58. The public procurement reform programme aims to drive continuous improvement in public sector procurement. In 2009 the Scottish Government introduced an annual evidence-based assessment, the procurement capability assessment (PCA), to monitor public bodies' adoption of good purchasing practice and as a basis for sharing best practice. In 2012, the council achieved a PCA score of 33%, a significant increase from 19% in 2011.
59. While the council expects an increased PCA score for 2013 it should be noted that the council's latest score failed to meet the March 2013 national PCA target of 50%.

Partnership working

60. The Scottish Government and Convention of Scottish Local Authorities reviewed community planning and Single Outcome Agreements in 2012. The results of the review were published in their "*Statement of Ambition*" which made clear that significant changes to improve community planning are needed to respond to the challenges of reducing public finances while demand for services increases.
61. The Audit Scotland report *Improving community planning in Scotland (March 2013)* concluded that partnerships have not been able to show that they have had a significant impact on delivering improved outcomes across Scotland. It is too early to determine whether some of the new initiatives being implemented in Shetland will help deliver efficiencies to support the council's financial position.
62. The council works with NHS Shetland and other partners in the public, private and voluntary sector and plays a key role in the Shetland Partnership. The Partnership is the community planning partnership for the Shetland Islands Council area and provides an overarching framework for partnership working in Shetland. The Partnership has developed and published a local community plan for the period 2013 to 2020.
63. The Shetland Single Outcome agreement (SOA) 2012/15 is the delivery plan for the Shetland Partnership Community Plan. It has been developed from the community, agency, directorate and service planning activity of local partners and sets out actions to deliver the Shetland Partnership's key objectives.
64. A key part of the council's partnership working is the Community Health and Care Partnership Agreement 2013-2016. A key objective is to continue to develop and redesign services so that more people are supported at home. The agreement sets out a challenging and ambitious plan for the council and NHS Shetland to work together to meet the health and care needs of the community.

Refer Action Point No. 3

Workforce reduction

65. The total cost of exit packages to the council for 2012/13 was £1.047 million for 26 employees (£3.592 million for 65 employees in 2011/12). The council anticipates a likely reduction in its workforce in future years which will result in an increase in one-off severance payments.

Outlook

2013/14 budget and beyond

66. In setting its 2013/14 budget, the council agreed to freeze its council tax. The revenue budget for 2013/14 of £116.118 million shows an decrease of 2.42% on that set for 2012/13 (£119.000 million). This includes a savings target of £12.526 million and a draw on reserves of £20.999 million.
67. The council's most recently reported financial position for 2013/14 anticipates an overspend of £1.220 million for the year, mainly due to progress on savings being delayed.

Refer Action Point No. 2

68. The council's MTFP sets out indicative budgets to aid forward planning and identifies medium-term spending pressures and funding constraints. Exhibit 6 shows the council's budget model:

Exhibit 6: Budget Model

Description	2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m
Planned Savings	12.526	6.539	2.223	1.720	0.000	0.000
Expected General Fund Expenditure	116.186	107.442	106.081	107.108	108.911	111.401
Expected Funding	-62.119	-94.641	-93.228	-92.816	-92.404	-91.994
Expected Harbour Account Surplus	-0.222	0.071	0.218	-4.784	-8.396	-8.000
Expected TOTAL Gas Plant contribution	0.000	-0.109	-2.600	-5.833	-5.749	-5.439
Expected Draw on Reserves	-20.845	-12.763	-10.471	-3.676	-2.362	-5.969

Source: Shetland Islands Council MTFP 2013-2018

69. The council's medium term budget model includes a number of assumptions used when determining cost pressures. These assumptions relate to expenditure (e.g. pay awards, pensions, demographic changes, utility costs, inflation, and savings targets) and income (e.g. Scottish Government revenue and capital funding, NDR and CT income, investment income). The council reviews these assumptions on an annual basis and updates them for any in-year developments if required.
70. The most significant assumption is the expected return on investment income which can fluctuate considerably from year to year. To aid financial planning, the council has estimated an average investment return of 5.75% (based on the last 20 years) and plans to establish a Reserves Equalisation Fund. If annual investment returns exceed 5.75% the excess will be

transferred to this fund. The fund will meet the shortfall if any annual investment returns fall below 5.75%.

71. Looking ahead, it is clear that the outlook for public spending remains challenging for the foreseeable future. At the same time, there will be increasing demands placed on services through the needs of an ageing population and the effects of the current economic conditions and levels of employment. Continuing to deliver vital public services with a reducing budget will remain a significant challenge for the council.

Governance and accountability

72. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
73. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance, including audit committees, in monitoring these arrangements.
74. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
- corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
75. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

76. In January 2013, the Accounts Commission statutory follow-up report found that the council had *'consolidated many of the improvements to its governance and accountability arrangements, including the political management arrangements and agreed a new code of governance'*
77. During 2012/13, the council continued to develop and embed its corporate governance framework. The full council, advised by the Executive Committee, has responsibility for overall strategic direction in terms of setting corporate priorities and allocating resources.
78. The full council is supported by a number of standing committees including the Executive Committee, Audit and Standards Committee and four functional committees (Development, Education and Families, Environment and Transport and Social Services).
79. The Audit and Standards Committee is a key part of the council's governance framework. Its remit covers internal control, financial management, risk, governance, performance management and consideration of audit plans and reports.

80. The Corporate Management Team receives regular monitoring reports on all areas of the council in order to identify and address any issues to ensure the council meets its agreed objectives.
81. The council recognises the importance of robust financial governance arrangements and made considerable improvements in this area during 2012/13 and continues to work on improving its financial governance framework.

Internal control

82. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. The extent of this work is informed by their assessment of risk and the activities of internal audit.
83. As part of our audit, we reviewed the high level controls in a number of the council's financial systems. Our work covered several systems including general ledger, cash and cash equivalents, council tax, treasury management, non domestic rates and housing rents as well as aspects of the payroll and trade payable systems. The findings from this work were reported to management in July 2013 and an action plan of improvements agreed.
84. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
85. Also, the Annual Report presented by the Executive Manager - Internal Audit to the Audit and Standards Committee concluded that *'the Council's system of internal control was generally 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.'*

Standing Orders for Contracts

86. In their annual report, internal audit highlighted compliance with Council Standing Orders for Tenders and Contracts and Small Contracts Procedures as a specific area of concern. Revised Contract Standing Orders were approved in August 2013 and took effect from 1 September 2013. It is anticipated that the updated procedures will assist budget-responsible officers to comply more easily with council procurement policy and EU procurement regulations. In our internal controls letter, a management action plan was agreed to address this issue.

Internal audit

87. A key element of our work on internal controls is the extent of reliance that we place on the work of internal audit in terms of International Standards on Auditing 610 (Considering the work of internal audit). The findings from our review of internal audit were reported in February

2013 and we concluded that the internal audit service operates in accordance with the CIPFA Code of Practice for Internal Audit in Local Government.

88. Also, we placed formal reliance on aspects of the work of internal audit for the purposes of our financial statement audit responsibilities, including grants, accountancy, and income & recovery /cashiers.

Public Services Network

89. The council exchanges data with many other public bodies and, in so doing, makes use of Cabinet Office sponsored arrangements to share electronic data with other public sector bodies such as the Department of Works and Pensions.
90. The Government Secure Intranet (GSI) is the mechanism which allows the council to share data and services and the council must re-apply annually to the Cabinet Office to be allowed to connect to the government secure network. This year, the government is replacing GSI with the Public Services Network (PSN).
91. From November 2012 all applicants have to apply to connect to PSN which means complying with the stricter PSN Code of Connection. The new code of connection is challenging and uncompromising about security measures and aims to provide a substantial level of trust between organisations.
92. The council's initial application was not successful and further work with Cabinet Officer assessors was required to progress the transition to PSN. The council's subsequent application was approved on 23 October 2013.

Housing and council tax benefits performance audit

93. Audit Scotland's latest risk assessment of the council's benefit service was carried out in 2012 and a detailed report was issued to management in September 2012. The report identified 16 risks to continuous improvement, including 9 risks from our previous risk assessment in 2008. Management agreed to an action plan to address the risks and Audit Scotland will continue to monitor progress.

Risk Management

94. Departmental risk registers have been updated to reflect the council's current service priorities and objectives. Approval of the corporate risk register has been delayed to ensure that it takes into account current strategic objectives. The council anticipates approving the corporate risk register later this year.

Refer to Action Point No. 4

Prevention and detection of fraud and irregularities

95. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. We noted that Shetland Islands Council has appropriate measures in place to prevent and detect fraud, although it should be noted that no system can eliminate the risk of fraud entirely.

NFI in Scotland

96. Shetland Islands Council participates in the National Fraud Initiative (NFI). The NFI uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error.
97. NFI expects public bodies to investigate matches and, if fraud or error has taken place, to stop payments and attempt to recover the amounts involved.
98. The most recent data matching exercise collected data from participants in October 2012 with matches identified for follow-up in February 2013.
99. The current NFI data exercise identified 3,460 data matches of which 802 are considered high quality and recommended for investigation. All these matches have been investigated there have been no identified cases of fraud.
100. Overall, we concluded that the council has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI.

Standards of conduct and arrangements for the prevention and detection of corruption

101. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place.
102. The council has a Protocol for Councillor / Officer Relations for members, a Code of Conduct for all staff and a Reporting Concerns at Work Policy. The council also has an Anti-Fraud and Corruption Policy.
103. We have concluded that the arrangements for the prevention and detection of corruption in Shetland Islands Council are satisfactory and we are not aware of any specific issues that we need to report.

Welfare Reform

104. The Welfare Reform Act 2012, as reported last year represents the biggest reform of the UK welfare system for 60 years. The council receives regular reports on the potential impact of

welfare reform on its communities and services. Some changes have already taken place since April 2013, particularly for those of working age.

105. The council is represented on the Financial Resilience Welfare Reform sub-group (a sub-group of the Fairer Shetland Partnership) which has been implementing an action plan to address welfare reform and financial resilience. This group meets on a monthly basis to share new issues, find solutions and agree actions. An action plan has been prepared by the group and there is evidence of good progress being made.
106. The council has set up a Welfare Reform page on its website and this provides:
- details on the changes resulting from welfare reform and locally available help
 - contact details for advice
 - information on relevant resources.

Outlook

107. Welfare reform will continue for several years to come and, from October 2013, the Universal Credit will start to be rolled-out nationally. This will replace a range of existing means-tested benefits and tax credits for people of working age. There are obvious financial implications for citizens and the council from the introduction of Universal Credit, as well as possible impacts on officers' workloads and duties. Aspects of this are still being developed by the DWP and will continue to be closely monitored through the various workstreams of the sub-group.
108. Rent arrears have been increasing in Shetland Islands. In 2011/12 arrears totalled £102,000 and these had increased to £137,000 in the current year (an increase of 34.3%).

Refer to Action Plan No. 5

Best Value, use of resources and performance

109. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning. Auditors are also required to review and report on the audited body's progress against its Best Value improvement plan.
110. This section includes a commentary on the Best Value/ performance management arrangements within the council. We also note any headline performance outcomes and measures used by the council and comment on any relevant national reports and the council's response to these.

Management arrangements

Best Value

111. In January 2013 the Accounts Commission statutory follow-up report found that:
- *The council had made good progress on its improvement agenda, but needs to ensure that the wide ranging and ambitious improvement plans are prioritised and managed in a sustainable way so that it has the capacity to deliver on its objectives; and*
 - *The council will need to take some difficult decisions if it is to deliver its medium-term financial plan. This will be challenging for council staff and the residents of the islands who have been used to providing and receiving a high level and quality of services over recent years.*
112. In April 2013 the council agreed arrangements to support the delivery of the Change Programme which sets out how the council will deliver key changes and meet its service priorities within the limits of its medium term financial strategy. A report to the Executive Committee in August 2013 on the 35 change programme projects showed that 18 projects were 'on timetable and budget' and 17 were 'slipping against either but still expected to deliver overall'. The report stated that 'given the challenging objectives and tight timescales against many projects it is not surprising that it needs much hard work to keep a number of them on timetable'. We will continue to keep this area under review and will comment on progress in our future Annual Reports.

Refer to Action Plan No. 6

113. In June 2013, following a period of significant community engagement, the council agreed its Corporate Plan 2013-17 which sets out how its strategic priorities will be delivered. The

Corporate plan is linked to the SOA, Community Plan and Change Programme. The Corporate Plan also confirms the MTFP as the council's key financial plan.

Performance management

114. When the council's Planning and Performance Management Framework (PPMF) was updated in July 2012 it was acknowledged that it would have to be updated again when the Council developed its Corporate Plan. In June 2013 the council approved an updated PPMF, including the integration of further improvement activity into the Corporate Plan and concluding the Improvement Sounding Board and returning full improvement scrutiny and performance management responsibility to the Executive Committee.
115. Council-wide financial performance is reported regularly to the Executive Committee, and departmental performance is reported to the relevant functional committee.
116. The council has acknowledged the challenges in having an overly large number of key actions. As a result, the Corporate Plan now lists less than 50 priority actions for next year with the Change Programme concentrating on only 30 of those.

Overview of performance in 2012/13

Shetland Islands Council performance measurement outcomes

117. In July 2012 the council approved a one year Action Plan to deliver key objectives in the early part of its term of office while long term objectives were being developed. In June 2013 the council reported its performance against the Action Plan. A summary of reported performance is shown in Exhibit 7:

Exhibit 7: Action Plan Performance

	Done	Not to be Progressed	Work Continuing
Service Delivery Actions	63	3	17
Improvement Actions	67	1	9
Savings Actions	44	2	47

Source: SIC Performance Report – 2012/13 Q4

118. The council put in place an Improvement Plan to address the recommendations of the Accounts Commission Section 102 report issued in May 2010. Progress against Improvement Actions has been regularly reported to the Executive Committee. An in depth position was reported in March 2013 in response to the Accounts Commission's latest findings. Highlights included
- agreeing a Medium Term Financial Plan
 - meeting 12/13 budget targets

- setting 13/14 budget
- being released from special measures by the Accounts Commission;
- developing the Corporate Plan on today's agenda

119. In June 2013 the council reported completion of around 90% of its Improvement Plan actions and agreed to embed further improvement work into the Corporate Plan and the Corporate and Chief Executive directorate plans.
120. Detailed progress against service delivery actions have been regularly reported to the relevant service committees during 2012/13 and a consolidated position was reported in the Single Outcome Agreement 2012 delivery report in February. Reported highlights include:
- securing funding for a new Anderson High School
 - delivery of fibre optic broadband infrastructure from Sandwick to Sullom Voe
 - progress on the Curriculum for Excellence
 - being a pathfinder for local engagement in police & fire reform
 - the new occupational therapy resource centre being close to completion.

Statutory performance indicators

121. Auditors of local government bodies have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission. In 2012/13, a total of 25 SPIs were required and these indicate a mixed picture of performance; 12 areas of improved performance, 9 areas of declined performance, 3 were unchanged and there was no direct comparison for one SPI.
122. Areas where performance has improved include:
- Sickness absence
 - Percentage of invoices paid within 30 days
 - Museum visits
 - Cleanliness index
123. Areas where performance has declined include;
- Net cost of refuse collection per premise
 - Net cost of refuse disposal
 - Cost of collecting council tax per dwelling
 - Library visits

Local performance reporting

124. During the year, we carried out a targeted follow-up of "*Scotland's public finances: Addressing the challenges*", published by the Auditor General and the Accounts Commission in August 2011. The report provided an overview of the scale of budget cuts expected to be faced by

the Scottish public sector during the period 2010/11 to 2014/15, and how public bodies were beginning to respond to the challenges of reducing expenditure. A follow-up audit of this report was carried out in all 32 councils in Scotland as well as all health bodies and in 20 central governmental bodies.

125. Overall, we found that the council has improved its budget-setting process and made significant progress in strengthening the link between the budget and the corporate plan. We also found that members have the opportunity to regularly scrutinise the council's financial position through regular budget monitoring reports and outturn reports. We note that the council continues to work on improving its financial planning and monitoring arrangements.
126. The council recognises the benefits of benchmarking costs and performance with similar organisations and is currently developing their benchmarking arrangements as it is aware that this is an area where improvements can be made

National performance reporting

127. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports of direct interest in 2012/13 are outlined in exhibit 8 below.

Exhibit 8: A selection of National performance reports 2012/13

- | | |
|---|---|
| • Responding to challenge and change - An overview of local government in Scotland 2013 | • Protecting consumers |
| • Improving community planning in Scotland | • Using cost information to improve performance - are you getting it right? |
| • Major capital investment in councils. | • Health inequalities in Scotland |
| | • Reducing reoffending in Scotland. |

Source: www.audit-scotland.gov.uk

128. The expectation is that Audit Scotland's performance reports are presented to an audit or scrutiny committee for members to consider and hold management to account for local performance.
129. We note that Audit Scotland national reports are submitted to the Audit and Standards Committee and to the relevant service committees for consideration.
130. As a matter of good practice, Audit and Standards Committee members should receive a paper from relevant managers outlining the position locally against national findings. Any areas with scope for improvement can then be identified together with an action plan. Relevant managers should also attend the committee to answer points raised by members and provide them with assurance on progress being made. This approach has been adopted successfully by a number of public sector bodies.

Refer to action plan 7

Assurance and improvement plan update 2013-16

131. The Local Area Network (LAN) of scrutiny partners for the council, conducted a Shared Risk Assessment (SRA), and produced an Assurance and Improvement Plan covering the period 2013 to 2016. This was published on Audit Scotland's website and was submitted to the Audit and Standards Committee on 9 May 2013 for information and consideration by members.
132. The AIP identified the following areas requiring further consideration by the LAN.
- housing
 - performance management
 - governance and accountability
 - risk management
 - asset management
 - procurement
 - financial position
133. Performance management, governance and accountability, risk management, asset management, procurement and financial position are mentioned elsewhere in this report. The council is making progress towards achieving the Scottish Housing Quality Standard (SHQS) in 2015 and is focussing on a programme of energy efficiency works and on pursuing funding streams. To progress this, the council has identified a skills gap relevant to the energy efficiency of its housing stock and is seeking to recruit to a new Contract Manager (Services) post.

Equality Act 2010

134. The Equality Act 2010 introduced a new public sector duty to ensure equality is mainstreamed into public bodies' core work and that it is not a marginal activity. One of the key requirements of the legislation is for public bodies to publish a set of equality outcomes and an equality mainstreaming report by 30 April 2013.
135. In April 2013 the council, along with its community planning partners, published Shetland's Equalities Mainstreaming Report and Equality Outcomes 2013 - 2017. The report sets out the partners approach to mainstreaming equality and provides details of quality outcomes (2013-2017).

Outlook

136. In response to a request from the Cabinet Secretary for Finance, Employment and Sustainable Growth, the Accounts Commission has led development work, with scrutiny partners, on how audit and inspection can support the delivery of better outcomes by Community Planning Partnerships (CPPs).
137. Shetland Islands Council has not been selected for a CPP audit during 2013/14. It is expected that the council will be subject to a CPP audit in a future year.

Appendix A: audit reports

External audit reports and audit opinions issued for 2012/13

Title of report or opinion	Date of issue	Date presented to Audit and Standards Committee
Annual Audit Plan	22 February 2013	7 March 2013
Assurance and Improvement Plan	18 April 2013	9 May 2013
Internal controls management letter	25 July 2013	27 September 2013
Report on financial statements to those charged with governance	13 September 2013	27 September 2013
Audit opinion on the 2012/13 financial statements	13 September 2013	27 September 2013
Audit opinion on the 2012/13 Whole of Government accounts consolidation pack	26 October 2013	N/A
Report to Members on the 2012/13 audit	31 October 2013	11 December 2013

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	<p>HRA Debt</p> <p>The council no longer receives government funding to support the management of HRA debt which stood at £38.6 million at 31 March 2013. The current level of draw on HRA reserves cannot be maintained.</p> <p><i>Risk: the HRA cannot be sustained without significant rent rises or reduction in service.</i></p>	<p>The HRA debt is the single biggest financial risk that the Council is currently managing.</p> <p>It is the view of the Council that the size of the HRA debt is of such a scale in relation to rent income that the level of increase in rent and reduction in service required to balance the HRA budget could not realistically be delivered. For example, Council House Rents would require to be increased by approximately 40% in order to balance the budget without the use of reserves.</p> <p>As a result, the Council is pursuing a solution to the size of the housing debt with both the Scottish and Westminster governments.</p> <p>As part of this solution the Council may write off up to £10m of the Housing Debt.</p>	Executive Manager - Finance	1 April 2014

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
2	<p>Mid Term Financial Plan - Savings</p> <p>The MTFP requires significant savings to be made, which will be challenging for the council.</p> <p><i>Risk: there is a risk that MTFP savings targets are not met and reserves are further depleted.</i></p>	<p>The Council's Corporate Management Team is committed to, and is driving the process for, ensuring that the Council meets its savings requirements as set out in the MTFP.</p> <p>The Finance Service holds monthly meetings with every Budget Responsible Officer in the Council to challenge their financial projections, so that CMT and the Council receive good quality financial projections to assist with the process of ensuring that the Council stays on track with its MTFP.</p>	<p>Executive Manager - Finance</p> <p>Chief Executive & All Directors</p>	Ongoing
3	<p>Partnership Working</p> <p>The council has agreed challenging and ambitious community plans that are linked to its corporate objectives.</p> <p><i>Risk: failure to deliver community plans will mean the council's corporate objectives are not met.</i></p>	<p>The Single Outcome Agreement (SOA) 2013-2017 was endorsed by Council in June 2013, and signed off by the Scottish Government in July 2013. Progress on the SOA will be reported to Council at least every six months. The Council's Corporate Plan was informed by the priorities and objectives identified in</p>	<p>Executive Manager - Community Planning & Development</p>	Continuous

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<p>the Community Plan and SOA.</p> <p>The Council is committed to community planning and is represented on the Board by the Leader, the Convener, a number of Elected Members and the Chief Executive. The Shetland Partnership Performance Group, which monitors progress on the SOA meets at least every 3 months, with the Council being represented by the Chief Executive and other senior managers from the Corporate Management Team.</p>		
4	<p>Corporate Risk register</p> <p>The council has yet to approve the corporate risk register.</p> <p>Risk: Corporate objectives may not be met if strategic risks are not identified or managed</p>	<p>The Corporate Risk Register is currently in draft version having been through a review process by senior managers within the Council. It will shortly go to CMT for sign off, and will be reviewed on a periodic basis thereafter.</p>	Executive Manager - G&L	31 December 2013
5	<p>Rent arrears</p> <p>Council rent arrears are continuing to rise and this may be exacerbated by welfare reform.</p>	<p>The Council's rent arrears has followed the trend across Scotland by increasing following the introduction of the</p>	Executive Manager - Finance	31 December 2013

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
	<i>Risk: there may be financial loss to the council if processes are not in place to minimise the level of rent arrears.</i>	<p>Spare Room Subsidy.</p> <p>The Council has recently received additional funding from both the Westminster and Scottish Governments to alleviate this issue, and it is anticipated that the rent arrears will fall as a result of this.</p> <p>The Finance Service will continue to monitor arrears levels, and rigorously pursue all outstanding debtors.</p>		
6	<p>Change Programme</p> <p>The council has agreed a very challenging Change Programme.</p> <p>Risk: failure to effectively manage the Change Programme will have a detrimental impact on the delivery of the council's corporate objectives.</p>	<p>The Council's Corporate Management Team (CMT) recognise that the success of the Change Programme is critical to the delivery of the Corporate Plan.</p> <p>A dedicated team has been established to drive the change, and CMT and the Executive Committee regularly monitor progress.</p> <p>The monthly management accounts provide a projected outturn, so that CMT can get a sense as to whether the delivery of the programme is on track.</p>	CMT	31 March 2014

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
7	<p>National performance reporting</p> <p>There is scope for providing more detailed information to Audit and Standards Committee members to evidence the council's response to Audit Scotland reports.</p> <p>Risk: there is a risk that areas requiring improvement are not identified timeously.</p>	<p>The Performance and Improvement Service have initiated arrangements whereby the decisions and actions of service committees in respect to Audit Scotland reports will be reported back to the Audit & Standards Committee.</p>	<p>Executive Manager - Improvement & Performance</p>	<p>31 March 2014</p>