

Shetland Islands Council

Report to the Audit Committee, Members of the Council and
the Controller of Audit on the 2018/19 audit

Issued 4 September 2019 for the meeting on 25 September 2019

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Introduction

The key messages in this report

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

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

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

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the **four audit dimensions** that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of Best Value and the five Strategic Audit Priorities agreed by the Accounts Commission.



Introduction (continued)

The key messages in this report (continued)

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

Conclusions from our testing

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

Following amendments to points identified through the audit process, the management commentary and annual governance statement comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of the Council.

Following changes arising from audit, we are satisfied that the auditable parts of the remuneration and staff report have been prepared in accordance with the relevant regulation.

A summary of our work on the significant risks is provided in the dashboard on page 9.

A total of 4 audit adjustments in excess of our reporting threshold for the Council of £155,000 have been identified up to the date of this report, as discussed further on page 30. It should be noted that the adjustment relating to the pension liability (£2.522m) is as a result of a post balance sheet event rather than an error by management. The net impact of audit adjustments is to reduce the General Fund balance by £2.404m (with a corresponding increase in the Housing Revenue Account of £1.658m and Capital Fund of £0.746m). We identified 9 disclosure deficiencies in the Council's accounts, set out on page 31.

One audit adjustment has been identified in relation to the audit of Shetland Leasing & Property Developments Ltd ('SLAP'), set out on page 32. This had the effect of reducing equity by £1.55m.

A further 2 audit adjustments in excess of our reporting threshold for the group of £158,000 have been identified, set out on page 33. We identified 2 disclosure deficiencies in the group accounts, set out on page 34.

Our audits of Zetland Educational Trust ('ZET') and SLAP are substantially complete, as discussed further on page 17 and page 18. An unmodified opinion is expected to be issued for ZET.

As management intend to liquidate SLAP in 2019/20, it is no longer a going concern. Our audit opinion includes an emphasis of matter to confirm that, in forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in the notes to the financial statements, which explains that the financial statements have been prepared on a basis other than that of a going concern.

Status of the financial statements audit

Outstanding matters to conclude the audit include:

- Receipt of signed management representation letter; and
- Our review of events since 31 March 2019.

Conclusions on audit dimensions

As set out on page 3, our audit work covered the four audit dimensions. This incorporated the specific risks highlighted by Audit Scotland, in particular, the impact of EU withdrawal, the changing landscape for public financial management, dependency on key suppliers, care income and increased focus on openness and transparency.

Our detailed interim report, presented to the Committee in June 2019, set out our findings and conclusions on each dimension. We have updated this for any significant changes since that report and our overall conclusion on each dimension is summarised on page 5 and 6.

Introduction (continued)

The key messages in this report (continued)

Conclusions on audit dimensions (continued)

Financial sustainability – The Council is not in a financially sustainable position. While the Council is aware of its funding gap in the short-to-medium term and is taking action to address this, it has planned an unsustainable draw on reserves of £3.5m to address the funding gap in 2019/20 and has not identified the savings required to close the £15.6m funding gap by 2023/24. We consider the medium-term funding gap identified by the Council to be optimistic and underestimates the significance of the funding gap by approximately 40%. The Council needs to prioritise and progress transformational change, considering alternative methods of service delivery or taking difficult decisions such as changes to the level of service provided in order to reach a financially sustainable position in the medium-to-longer term.

Financial management – The Council generally has effective financial management processes in place. However, there is room for improvement in the budget setting process and the reporting of progress against budget and changes to the budget in year. There are particular concerns with the ability of the Council to budget for and deliver capital projects on time and on budget, having not delivered over £54m (30%) of projects between 2012/13 – 2018/19. To improve financial management, the Council should review the structure of its finance function and consider adopting a business partnering model. Given recent changes in key financial posts, the Council needs to consider the training provided to its finance function.

Governance and transparency – The Council promotes a culture of openness and transparency, although there is room for improvement and the Council needs to adopt an approach of always 'striving for more'. While attendance at meetings is good, scrutiny could be improved through better sharing of Council business workload and the development of tailored training plans for Members.

The Council needs to significantly improve its approach to self assessment. It should develop a self assessment programme and assign a specific officer with responsibility for ensuring the Council has adequate self assessment arrangements in place.

The Council is not meeting all of its obligations under the Community Empowerment Act. It needs to develop and document its community empowerment arrangements, provide training to Members and officers on what empowerment means, and work to develop community capacity.

Value for money – While the Council's performance continues to fare well against the national average, this comes at substantial financial cost to the Council. Given the current financial position, the Council needs to consider the targets it sets and outline what it considers acceptable performance in lower-priority areas, ensuring such decisions are made through engagement with the wider community. When preparing its budget, the Council should make clear links to outcomes and outline how spend is improving outcomes or how spend will be reduced in areas that are not.

Substantial improvements are needed in relation to performance monitoring. The Council should report on an annual basis on the indicators it intends to monitor in the coming year, the targets for each quarter, and the target for the corresponding period in the previous year. This will enable Members to assure themselves that the Council is appropriately focused on continuous improvement.

The Council has numerous disparate improvement plans. Going forward, a clear and concise annual Improvement Plan should be reported to the Council to monitor performance Council-wide. This Improvement Plan should be informed by service self-assessments, stakeholder surveys and national reports.

Introduction (continued)

The key messages in this report (continued)

Conclusions on audit dimensions (continued)

Value for money (continued) – The Council needs to work with its partners in the NHS and Integration Joint Board ('IJB') to address the issues facing the IJB, which can be progressed through a review of the Integration Scheme required by mid 2020.

We considered that if appropriately managed, progressed and monitored, the Council should achieve value for money from the decision to purchase SLAP and progress with the College Merger. Since the issuing of our interim report, a number of issues with the acquisition of SLAP have arisen from which lessons must be learned to ensure value for money in future projects, as discussed on page 27.

Our conclusions are included on pages 24 to 27 of this report, with the detailed findings and agreed Action Plan included in our interim report in June 2019. Management have agreed to all the recommendations in the Action Plan and are in the process of implementing them.

We will consider progress with the agreed actions as part of our 2019/20 audit.

Added value

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

This is provided throughout this report, our Interim Report and the Sector Development paper presented in June 2019. In particular we have added value through our work with the Council on its Business Transformation Programme ('BTP') and Service Redesign Programme ('SRP'), sharing best practice in this area. We also believe that our input has encouraged a constructive discussion of the Council's approach to openness and transparency and how it works to improve outcomes for local residents.

Pat Kenny
Audit Director

Our audit explained

Area dimensions

In accordance with the 2016 Code of Audit Practice, we have considered how you are addressing the four audit dimensions:

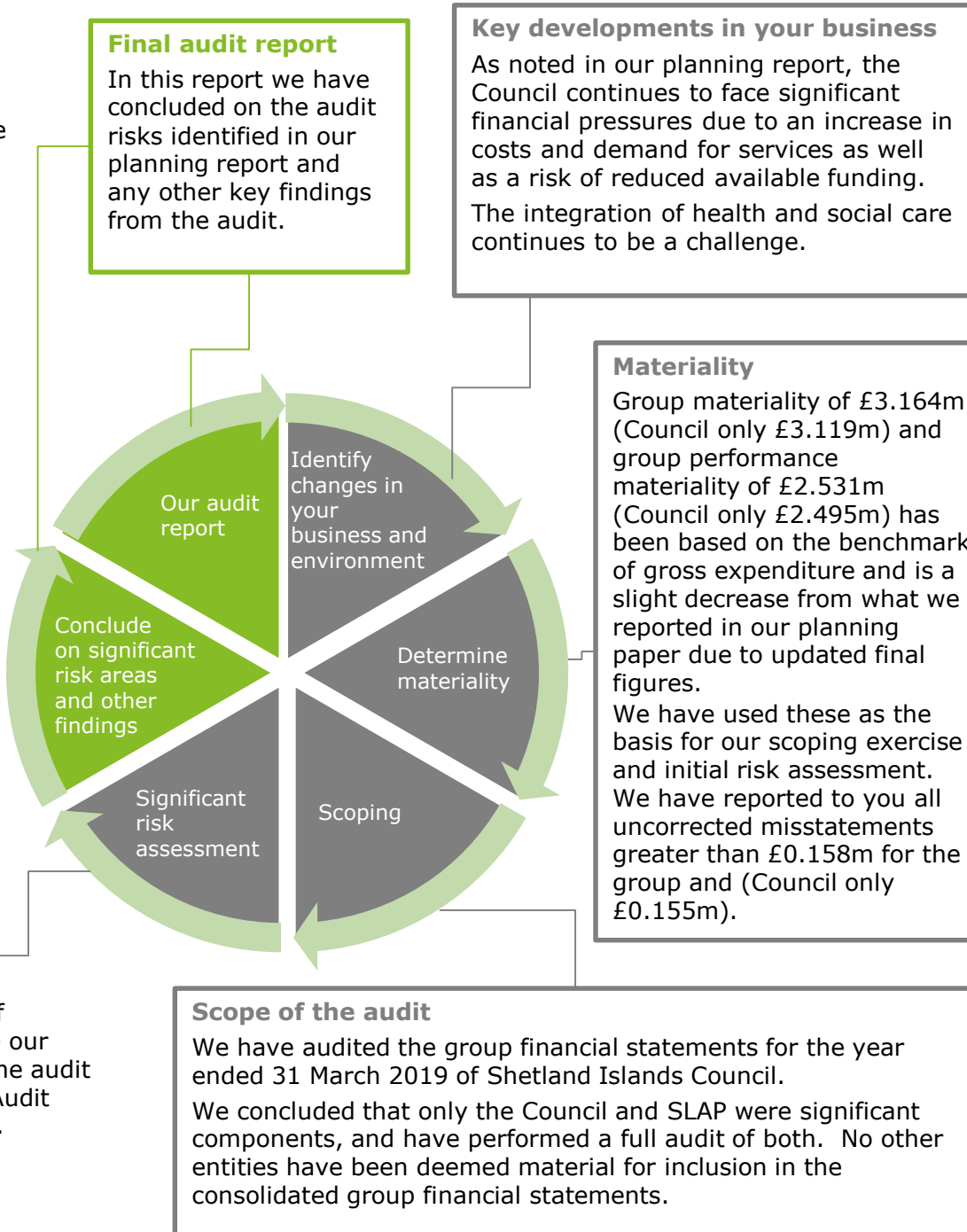
- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

Significant risks

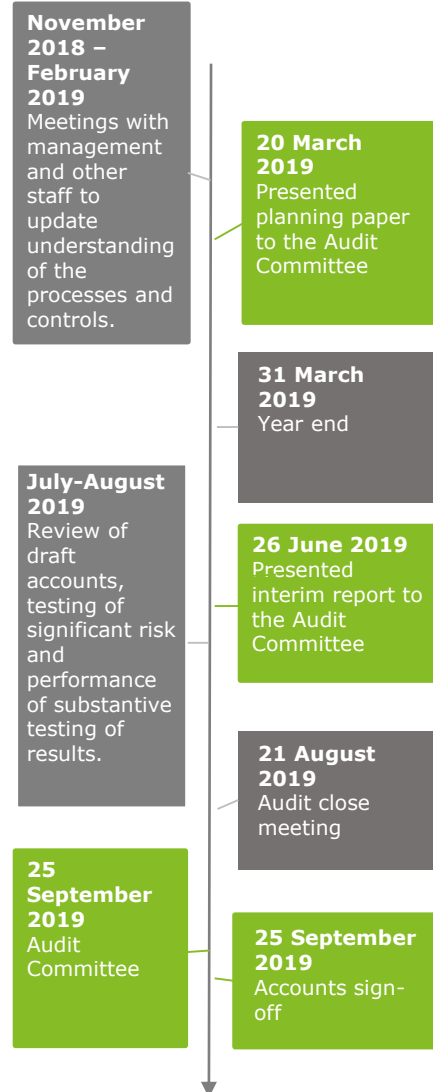
Our risk assessment process is a continuous cycle throughout the year. Page 9 provides a summary of our risk assessment of your significant risks.

Quality and Independence

We confirm we are independent of Shetland Islands Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.












Timeline 2018/19



Financial statements audit



Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Comments	Slide no.
Recognition of grant income			D+I	Satisfactory		Satisfactory	10
Valuation of property assets*			D+I	Satisfactory		Satisfactory	11
Management override of controls*			D+I	Satisfactory		Satisfactory	12

* These risks apply to the audits of both the Council and SLAP

Overly prudent, likely to lead to future credit      Overly optimistic, likely to lead to future debit.

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

Significant risks (continued)

Risk 1 - Recognition of grant income

Risk identified

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

Key components of income for the Council are summarised in the table below. The revenue support grant and non-domestic rates income are directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%. Council tax and housing rent income are set through the annual budget process with no management judgement and therefore have a low risk of fraud. Similarly, other service income includes fees and charges across all Services, which are set through formal approval processes, with no history of fraud or error. The significant risk is therefore pinpointed to the recognition of grant income, comprising capital grants and contributions, and grants credited to services.



Key judgements and our challenge of them

Grant income is a significant risk due to:

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



Deloitte response

We have performed the following:

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

Deloitte view

We have concluded that grant income has been correctly recognised in accordance with the requirements of the Code of Practice on Local Authority Accounting. One error has been identified (£2.092m), as detailed on page 31, whereby service income was not disclosed as a grant, however this is simply a disclosure misstatement and the income has been correctly recognised in the Comprehensive Income and Expenditure Statement (CIES).

Type of income	2018/19 (£m)	Significant risk
<u>Taxation and Non-Specific Grant Income</u>		
Council tax income	9.372	
Non domestic rates	23.851	
Revenue support grant	56.727	
<i>Capital grants and contributions</i>	6.461	✓
<u>Service Income</u>		
<i>Grants credited to services</i>	18.263	✓
Housing Benefit Subsidy	3.137	
Housing Revenue Account	6.965	
IJB commission income (book entry)	22.553	
Harbour Account	30.237	
Other Service Income	15.314	
Total Service Income	96.469	

Significant risks (continued)

Risk 2 - Valuation of property assets

Risk identified

The Council is required to hold property assets within Property, Plant and Equipment at a modern equivalent use valuation. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value. In the prior year audit, an internal control deficiency in relation to the valuation of property assets was identified relating to segregation of duties in the valuation process.

The same significant risk applies to SLAP and the group accounts.



Key judgements and our challenge of them

The Council held £273.338m of property assets at 31 March 2019. The financial year to 31 March 2019 represented year two of a five year rolling programme in which 20% of the portfolio were revalued along with 100% of Council dwellings. Due to prevailing market conditions, there was an overall revaluation gain in the year.

SLAP held £14.992m of investment properties at 31 March 2019. The full portfolio was revalued in the year – in addition to SLAP's property, plant and equipment.

- We involved the use of our internal property specialists to review and challenge the assumptions and methodology adopted by the council's internal valuation specialists, including sample testing of inputs to the valuation; and
- For valuations performed prior to the year end, where the valuer confirms to the Council that there are no significant differences between the valuation date and 31 March 2019, we have challenged whether any potential impact of a "Brexit shock" has been included and concluded that it is reasonable not to include.



Deloitte response

- We assessed management's controls around the valuation of property assets;
- We reviewed the revaluations performed in the year and assessed whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified independent individuals;
- We tested a sample of revalued assets and re-performed the calculation assessing whether the movement has been recorded through the correct line of the accounts; and
- We considered material changes in assets not subject to full revaluation during the year.

Deloitte view

We have concluded that the net book value of the Council's property assets is not materially misstated. The Council's valuation assumptions are generally reasonable, in line with other Councils and fall within our expected range.

For SLAP, we have concluded that the valuation of investment properties was overstated by £1.55m, as highlighted on page 32. This has been corrected by management.

For the group, we have concluded that the valuation of investment properties was overstated by £10.561m, with property, plant and equipment understated by £9.115m. This was due to an incorrect basis of valuation being adopted, as set out on page 33. This has been corrected by management.

Significant risks (continued)

Risk 3 - Management override of controls

Risk identified

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



Deloitte response

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

- the Council's results throughout the year were projecting overspends in the year. This was closely monitored and whilst projecting overspends, the underlying reasons were well understood; and
- senior management's remuneration is not tied to particular financial results.

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

Significant and unusual transactions

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

Journals

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

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

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

Accounting estimates (see next page)

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

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

We tested accounting estimates and judgements including goodwill, investments, the pension liability, valuation of property assets, valuation of fishing quota, provisions and consideration of any adjustments required for the transition to the new standards (IFRS 15 Revenues from contracts with customers and IFRS 9 Financial Instrument), focusing on the areas of greatest judgement and value. Our procedures included comparing amounts recorded or inputs to estimates to relevant supporting information from third party sources.

Deloitte view

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

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

We have identified errors in the determination of goodwill in the Group accounts of £1.61m, as set out on page 33. Adjustments to valuations of property assets and pensions are discussed further on page 11 and 15 respectively.

Significant risks (continued)

Risk 3 - Management override of controls (continued)

Key judgements

The key judgment in the financial statements are those which we have selected to be the significant audit risks around the recognition of grant income (page 10) and valuation of property assets (page 11). While not considered to be a significant audit risk, we have considered the assumptions used to calculate the pension liability (page 15). In the table below, we set out our challenge of the assumptions used in the determination of the value of fishing quota, investments, provisions and expected credit loss. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

As part of our work on this risk, we reviewed and challenge management's key estimates and judgements including:

Estimate / judgement	Details of management's position	Deloitte Challenge and conclusions
Investments	The Council holds investments at fair value, with valuations provided to the Council by independent fund managers. When the fair value of financial assets and liabilities cannot be measured based on quoted prices in active markets (i.e. Level 1 inputs), their fair value is measured using valuation techniques. Where possible, the inputs to these valuation techniques are based on observable data, but where this is not possible judgement is required in establishing fair values. These judgements typically include considerations such as uncertainty and risk.	Investments are managed by external fund managers, with the valuation of investments provided by them independently. While the balance sheet value is material, the Council only records what they are advised by the independent fund managers in terms of valuations and gain/losses on disposals. The Council have little scope to manipulate the balances as the fund managers provide monthly reports with a comprehensive breakdown of additions, disposals and revaluations. After consultation with financial instrument experts to review the assumptions and valuations performed by the fund managers, as well as agreeing the valuation of investments to third party evidence or developing a point estimate based on adjusted net asset values, we concluded that management's estimates are within a reasonable range.
Fishing Quota	The Council holds a substantial amount of fishing quota, leased to third parties for use in the year. The valuation of fishing quota is performed by an independent expert. The price that quota attract is affected by the quantity of Fixed Quota Allocation Units (FQAs) in the market.	All valuations are completed by an external expert. Deloitte are satisfied that the independent valuer is suitably competent and has the capabilities to carry out a valuation of the fishing quotas held by the Council. We have assessed management's expert and developed an independent estimate of the value based on information obtained from the active market in the year. We have also assessed the Council's valuation against fishing quota held by similar local authorities and assessed the movement against the movement in the market in the year. We have concluded that fishing quota are held at a reasonable value.

Significant risks (continued)

Risk 3 - Management override of controls (continued)

Estimate / judgement	Details of management's position	Deloitte Challenge and conclusions
Provisions	<p>The total provisions held within the Council's balance is material, at £3.972m. The balance is primarily comprised of the pension cessation costs as a result of the Shetland College, Train Shetland and NAFC merger, accounting for £3.271m. The calculation of this amount has been determined by the Council's independent actuary.</p>	<p>We examined the rationale for each provision, including a retrospective review of amounts provided in 2017/18. We have also challenged the completeness of the provisions made through discussion with the Council's legal advisors.</p> <p>For the pension cessation costs, we confirmed that the calculation was provided by the same actuaries we assessed for the pension liability. We have confirmed that the amount recorded by the Council is in line with the amount provided by the actuary.</p> <p>We concluded that the provisions made were reasonable.</p>
Expected credit loss (IFRS9)	<p>The risk of default across the classifications has been assessed by management as being low. 39% of the Council's debtors are with other public bodies for which there is no expected credit loss. For the remaining 61% of debtors – representing £9.72m at the year end – an expected credit loss of £0.27m (2.8%) has been posted by the Council.</p>	<p>We have confirmed that it is appropriate in line with the Code to consider that amounts owing by public bodies do not have any expected credit loss. We have assessed the historic bad debt and write-offs of amounts owing to the Council and developed an independent point estimate, which was in line with the amount provided by the Council. We are therefore satisfied that the estimate is reasonable.</p>

Other matters

Defined benefits pension scheme

Background

The Council participates in two defined benefits schemes:

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

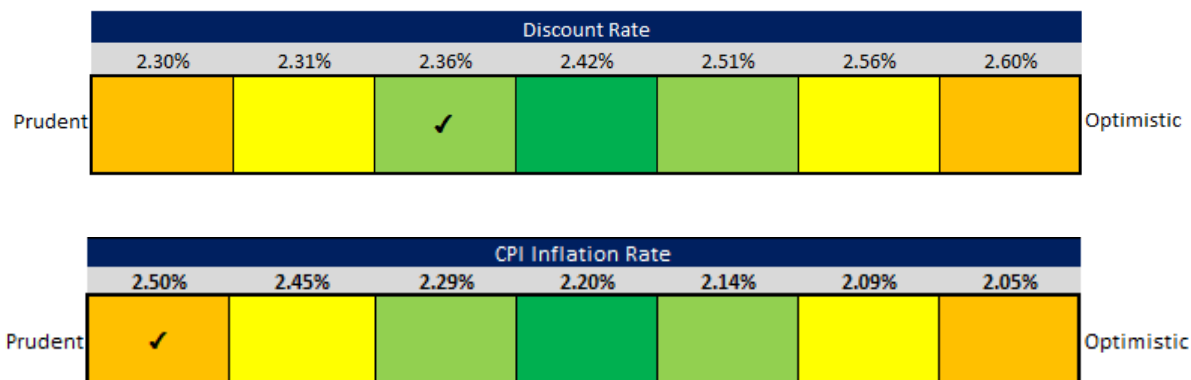
After taking into account the adjustment noted on the following page in relation to the McCloud judgement, the net pension liability has increased from £165.171m in 2017/18 to £209.906m in 2018/19. The increase is as a result in changes in assumptions, specifically the discount rate has reduced and salary increase rate has increased, together with the impact of McCloud.



Deloitte response

- We obtained a copy of the actuarial report produced by Hymans Robertson, the scheme actuary, and agreed in the disclosures to notes in the accounts;
- we reviewed and challenged the assumptions made by Hymans Robertson, including benchmarking as shown the table opposite;
- we assessed the reasonableness of the Council's share of the total assets of the scheme with the Pension Fund financial statements;
- we have reviewed and challenged the calculation of the impact of the McCloud case and GMP on pension liabilities;
- we reviewed the disclosures within the accounts against the Code; and
- we assessed the independence and expertise of the actuary supporting the basis of reliance upon their work.

	Council	Benchmark	Comments
Discount rate (% p.a.)	2.4	2.42	Reasonable, slightly prudent
Consumer Price Index (CPI) Inflation rate (% p.a.)	2.5	2.2	Prudent
Salary increase (% p.a.) (over CPI inflation)	0.6	Council specific	Reasonable
Pension increase in payment (% p.a.)	2.5	2.25	Prudent
Pension increase in deferment (% p.a.)	2.5	2.2	Prudent
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	22.1	21.70	Reasonable, slightly prudent
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	23.9	23.60	Reasonable, slightly prudent



Other matters (continued)

Defined benefits pension scheme (continued)

Impact of McCloud ruling

Two employment tribunal cases were brought against the Government in relation to possible discrimination in the implementation of transitional protection following changes made to public service pension scheme legislation in 2014. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

In December 2018, the Court of Appeal ruled that the transitional protection gave risk to unlawful discrimination on the basis of age. The Government requested leave to appeal the decision to the Supreme Court, however the request was denied on 27 June 2019. As a result, certain scheme members will need to be compensated for any discrimination suffered as a result of the transitional protections. As Scottish Public Service Pension Schemes implemented the changes to the legislation in 2015, this may impact benefits accrued from 1 April 2015 for these members.

The Council's actuary has provided an updated results schedule which included an allowance for the additional liability potentially arising as a result of the McCloud ruling. This has resulted in an audit adjustment of £2.522m for past service costs (approximately 1.2% of the pension liability) arising from this post balance sheet event.

The calculation of this amount was based on the Government Actuary Department's analysis, adjusted for local circumstances. Based on the limited information available, the amount appears reasonable.

Impact of Guaranteed Minimum Pension (GMP) indexation

In order to ensure smooth transition to the single tier State pension and equalisation of GMP benefits between males and females, the Government introduced an interim solution in 2016 in respect of people, who are in public service pension schemes and who have a State Pension Age (SPA) between 6 April 2016 and 5 December 2018, where full inflationary increases will be provided by the scheme.

In January 2018, this interim solution was subsequently extended to members who reach SPA between 6 December 2018 and 5 April 2021.

Details of any permanent solution are still unknown.

No allowance has been made for the potential additional liability in respect of GMP indexation. We have not seen many schemes allowing for GMP indexation due to the uncertainty regarding the permanent solution, however we note that Hymans Robertson LLP have made allowance for other Scottish LGPS. Therefore, not making an allowance for GMP indexation is reasonable.

Deloitte view

On the whole, the set of assumptions is reasonable and lies towards the prudent end of the reasonable range when compared with the Deloitte benchmarks. The assumptions have been set in accordance with generally accepted actuarial principles and are compliant with the accounting standard requirements of IAS 19.

The allowances made for the McCloud ruling are reasonable and within the expected range. The decision not to include any allowance for GMP does not result in the pension liability being outwith a reasonable range and therefore no error has been identified.

Other matters (continued)

Charitable trusts

Risk identified

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

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



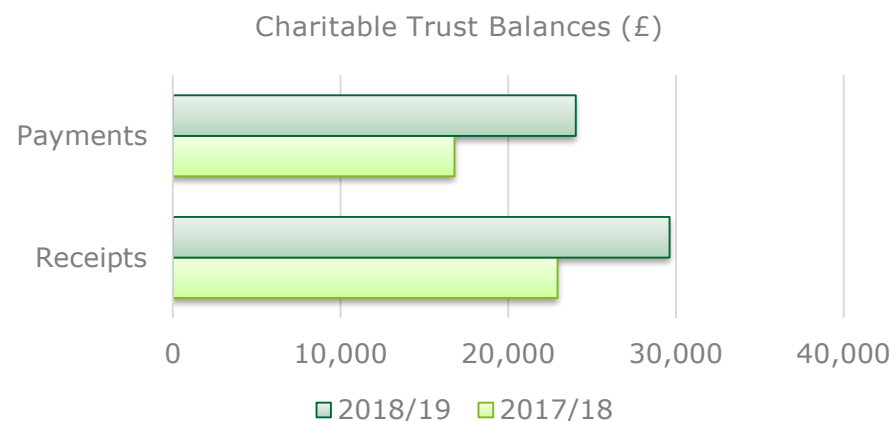
Deloitte response

We have assessed that the Statement of Receipts and Payments and the Statement of Balances to ensure these have been prepared in accordance with the Charities Accounts (Scotland) Regulations 2006. A couple of disclosure issues were identified, relating specifically to the naming of Trustees and the signing of the accounts, which were corrected by management.

A summary is provided in the table adjacent. We note that there has been very little movement in the Trust over the last 12 months, with the movements largely relating to interest from investments held.

Deloitte view

Following adjustments made arising from audit of Zetland Educational Trust's accounts for the year, we are satisfied that they have been correctly accounted for in accordance with the Regulations.



Other matters (continued)

SLAP

Risk identified

In August 2018, the Council approved a decision in principle to purchase SLAP. The agreement to purchase was finalised in October 2018. In April 2019, the Council hived up the company into the Council, with the company being expected to be dissolved in 2019/20.

The acquisition of SLAP required to be accounted for in line with IFRS 3 Business Combinations. There are numerous complex accounting entries and legal requirements involved in the acquisition, including but not limited to consideration of goodwill or bargain purchase amounts, legal compliance requirements in hiving up the reserves of SLAP and revaluing SLAP's investment properties which become operational on transfer to the Council. Given that SLAP remained an active company as at 31 March 2019, the Council is required to prepare consolidated annual accounts for 2018/19, including additional disclosures in the accounts for group accounting purposes.

Despite involving substantial complexity, this has not been identified as a significant risk given that the valuation of properties is addressed through our significant risk on valuation of property assets (page 11) and there is immaterial goodwill or bargain purchase arising on the acquisition.

Deloitte response – SLAP

- SLAP performed an independent valuation of its investment property portfolio. This was then subjected to review and challenge by our independent experts. Based on this work, an impairment in the value of properties held by SLAP of £1.55m was identified, as set out on page 11.
- We assessed the steps taken by management to reduce SLAP's share capital and increase its reserve by a corresponding amount, confirming all steps required by legislation were appropriately completed.
- We performed a full audit of SLAP's accounts, with adjustments as set out on page 32.

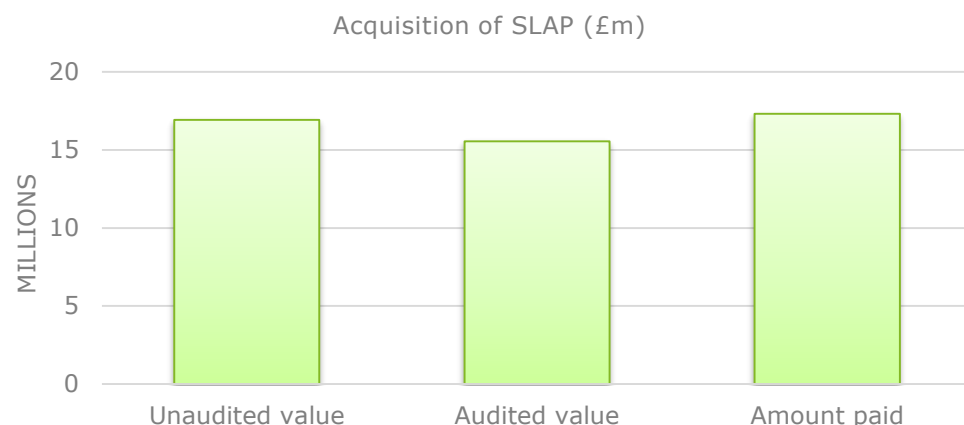
Deloitte response – Council

- We recalculated the goodwill recorded by the Council on the acquisition of SLAP, which is the premium paid by the Council above the fair value of the company. The amount recorded by the Council (£0.16m) was calculated incorrectly, with an adjustment of £1.61m to record the amount correctly being posted (page 33).
- We assessed the disclosures in the Council's accounts with regards to the acquisition of SLAP and following changes arising during audit, are satisfied that these comply with requirements.
- We have considered the impacts of the adjustments to the fair value of SLAP and the acquisition and implementation process on value for money at page 27.
- We have reviewed the Council's fixed asset register and lease disclosures to ensure assets are not double counted.

Deloitte view

An emphasis of matter, which does not modify our audit opinion, will be included in the audit report for SLAP given that it is no longer a going concern. See page 27 for our consideration of the impact of the adjustments on value for money. See page 32 for SLAP adjustments and page 33 for group adjustments.

Following these adjustments being corrected by management, we are satisfied that the Council has correctly accounted for the acquisition of SLAP.



Other matters (continued)

Implementation of IFRS 9 and IFRS 15

Matter identified	<p>The Council was required to adopt the new accounting standards IFRS 9 <i>Financial Instruments</i> and IFRS 15 <i>Revenues from contracts with customers</i> in the year ended 31 March 2019. In both cases, the Council is using a modified retrospective approach to implementation where effectively the cumulative impact of transition to 1 April 2018 is posted as an adjustment to reserves. The Council has posted no retrospective adjustments with regard to IFRS 15 as there is no material impact on the financial statements. For IFRS 9, the Council has transferred the Available for Sale Financial Instruments Reserve to the General Fund from 1 April 2018, by recycling accumulated gains through the CIES.</p>
Response	<p>Management prepared papers and held discussions regarding the accounting impact of the new standards on the Council for the period and determined that the impact of IFRS 15 is immaterial, whereas IFRS 9 is material.</p> <p>The key element impacted by IFRS 9 is the accounting for the bad debt provision, which must move to a methodology of expected credit losses. A practical expedient available for portfolios of debt is to use a matrix based on past experience, and modified in specific cases where more information is available, in order to provide at a suitable percentage.</p> <p>IFRS 9 also introduced changes in the recording of gains and losses on long-term investments. This resulted in the Council's accumulated gains being recycled through the CIES in the year, with accumulated gains now sitting in an earmarked reserve in the General Fund. All future movements in investments will be recorded in the CIES.</p> <p>Regarding IFRS 15, officers were satisfied that no transitional adjustments would be required as the Council's larger sources of income including grant income, rents and taxation are outside of the scope of the standard and in other income streams which fall within the scope of IFRS 15 there are no material performance obligations which span the year end. This is consistent with a general expectation for local authorities which have not entered into material unusual transactions.</p> <p>Both IFRS 9 and IFRS 15 include disclosure changes, with these being actioned by the Council.</p>

Deloitte view



The Council has correctly accounted for the impact of IFRS 9 and IFRS 15. We are satisfied that, following changes made during the audit process, the Council's accounts comply with the Code requirements in respect of disclosures for these new standards. Management are to be commended for their detailed papers on the new standards and their impact on the Council.

Through our detailed analysis of income to assess the impact of the application of IFRS 15, we identified errors in the disclosure of grant income of £2.092m, the failure to remove internal recharges (£0.7m) as required by a change in the Code and the recording of the use of reserves (£0.2m). These errors are set out in detail on pages 30 and 31 and have been corrected by management.

Other significant findings

Internal control and risk management

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

Area	Observation	Priority
<p>Risk management: Preparation for IFRS 16</p>	<p>The implementation of IFRS 16, Leases, for 2020/21 is expected to have a greater and more complex impact upon most Councils than the adoption of IFRS 9 and 15. The scope and potential complexity of work required, which may require system or process changes to underpin correct accounting under the standard, will require work to be completed at a significantly earlier stage than has been the case for IFRS 9 and 15 to allow for financial reporting timetables to be met.</p> <p>As reported in our "Sector developments paper" presented to the Audit Committee in March 2019, the changes introduced by the standard will have substantial practical implications for Councils that currently have material leases, and also likely to have an effect on the capital financing arrangements of the authority. CIPFA/ LASAAC included a readiness assessment questionnaire in the consultation document which will help Councils consider their own preparedness.</p> <p>We recommend the Council targets completion of its IFRS 16 impact analysis during 2019/20, and to calculate an adjusted opening balance sheet position for audit following the 31 March 2020 audit. We recommend early consideration following the impact analysis of actions required to embed IFRS 16 accounting in the Council's underlying accounting systems.</p>	
<p>Internal control: Review of financial statements</p>	<p>Through our audit work, a substantial number of errors were identified (pages 30 – 34) which arose primarily due to journals being missed and incorrect formulae being used to drive the financial statements. These errors are simple in nature and should have been picked up by the Council's internal review process prior to the publication of the unaudited financial statements. The Council needs to ensure that it has a more thorough internal review of the supporting working papers which are used in the preparation of the financial statements prior to their publication.</p>	

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

Low Priority

Medium Priority

High Priority

Our audit report

Other matters relating to the form and content of our report

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



Our opinion on the financial statements

Based on our work completed to date, our opinion on the financial statements is unmodified.



Material uncertainty related to going concern

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

While the Council is faced with financial sustainability issues (as discussed on page 25), it achieved a balanced budget in 2018/19. There is also a general assumption set out in Practice Note 10 (Audit of financial statements of public sector bodies in the United Kingdom) public bodies will continue in operation, therefore it is appropriate to continue as a going concern.



Emphasis of matter and other matter paragraphs

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



Other reporting responsibilities

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

Our opinion on matters prescribed by the Controller of Audit are discussed further on page 22.



Your annual report

We are required to provide an opinion on the auditable parts of the remuneration report, the annual governance statement and whether the management commentary has been prepared in accordance with the statutory guidance..

	Requirement	Deloitte response
Management Commentary	The management commentary comments on financial performance, strategy and performance review and targets. The commentary included both financial and non financial KPIs and made good use of graphs and diagrams. The Council also focusses on the strategic planning context.	<p>We have assessed whether the management commentary has been prepared in accordance with the statutory guidance.</p> <p>We have also read the management commentary and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p> <p>Following amendments made during the course of the audit – in relation to including KPIs, links to outcomes and updating narrative to ensure that it is fair, balanced and understandable – we are satisfied that the management commentary has been prepared in accordance with guidance, is consistent with our knowledge and is not otherwise misleading.</p>
Remuneration Report	The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior councillors and Senior Employees of the council.	We have audited the disclosures of remuneration and pension benefits, pay bands, and exit packages and apart from a disclosure misstatement, which is highlighted on page 31 and which has been corrected, we can confirm that they have been properly prepared in accordance with the regulations.
Annual Governance Statement	The Annual Governance Statement reports that Shetland Islands Council governance arrangements provide assurance, are adequate and are operating effectively.	We have assessed whether the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts regulations. We have required management to make changes in light of the findings of our interim report issued in June 2019, but are satisfied following these changes that the Annual Governance Statement is consistent with the financial statements, our knowledge and the accounts regulations.

Audit dimensions



Audit dimensions

Overview

Public audit in Scotland is wider in scope than financial audit. This section of our report sets out our conclusions on our audit work covering the following area, with our detailed findings and conclusions reported to the Audit Committee in June 2019 as part of our [Interim Report](#). Our report is structured in accordance with the **four audit dimensions**, but also covers our specific audit requirements on strategic audit priorities, best value, statutory performance indicators and specific risks as summarised below.



Audit Dimensions

Strategic Audit Priorities

As set out in our Annual Audit Plan, the Accounts Commission sets out five Strategic Audit Priorities that are built into audit expectations, as follows:

- Having clear priorities with a focus on outcomes, supported by effective long term planning
- Demonstrating the effective appraisal of options for changing how services are delivered in line with their priorities
- Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future
- Empowering local communities and involving them in the design and delivery of local services and planning for their local area
- Reporting the council's performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.

Best Value (BV)

The BV framework follows a five year approach to auditing BV. 2018/19 represents year three of the BV audit plan. The Best Value Assurance Report (BVAR) report for Shetland Islands Council is planned for year five in the five-year programme (i.e. 2020/21). The BV audit work in 2018/19 was integrated into our audit approach, including our work on the audit dimension.

Statutory Performance Indicators

We have assessed the suitability of the arrangements for preparing and publishing the information, closely linked to our work on the Strategic Audit Priority "Reporting the council's performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes".

Specific risks

As set out in our Annual Audit Plan, Audit Scotland had identified a number of specific risks faced by the public sector which we have considered as part of our work on the four audit dimensions.

- EU Withdrawal
- Changing landscape for public financial management
- Care income, financial assessments and financial guardianship
- Dependency on key suppliers
- Openness and transparency

Our conclusions on the above were reported in our [Interim Report](#) to the Audit Committee in June 2019.

In relation to EU Withdrawal, we have received assurance that the Council continues to maintain a watching brief on developments and plan as far as possible in response to changes.

Audit dimensions (continued)

Financial sustainability and financial management

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Key facts:

2018/19 financial position

- £15.31m use of reserves (£4.83m under budget)

2019/20 financial position

- £17.57m use of reserves planned for 2019/20

Medium-term financial position

- £15.6m recurring savings needed by 2023/24

Overall conclusions

The Council has achieved short-term financial balance but over the medium to longer term is not in a financially sustainable position. The Council has planned an unsustainable draw on reserves of £3.5m to address the funding gap in 2019/20 and has not identified the savings required to close the £15.6m funding gap by 2023/24.

The medium-term funding gap identified by the Council is optimistic and underestimates the significance of the funding gap by approximately 40%. The Council needs to prioritise and progress transformational change, considering alternative methods of service delivery or taking difficult decisions such as changes to the level of service provided in order to reach a financially sustainable position in the medium-to-longer term.

Our review of capital budgeting and spend raises questions about the achievability of the Council's Asset Investment Plan and the robustness of its capital budgeting process. For each capital project planned, the Council needs to clearly outline the due dates for projects and their original budgeted cost, with an annual report outlining any changes to the planned due date and budgeted cost, documenting which projects have been completed and at what cost. Management have accepted the above points and the related recommendations as set out in our Interim Report, and are progressing action on them in 2019/20.

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Key facts:

2018/19 budget

- Original budgeted expenditure of £107.71m
- Savings of £0.41m achieved, against budgeted savings of £1.94m
- Overspends reported during the year across the Council
- Regularly reported to management and Members

Overall conclusions

The Council generally has effective financial management processes in place. There is room for improvement in the budget setting process and the reporting of progress and changes in year. The Council also needs to better align its budget with its Corporate Plan, making clear how the budget progresses the Council's priorities. Management have accepted this recommendation and are making progress on it in 2019/20.

To improve financial management, the Council should review the structure of its finance function and consider adopting a business partnering model. Management have confirmed they will review this option.

We note that issues raised in relation to the NFI exercise in 2016/17 have arisen again in the 2018/19 exercise, in relation to prioritisation, resourcing and responsible officers. The Council needs to put plans in place this year to ensure these issues do not recur for the 2020/21 exercise. Management have confirmed they will address these issues for 2020/21.

The Council has changed internal auditors in the year, given the retirement of its Chief Internal Auditor. The internal audit function is now provided by 'Audit Glasgow', the internal audit service in Glasgow City Council. The transition has been well managed.

Audit dimensions (continued)

Governance and transparency and value for money

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

Key facts:

- High attendance at Council meetings
- Consistent leadership team in place at the Council

Overall conclusions

The Council promotes a culture of openness and transparency, although there is room for improvement and the Council needs to adopt an approach of always 'striving for more'. While attendance at meetings is good, scrutiny could be improved through better sharing of Council business workload and the development of tailored training plans for Members.

The Council needs to significantly improve its approach to self assessment. It should develop a self assessment programme and assign a specific officer with responsibility for ensuring the Council has adequate self assessment arrangements in place.

The Council is not meeting all of its obligations under the Community Empowerment Act. It needs to develop and document its community empowerment arrangements, provide training to Members and officers on what empowerment means, and work to develop community capacity.

Value for money is concerned with using resources effectively and continually improving services.

Key facts:

- The Local Government Benchmarking Framework shows an increase in 30 indicators, decrease in 28 indicators and no change in 18 indicators in 2017/18 compared to 2016/17.
- A number of performance issues have been highlighted by the Housing Regulator in relation to homelessness services.

Overall conclusions

While the Council's performance continues to fare well against the national average, this comes at substantial financial cost to the Council. Given the current financial position, the Council needs to consider the targets it sets and outline what it considers acceptable performance in lower-priority areas, ensuring such decisions are made through engagement with the wider community. When preparing its budget, the Council should make clear links to outcomes and outline how spend is improving outcomes or how spend will be reduced in areas that are not.

Substantial improvements are needed in relation to performance monitoring. The Council should report on an annual basis on the indicators it intends to monitor in the coming year, the targets for each quarter, and the target for the corresponding period in the previous year. This will enable Members to assure themselves that the Council is appropriately focused on continuous improvement.

The Council has numerous disparate improvement plans. Going forward, a clear and concise annual Improvement Plan should be reported to the Council to monitor performance Council-wide. This Improvement Plan should be informed by service self-assessments, stakeholder surveys and national reports.

Audit dimensions (continued)

Governance and transparency and value for money (continued)

Value for money is concerned with using resources effectively and continually improving services.

Overall conclusions (continued)

The Council needs to work with its partners in the NHS and Integration Joint Board ('IJB') to address the issues facing the IJB, which can be progressed through a review of the Integration Scheme required by mid 2020.

We considered that if appropriately managed, progressed and monitored, the Council should achieve value for money from the decision to purchase SLAP and progress with the College Merger. Since the issuing of our interim report, a number of issues with the acquisition of SLAP have arisen from which lessons must be learned to ensure value for money in future projects.

Acquisition of SLAP

In relation to the acquisition of SLAP, we noted in our Interim Report that:

"The Full Business Case for the acquisition of SLAP identifies a rate of return for the acquisition of 7.14%, with the net present value of the acquisition being in excess of £7m. The acquisition of SLAP will reduce annual lease expenditure of the Council by over £1.2m. Appropriate due diligence was performed which did not identify any issues with the approach or methodology used in the Full Business Case. While the acquisition of SLAP itself is not transformative, it enables the Council to explore transformative actions and to identify alternative models of service delivery given that it has much more control over its property base."

"The Full Business Case produced for the acquisition of SLAP demonstrate clear financial savings which can be made, identify positive changes to service delivery and provide assurance that if appropriately managed, progressed and monitored, value for money will be achieved."

"The Council needs to carefully monitor progress against these actions to ensure that benefits are realised, and a post-implementation benefits realisation analysis should be performed by the Council to ensure any areas of good practice and lessons learned are appropriately used in future. "

We have reviewed the acquisition and implementation of it during our financial statements audit and have made the following observations:

1. Completion accounts were not filed with the former parent entity within the agreed timeframe, resulting in the council being unable to recoup the difference between the amount paid and the fair value per the completion accounts as set out in the purchase agreement. This resulted in the Council failing to recoup £0.38m. We are aware that the Council is currently considering the impact and the recovery mechanism available to it in respect of this amount.
2. The due diligence performed on the completion accounts should have been more thorough. From our engagement of an independent expert, in discussion with the Council's internal valuer, we concluded that the value of SLAP's assets in the year-end (and completion accounts) was overstated by £1.55m. Had the Council undertaken independent valuations of SLAP's property portfolio prior to the acquisition, the price paid by the Council to acquire SLAP could have been up to £1.55m less.
3. The Council did not appropriately plan and resource the implementation of the acquisition and the subsequent hive up process, consequently failing to complete the hive up of SLAP by the year-end, resulting in assumed savings not being realised in the year and additional costs being incurred by the Council (in relation to professional fees, management time and audit costs).

These issues reduce the benefits anticipated by the business case developed for the purchase of SLAP. However, the Council will still benefit from the acquisition in the longer term. We are pleased to note that the Council has planned an internal 'lessons learned' debrief. These issues and their causes must be addressed to ensure that appropriate scrutiny is demonstrated by Members based on accurate and complete information and that value for money is obtained in future projects.

Appendices



Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

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

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

What we don't report

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

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

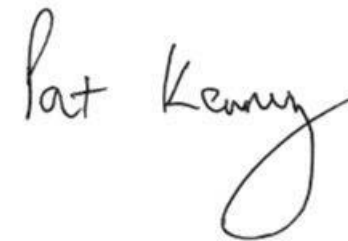
Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our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

The scope of our work

Our observations are developed in the context of our audit of the financial statements. We described the scope of our work in our audit plan and again in this report.

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

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



Pat Kenny

for and on behalf of Deloitte LLP
Glasgow

4 September 2019

Audit adjustments

Summary of Council corrected and uncorrected misstatements and disclosure deficiencies

Corrected misstatements

		Debit/ (credit) CIES £m	Debit/ (credit) MIRS £m	Debit/ (credit) in net assets £m	Debit/ (credit) reserves £m	If applicable, control deficiency identified
Misstatements identified in current year						
Classification of use of reserves as income	[1]	0.186	(0.186)	-	-	
Completeness of internal recharges	[2]	-	-	-	-	
Pensions – McCloud judgement	[3]	2.522	(2.522)	(2.522)	2.522	
Classification of reserves	[4]	-	-	-	-	
Total		2.708	(2.708)	(2.522)	2.522	Page 20

[1] In the year, the Council drew down £0.186m of its Community Care Reserve for services provided in the year. The correct recording of this is to simply incur the expenditure and the reserves will be reduced by the year-end deficit. This has no impact on the General Fund.

[2] The Council failed to exclude all internal recharges from its gross income and gross expenditure as required by a change in the Code in the year. The net impact on each line in the CIES and the CIES as a whole is £nil, but gross expenditure and gross income are both reduced by £1.810m.

[3] As discussed on page 16, the McCloud judgment has been confirmed as final following the Supreme Court's refusal of leave for the UK Government to appeal the ruling. This has resulted in the pension liability being adjusted to account for the impact of this judgment, with a corresponding increase in the pension reserve. The impact of this is a £2.522m increase in both the liability and the reserve. This has no impact on the General Fund.

[4] The Housing Revenue Account reserves in the Movement in Reserves Statement did not match the amount in the Housing Revenue Account statement. On investigation of the Integra system, it was noted that amounts relating to investment income and pension interest costs were incorrectly coded to the General Fund when they should have been coded to the Housing Revenue Account. An adjustment has been posted to correct for this. This reduces the General Fund by £1.658m (and increases the Housing Revenue Account by the same amount).

Uncorrected misstatements

No uncorrected misstatements have been identified from our audit work performed to date.

Audit adjustments (continued)

Summary of Council corrected and uncorrected misstatements and disclosure deficiencies (continued)

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable the Audit Committee to evaluate the impact of those matters on the financial statements. We have identified the following corrected disclosure misstatements:

Note	Description
Remuneration Report	Exit packages were misstated by £0.002m.
Remuneration Report	No disclosure of remuneration or accrued pension and pension contributions should be made for senior councillors and officers where they have not been remunerated in 2018/19.
CIES	The surplus on revaluation of available for sale financial instruments and amounts recycled on derecognition should not be included in Other Comprehensive Income and Expenditure following changes as a result of IFRS 9. This reduces the amount recorded by £2.524m.
Cash Flow Statement	A number of classification errors were identified, namely: 1. "Cash effects are investing or financing cash flows" being reduced by £0.745m, with "other receipts from investing activities" being increased by the same amount. 2. "Depreciation, impairment and revaluations" being reduced by £0.351m, with "other non-cash items" increasing by the same amount.
Note 12 – Grants Credited to Services	The Council received £2.092m of grants from the Shetland Charitable Trust in the year which should be disclosed as a grant credited to service. This replaced the previous partnering arrangement for the Rural Care Model.
Note 19 – Financial Liabilities	The fair value of financial liabilities was understated by £11.404m.
Note 28 – Operating Leases	The lease payment amounts for 2-5 years and more than 5 years were amended as follows: 1. Lessee – Reduce 2-5 years by £1.056m and increase more than 5 years by the same amount 2. Lessor – Reduce 2-5 years by £1.340m and increase more than 5 years by the same amount 3. Sublease – Reduces 2-5 years by £0.785m and increase more than 5 years by the same amount These amendments have a net £nil impact.
Note 32 – Related Parties	Transactions with North Atlantic Fisheries College need to be included, whereas those with SLAP do not need to be. The net effect of these adjustments is to reduce the amount disclosed by £0.194m.
Note 33 – Capital Financing	A classification error was identified whereby the "lease principal" figure was overstated by £1.796m with the "PFI contract principal repayments" being understated by the same amount.

Audit adjustments (continued)

Summary of SLAP corrected and uncorrected misstatements and disclosure deficiencies

Corrected misstatements

		Debit/ (credit) income £m	Debit/ (credit) reserves £m	Debit/ (credit) in net assets £m	If applicable, control deficiency identified
Misstatements identified in current year					
Property Valuation	[1]	-	1.55	(1.55)	
Total		-	1.55	(1.55)	

[1] Following review of the property portfolio of SLAP – including both investment properties and property, plant and equipment – our independent expert determined that the amounts recorded by management were overstated by £1.55m. Management’s valuer agreed. This resulted in assets being reduced by £1.55m and reserves by a corresponding amount.

Uncorrected misstatements

No uncorrected misstatements have been identified from our audit work performed to date.

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable the Audit Committee to evaluate the impact of those matters on the financial statements. We have noted no material disclosure deficiencies in the course of our audit work

Audit adjustments (continued)

Summary of Group corrected and uncorrected misstatements and disclosure deficiencies

Corrected misstatements

		Debit/ (credit) CIES £m	Debit/ (credit) MIRS £m	Debit/ (credit) in net assets £m	Debit/ (credit) reserves £m	If applicable, control deficiency identified
Misstatements identified in current year						
Goodwill on acquisition of SLAP	[1]	-	-	-	-	
Valuation of investment properties	[2]	-	-	(1.446)	1.446	
Total		-	-	(1.446)	1.446	Page 20

[1] The amount of goodwill recorded by the Council was incorrectly calculated. An adjustment of £1.611m was posted to correctly recognise the goodwill arising on the acquisition of SLAP. This reduces the investment value by the same amount.

[2] The Council did not originally value group-owned properties on the correct basis. A subsequent valuation was performed to correctly value operational assets, resulting in investment properties being reduced by £10.561m and property, plant and equipment being increased by £9.115m, with reserves being reduced by £1.446m.

Uncorrected misstatements

No uncorrected misstatements have been identified from our audit work performed to date.

Audit adjustments (continued)

Summary of Group corrected and uncorrected misstatements and disclosure deficiencies (continued)

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable the Audit Committee to evaluate the impact of those matters on the financial statements. We have identified the following corrected disclosure misstatements:

Note	Description
Note 28 – Operating Leases	<p>The lease payment amounts for less than 1 year, 2-5 years and more than 5 years were amended as follows:</p> <ol style="list-style-type: none">1. Lessee – Increase less than 1 year by £1.448m, 2-5 years by £4.505m and more than 5 years by £4.335m2. Lessor – Increase less than 1 year by £2.210m, 2-5 years by £7.421m and more than 5 years by £25.023m3. Sublease – Increase less than 1 year by £0.821m, 2-5 years by £3.285m and more than 5 years by £1.247m
Note 15 – Investment Properties	Reduce the amount of investment properties by £10.561m.

Action plan

Recommendations for improvement

Our interim report submitted to the Audit Committee in June 2019 reported our detailed recommendations arising from our work on the wider audit dimensions. In this report, we made 22 recommendations, as follows:

Wider audit dimension	Recommendations made
Financial sustainability	7
Financial management	5
Governance and transparency	8
Value for money	2

We have made three recommendations arising from our financial statements audit, as set out on page 36.

We will follow up these recommendations and report to the Audit Committee on progress as part of our 2019/20 audit.

In our interim report, we followed up on recommendations for improvement made in 2017/18 on the wider scope areas. The following page reports our follow up of the recommendation made in relation to the financial statements audit.

A summary of progress against 2017/18 actions has been included below. Of the 10 recommendations outstanding, 6 have an updated recommendation included above. Consequently, there are 26 total recommendations which we will follow up in our 2019/20 audit.

Area	Recommendations made	Recommendations implemented
Financial statements	2	2
Financial sustainability	4	1
Financial management	2	-
Governance and transparency	5	1
Value for money	3	2

Action plan (continued)

Recommendations for improvement (continued)

Recommendations for improvement arising from the wider scope work are included in the Interim Report, with a summary on the preceding page. The below recommendations arising from our financial statements work are also to be addressed.

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Valuation of property assets	<p>Where the Council's valuer is deviating from recognised third party data sources for build costs, the rationale for this and supporting evidence needs to be clearly set out.</p> <p>The Council should assess useful lives of housing stock in line with industry averages.</p> <p>The valuer should ensure that investment properties are valued net of Land & Building Transaction Tax, agent and legal fees.</p> <p>(See page 11 for details.)</p>	<p>Standard practice is to use published industry figures which are adjusted for location and date. Where the Council has deviated from the third party build costs, such deviations only occur where accurate and actual build costs for the same or similar properties are known to the Council from existing Council projects and is noted in the valuation commentary. The Council will ensure the justification for any deviation in the future is set out clearly and supported by appropriate evidence.</p> <p>In the future, the Council will assess the useful life of the housing stock at valuation in line with industry averages where applicable.</p> <p>The Council will ensure that the cost of sale and LBTT will be factored in to the valuation for investment properties in the future.</p>	Executive Manager – Capital Programmes	31/3/20	Medium
IFRS 16	<p>Given issues identified in the testing of operating leases both historically and in the current year, we recommend the Council targets completion of its IFRS 16 impact analysis during 2019/20, and to calculate an adjusted opening balance sheet position for audit following the 31 March 2020 audit.</p> <p>We recommend early consideration following the impact analysis of actions required to embed IFRS 16 accounting in the Council's underlying accounting systems.</p> <p>(See page 20 for details.)</p>	<p>The Council is undertaking a review of its operating leases in preparation for implementation of IFRS 16 from 1 April 2020, with a view to providing an updated opening balance position to auditors by end of June 2020.</p>	Executive Manager – Finance	30/6/20	Medium
Review of financial statements	<p>The Council needs to ensure that it has a thorough internal review of the supporting working papers which are used in the preparation of the financial statements prior to their publication. Going forward, we would expect to see documented evidence of the amendments identified in the review process by the Financial Accountant and Executive Manager – Finance.</p> <p>(See page 20 for details.)</p>	<p>The finance team will undertake a 'lessons learned' exercise shortly after the conclusion of the annual external audit in the autumn. This exercise will capture any learning points arising from the 2018/19 audit, which will be subsequently built into our planning for preparing the 2019/20 accounts.</p>	Executive Manager – Finance	30/6/20	Medium

Action plan (continued)

Follow-up 2017/18 action plan

We have followed up the recommendations made in our 2017/18 annual report in relation to the wider scope areas in our Interim Report. In 2017/18, we made two recommendations arising from our financial statements work and are pleased to note that both have been fully implemented.

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Valuation of property assets	The Council should ensure that the post of Valuer, independent of the Team Leader of Estates and Assets, is filled for 2018/19 and that sufficient segregation of duties exist between the person carrying out the valuation of property assets and the person carrying out the technical review of that work.	Management have confirmed that the post has been filled for 2018/19.	Executive Manager – Capital Programmes	31/12/18	High	<i>Fully implemented:</i> We have confirmed that the post has been filled and appropriate segregation of duties has been maintained in the valuation process in 2018/19.
Valuation of property assets	A number of recommendations have been made in review of the valuation exercise, undertaken by our property specialists. These points should be considered when preparing the valuation report in the coming year.	Management confirmed that they aim to address all recommendations in the year they are raised, and that they will follow up and implement all recommendations made with regards to the valuation process in 2018/19.	Executive Manager – Capital Programmes	31/12/18	High	<i>Fully implemented:</i> We are pleased to note that the recommendations made by our independent expert have been actioned by management. In 2018/19, our independent expert praised the quality of the work prepared by the Council's valuer in relation to council housing stock.

Fraud responsibilities and representations

Responsibilities explained



Responsibilities:

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



Required representations:

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

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



Audit work performed:

In our planning we identified the achievement of recognition of grant income, property valuations and management override of controls as key audit risks for your organisation.

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

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

We have reviewed the paper prepared by management for the Audit Committee on the process for identifying, evaluating and managing the system of internal financial control.

Concerns:

No concerns have been identified regarding fraud.



Independence and fees

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

Independence confirmation We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.

Fees The audit fee for 2018/19, above the fee range provided by Audit Scotland due to additional work in the year in relation to the College Merger, acquisition of SLAP, IFRS 9 and group accounts, is £246,730 as broken down below:

£

Auditor remuneration	177,420
Audit Scotland fixed charges:	
Pooled costs	13,560
Contribution to PABV	46,970
Audit support costs	8,780
Total agreed fee	246,730

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

Non-audit services fees of £24,000 (plus VAT) have been charged in the year, in relation to tax due diligence services provided on the 'Effective and sustainable tertiary education, research and training in Shetland' project. The provision of these services was agreed with Audit Scotland in accordance with audit planning guidance.

We were appointed as statutory auditor for SLAP for 2018/19, for which fees of £33,500 (plus VAT) have been agreed. This fee will be levied on and paid by SLAP as a distinct entity, rather than being paid through the Council.

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

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

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



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