

**Audit & Standards Committee****16 February 2012****Audit & Standards – Matters Arising****HR-013 F****Performance & Improvement Adviser****Corporate Services****1.0 Summary**

- 1.1 This report is a standing item on the Audit & Standards Committee agenda. It provides Members with an update on items from previous meetings, items raised by Members and any forthcoming or overdue “Work Programme” items.

2.0 Decision Required

- 2.1 The Audit and Standards Committee should consider the contents of this report and highlight any issues that they feel should be monitored or further addressed through this, other Committees or Council management.

3.0 Previous Items**Electronic Alternatives to Paper Agendas - Update**

- 3.1 Committee Chairs will be involved in a short trial of these devices. If the trial is successful, these devices may be offered as part of the new Council’s induction process in May.

Absence Management

- 3.2 The December 2011 meeting of Audit & Standards Committee received a report on absence management ([Min Ref 30/11](#)). A question was raised about the short-term/long-term sickness absence ratio and sickness reasons.

3.3 Comparison of days lost, Short-Term / Long Term Absences

Short Term Absences (under 4 weeks)	2.1%
Long Term Absences (over 4 weeks)	3.3%
Total	5.4%

3.4 Appendix A contains a breakdown of sickness reasons showing both total days lost, and the number of individual events. It also gives some guidance on the categories used.

Ethical Investments

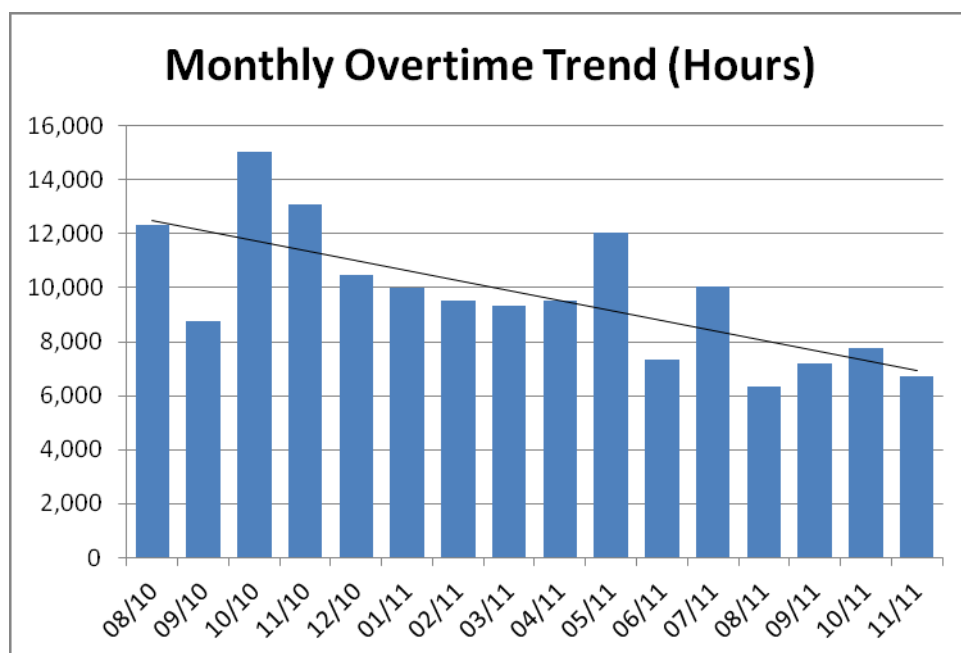
3.5 A question was raised during the December 2011 meeting of Audit & Standards Committee regarding ethical investments. A report on ethical investments is due to be presented to the Executive Committee on 13 February 2012.

School Transport Policy

3.6 An issue was raised during the December 2011 meeting of Audit & Standards Committee that the new School Transport contract could be detrimental to small rural businesses. The extensions to the current contracts, and future contracts, were discussed at the Environment & Transport Committee on 30 August 2011 ([Min Ref 10/11](#)).

Overtime Trends

3.7 A request was made at the last Audit & Standards Committee meeting for Overtime trends to be shown in hours, and a trend line added to the graph (Min Ref 29/11). The following graph shows hours and a trend line. It also shows a further two months of overtime figures



4.0 Implications

Strategic

- 4.1 Delivery On Corporate Priorities – This report is in line with Section 4 of the Council's Corporate Plan, "Organising Ourselves Better" and section LV04 of the Improvement Plan "Establish dedicated support services for Members"..
- 4.2 Community /Stakeholder Issues – NONE
- 4.3 Policy And/Or Delegated Authority – As outlined in Section 2.6 of the Council's Scheme of Administration and Delegations, the remit of the Audit and Standards Committee includes promoting good internal control, financial management, risk, governance and performance management.
- 4.4 Risk Management – Failure to undertake a robust approach to Audit & Standards may risk the Council not following its own improvement plan.
- 4.5 Equalities, Health And Human Rights – NONE.
- 4.6 Environmental – NONE.

Resources

- 4.7 Financial – NONE.
- 4.8 Legal and Administration – NONE
- 4.9 Human Resources – NONE.
- 4.10 Assets And Property – NONE.

5.0 Conclusions

- 5.1 This report gives the Members of the Audit & Standards Committee an update on outstanding items and an opportunity to suggest items for the 2012/13 "Work Programme".

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02/02/12

Appendix A – Sickness absence reasons for April – September 2011

Code	Description	Episodes
501	Infectious	672
510	Gastrointestinal	576
512	Musculoskeletal	433
505	Mental Health and Behavioural	275
506	Neurology	275
518	Surgery Related	235
509	Respiratory	174
507	Ear/Nose/Throat & Eyes	152
400	Other	106
513	Genitourinary	89
514	Accidents, Injuries, Poisoning	89
517	Dental	55
516	Pregnancy Related	51
511	Skin	27
503	Blood	22
502	Neoplasm	21
508	Cardiovascular	18
504	Endocrine	17
515	Exposure	0
	Total	3287

Code	Description	Days
505	Mental Health and Behavioural	4747
512	Musculoskeletal	4611
518	Surgery Related	2704
501	Infectious	1419
510	Gastrointestinal	1289
506	Neurology	1145
509	Respiratory	1079
514	Accidents, Injuries, Poisoning	795
507	Ear/Nose/Throat & Eyes	466
502	Neoplasm	411
508	Cardiovascular	373
513	Genitourinary	305
516	Pregnancy Related	286
517	Dental	123
504	Endocrine	118
511	Skin	118
400	Other	92
503	Blood	57
515	Exposure	0
	Total	20138

Description Guidance

Code	Category Description / Examples
501	Infectious - Colds, Flu, Glandular Fever, Chicken Pox, Meningitis, Mumps, Measles, Temperature, Shingles
502	Neoplasms - Malignant & non-malignant tumours in all body regions – i.e. Breast Cancer, Colon Cancer, Cerebral Tumour, Adenoma
503	Blood - Different Anaemias, Leukaemias & clotting disorders such as Haemophilia & Nutritional Disorders, Iron deficiency, Haemorrhoids, Pulmonary Embolism
504	Endocrine - Thyroid Problems, Diabetes & other Hormonal or Metabolic Problems, Liver Problems
505	Mental Health & Behaviour - Fatigue, Stress, Anxiety, Depression, Schizophrenia, Manic Depression, Drug & Alcohol Abuse, Panic Attacks, Exhaustion, Bipolar
506	Neurology - Headache, Migraine, Stroke, Multiple Sclerosis, Concussion, Vertigo, Dizziness, ME, Epilepsy
507	Ear/Nose/Throat & Eyes - Tonsillitis, Sinusitis, Nasal Polyps, Glaucoma, Conjunctivitis, Hearing & Visual problems, Laryngitis
508	Cardiovascular - Heart Attack, Coronary Thrombosis, Hypertension, Angina, Heart Failure, Deep Vein Thrombosis
509	Respiratory - Cough, Chest Infection, Asthma, Emphysema, Pneumonia, Pleurisy, Bronchitis
510	Gastrointestinal - Abdominal pain, Vomiting & Diarrhoea, Gallstones, Peptic Ulcer, Appendicitis, Hepatitis, Pancreatitis, Food Poisoning, Irritable Bowel Syndrome, Diverticulitis, Gastro Flu
511	Skin - Eczema, Psoriasis, Cellulitis, Boils, Abscess, Carbuncle, Sunburn/Sunstroke, Corns
512	Musculoskeletal - Pain from Back, Neck, Wrist, Arm, Knee, Hip etc. Also includes Gout, Osteoarthritis, Rheumatoid Arthritis, Trapped Nerve, Joint problems, Muscle Sprain, Sciatica
513	Genitourinary - Urinary Tract Infections, Prostatism, Endometriosis, Fibroids, Period Pains, Renal Stones, Menopausal problems, Genital problems, Kidney Infection/Stones
514	Accidents, Injuries, Poisoning - Cuts, Lacerations, Fractures, Amputations, Road Traffic Collision, Assault, Carbon Monoxide Poisoning, Burns, Frostbite, Hypothermia, Reaction to Medication, Allergy
515	Exposure - Exposed to noise, Vibration, Ionising & Non-Ionising Radiation
516	Pregnancy Related - Pregnancy Sickness, Miscarriage, Ectopic Pregnancy, Termination, Pre-eclampsia
517	Dental - Dental Abscess & Infections, Extractions, Removal of Wisdom Teeth
518	Surgery Related - Hospital in-patient Appointments, Hysterectomy, Tonsillectomy, Hip Replacement, Arthroscopy, Varicose Vein, Investigations, Appendectomy, Post Op Recovery, Hernia Repair

**Audit & Standards Committee****16 February 2012****Audit Scotland Reports**

IP-004-F

Executive Manager – Improvement and Performance**Corporate Services Department****1.0 Summary**

- 1.1 This report contains links to reports produced by Audit Scotland since the last meeting of the Audit and Standards Committee.

2.0 Decisions Required

- 2.1 The Audit and Standards Committee should consider the contents of this report and highlight any issues in the linked reports that they feel should be monitored or further addressed through this, other Committees or Council management.

3.0 Detail

- 3.1 Representatives of Audit Scotland are expected to be in attendance to provide further background or answer questions.

3.2

Report	Appropriate Body
Audit Scotland Audit plans for the Council and the pension fund.	Council / Executive Committee / Chief Executive.
Central Scotland Fire & Rescue	Chief Executive
Shetland Islands Council – Statutory follow-up report	Council / Chief Executive
Overview of NHS in Scotland's performance 2010/11	Social Service Committee / Director Community Care / Executive Manager Improvement & Performance
The 2010/11 audit of the National Libraries of Scotland	Chief Executive

Reducing Greenhouse Gas Emissions	Environment and Transport Committee / Director of Infrastructure
Lothian and Borders Police and Police Board	Chief Executive

4.0 Implications

Strategic

- 4.1 Delivery On Corporate Priorities – Improved external engagement and sharing best practice are both elements of the Council's Improvement Plan.
- 4.2 Community /Stakeholder Issues – NONE
- 4.2 Policy And/Or Delegated Authority – The Audit and Standards Committee remit includes consideration of reports from Audit Scotland.
- 4.3 Risk Management – Failure to deliver effective external engagement and learn from best practice elsewhere increases the risk of the Council working inefficiently.
- 4.4 Equalities, Health And Human Rights – NONE
- 4.5 Environmental – NONE

Resources

- 4.6 Financial – NONE
- 4.7 Legal – NONE.
- 4.8 Human Resources - NONE
- 4.9 Assets And Property – NONE

5.0 Conclusions

- 5.1 The attached reports provide valuable information for Committees and officers throughout the Council.

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27/1/12

Links to Background documents:




Appendix 1 – Shetland Islands Council Audit Plan

Appendix 2 – Shetland Islands Council Pension Fund Audit Plan

Central Scotland Fire and Rescue

26 January 2012 for the Accounts Commission



Central Fire & Rescue provides an effective, low cost service but would be better placed to provide Best Value if it had stronger performance arrangements. It needs to develop a culture of continuous improvement, and the board should be more proactive in its scrutiny.

-  [Central Scotland Fire and Rescue \(PDF | 596 KB\)](#)Opens in new window
-  [Main report - Black and white version \(PDF | 474 KB\)](#)Opens in new window
-  [Press release - Central Scotland Fire and Rescue \(PDF | 151 KB\)](#)Opens in new window

Shetland Islands Council - Statutory follow-up report

18 January 2012 for the Accounts Commission




Shetland Islands Council has made good progress in implementing its improvement plan. It now has many of the building blocks needed to provide Best Value. New political management arrangements and management structures are in place and the council is developing a culture of continuous improvement. However aspects of financial management continue to be of significant concern.

-  [Shetland Islands Council - Statutory follow-up report \(PDF | 367 KB\)](#)Opens in new window
-  [Press release - Shetland Islands Council \(PDF | 163 KB\)](#)Opens in new window

Overview of the NHS in Scotland's performance 2010/11

15 December 2011 for the Auditor General

The overall performance of the NHS in Scotland was good in 2010/11, but there are significant financial pressures building.

-  [Overview of the NHS in Scotland's performance 2010/11 \(PDF | 1.82MB\)](#)Opens in new window
-  [Main report - Black and white version \(PDF | 1.87MB\)](#)Opens in new window
-  [Press release - Overview of the NHS in Scotland's performance 2010/11 \(PDF | 165 KB\)](#)Opens in new window

The 2010/11 audit of the National Libraries of Scotland





13 December 2011 for the Auditor General

-  [The 2010/11 audit of the National Libraries of Scotland \(PDF | 201 KB\)](#)Opens in new window

Reducing greenhouse gas emissions

8 December 2011 for the Auditor General




Scotland has made good progress in cutting greenhouse gas emissions. However, the country has very ambitious targets for further emissions reductions which could cost about £10-11 billion to achieve.

-  [Reducing greenhouse gas emissions \(PDF | 906 KB\)](#)Opens in new window
-  [Main report - Black and white version \(PDF | 1.59MB\)](#)Opens in new window
-  [Report annexe - Reducing greenhouse gas emissions \(PDF | 368 KB\)](#)Opens in new window
-  [Press release - Reducing greenhouse gas emissions \(PDF | 89 KB\)](#)Opens in new window

Lothian and Borders Police and Police Board

6 December 2011 for the Accounts Commission

The force and board perform well and have a sound basis for future development. They have an effective working relationship and work well together and with partner organisations to provide services to communities. They are building on the progress they have achieved to make further improvements.

-  [Lothian and Borders Police and Police Board \(PDF | 861 KB\)](#)Opens in new window
-  [Main report - Black and white version \(PDF | 677 KB\)](#)Opens in new window
-  [Press release - Lothian and Borders Police and Police Board \(PDF | 84 KB\)](#)Opens in new window

Shetland Islands Council

Annual Audit Plan 2011/12



Prepared for Audit and Standards Committee
February 2012

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.

Contents

Summary plan	4
Summary of planned audit activity	4
Introduction	4
Our responsibilities	5
Our approach to the audit of the accounts	6
Responsibility for the preparation of accounts	7
Format of the accounts	7
Audit issues and risks	7
National performance audit studies – impact and follow up	12
Summary assurance plan	13
Materiality	13
Reporting arrangements	13
Quality control	15
Fees and resources	15
Independence and objectivity	16
Appendix A - Summary assurance plan	17
Appendix B - Financial statements audit timetable	23
Appendix C - Audit team	24
Appendix D - Reliance on internal audit	25
Appendix E - Independence and Objectivity	26

Summary plan

Summary of planned audit activity

Based on our analysis of the risks facing Shetland Islands Council, our planned work in 2011/12 includes:

- an audit of the financial statements and provision of an opinion on whether:
 - they give a true and fair view of the financial position of the council as at 31 March 2012 and its income and expenditure for the year then ended
 - the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2011 Code
- reporting the findings of the shared risk assessment process in an Assurance and Improvement Plan Update. This will consist of the Local Area Network (LAN) examining new evidence in terms of its impact on existing risk assessments and will include updated scrutiny plans for the period 2012/13 to 2013/14 for the council
- provision of the annual report on the audit addressed to the council and the Controller of Audit
- a review and assessment of the council's governance and performance arrangements in a number of key areas including the review of internal controls; the adequacy of internal audit; Statutory Performance Indicators; national study follow-up work; and ICT computer service reviews.
- provision of an opinion on a number of grant claims and returns, including Whole of Government Accounts
- review of National Fraud Initiative arrangements throughout 2011/12

Introduction

1. Our audit is focused on the identification and assessment of the key challenges and risks to Shetland Islands Council in achieving its business objectives. We also assess the risk of material misstatement or irregularity in the council's financial statements. This report summarises specific governance and other risks that may affect the financial statements of Shetland Islands Council and sets out the audit work that we propose to undertake in 2011/12 to address these. Our annual audit plan reflects:
 - the risks and priorities facing the council
 - current national risks relevant to local circumstances
 - the impact of changing international auditing and accounting standards

- our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland and the Accounts Commission
 - issues brought forward from previous audit reports.
2. In addition to this annual audit plan which focuses on those risks which may impact on the financial statements, we will issue, on behalf of the Local Area Network (LAN), an Assurance and Improvement Plan Update which will update the LAN's joint assessment of the strategic and performance risks facing Shetland Islands Council and set out the planned scrutiny activity in the council for the period April 2011 to March 2014.
 3. Following receipt of a report in December 2011 on the progress the council has made on implementing its Improvement Plan, the Accounts Commission requested a further update report in 12 months time. This report will be informed by the work of the local audit team who will monitor further progress during 2011/12.

Our responsibilities

4. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.
5. Audit in the public sector goes beyond simply providing assurance on the financial statements and the organisation's internal control environment. We are also required to provide a view on performance and the organisation's use of resources. In doing this, we aim to support improvement and accountability.
6. In carrying out our audit, we seek to gain assurance that the council:
 - has good corporate governance arrangements in place which reflect the three fundamental principles of openness, integrity and accountability
 - has systems of recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests
 - prepares financial statements which give a true and fair view of the financial position at 31 March 2012 and income and expenditure for the year then ended, in accordance with the Local Government (Scotland) Act 1973 and other applicable laws and regulations, including the 2011 Code of practice on local authority accounting in the United Kingdom (the Code). The 2011 Code applies to reporting periods commencing 1 April 2011.
 - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
 - complies with established policies, procedures, laws and regulations
 - proactively manages and reviews its performance in line with its strategic and operational objectives
 - has made proper arrangements for securing best value in its use of resources and is complying with its community planning duties.

Our approach to the audit of the accounts

7. Our audit approach is based on an understanding of the characteristics, responsibilities and principal activities, risks and governance arrangements of the council, and identification of the key audit risks and challenges in the local government sector generally. This approach includes:
 - understanding the business of the council and the risk exposure which could impact on the financial statements
 - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
 - identifying major transaction streams, balances and areas of estimation, understanding how the council will include these in the financial statements and developing procedures to audit these
 - assessing the risk of material misstatement in the financial statements, in conjunction with our evaluation of inherent risk, the control environment and control risk as part of our risk assessment
 - determining the nature, timing and extent of our testing programme to provide us with sufficient appropriate audit evidence as to whether the financial statements are free of material misstatement.
8. Through this approach we have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Management action being relied on for 2011/12 includes:
 - comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff
 - clear responsibilities for provision of accounts and working papers being agreed
 - delivery of unaudited accounts to agreed timescales
 - a comprehensive working papers package and supporting records
 - completion of the internal audit programme for 2011/12.
9. Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and, as part of our planning process we carry out an early assessment of the internal audit function. Internal audit is provided by the internal audit section within the council. Based on our review of internal audit we plan to place formal reliance on the areas of work set out in Appendix D.
10. Our approach to the audit of the financial statements is based on an integrated assessment of risk across the Code of Audit Practice responsibilities in relation to governance, performance and opinion.

11. At the completion of the audit we will provide members and the Controller of Audit with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

Responsibility for the preparation of accounts

12. It is the responsibility of the council and the Section 95 Officer to prepare the financial statements in accordance with the Code. This means:
- acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
 - maintaining proper accounting records;
 - preparing financial statements timeously which give a true and fair view of the financial position of Shetland Islands Council as at 31 March 2012 and its expenditure and income for the year then ended;
 - reviewing the main components of the system of internal control, including the arrangements for internal audit and group entities. This should include consideration of issues identified as part of the audit process;
 - preparing an explanatory foreword.

Format of the accounts

13. The financial statements should be prepared in accordance with the Code which constitutes proper accounting practice for the purposes of section 12 of the Local Government Scotland Act 2003.
14. The council prepares a Whole of Government Accounts consolidation pack annually for the Scottish Government and is required to prepare its accounts using common accounting principles and standard formats for summarisation.

Audit issues and risks

15. Based on our discussions with staff, attendance at committee meetings and a review of supporting information, we have identified the following main financial statements risk areas for your organisation.

Improvement Plan

16. In December 2011 **the Controller of Audit submitted a report** to the Accounts Commission on the council's progress on implementing its Improvement Plan. The report found that *'The council has made good progress overall on its improvement plan, in particular by implementing new political management arrangements and a new management structure. Some areas of financial management, including financial planning and budgeting, have improved. Significant concerns remain however about other aspects of financial management, including the process of finalising the financial statements, the qualification of*

the accounts and the resourcing of the finance function.' The council's progress on particular areas of the Improvement Plan is addressed below.

Governance

17. **Revised Governance Arrangements:** As part of its improvement plan the council has made significant changes to its political management arrangements. These new arrangements include a revised committee structure, a new constitution, standing orders for meetings, a scheme of administration and delegation and a code of corporate governance. In addition a new Executive Committee has been established to help the council work effectively on improving its leadership role, its planning and performance management function and its corporate working.
18. The Accounts Commission's report stated that *'the council approved new political management arrangements and made appointments to various posts and committees. Though the arrangements have not been in place that long, the initial indications are that they are helping the council to conduct business in a more focussed and organised way.'* The report also stated that *'The council has made significant progress in reviewing, updating and improving its governance arrangements. Though the new arrangements are still relatively new and are bedding in, the early indications are that improvement is being achieved'*.
19. The risk remains, **however**, that the progress is not maintained and the new governance arrangements do not become fully embedded.
20. **Management Restructure:** The council has put in place a new management structure and significant progress has been made in implementing the new arrangements. The current Chief Executive has been appointed on an interim basis and no timetable has been confirmed for a permanent replacement. It is **important** that the council put in place effective succession planning arrangements for this key strategic **role**.
21. Four of the five newly **specified** director posts have been filled on a permanent basis. The council has encountered problems recruiting to the post of Director of Corporate Services and an interim appointment has been made until the end of the 2011/12 financial year. The new structure includes 34 executive managers and the council is now working towards appointing officers at team leader level. There is a risk that this period of change **may** impact on the day to day operations of the council.
22. **Revised financial regulations:** In December 2011 the Executive Committee recommended a revised set of financial regulations which will be submitted to the full council for approval. Until the revised financial regulations are approved by the council there is a risk that current **processes** do not reflect the revised governance and management arrangements.
23. **Replacement Section 95 Officer:** Under Section 95 of the Local Government (Scotland) Act 1973 "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". In January 2012 the council appointed a new Executive Manager - Finance as the Section 95 officer.

- 24. Risk management arrangements & risk registers:** In recent years there has been no systematic monitoring of risk management and risk assessments across the council. Following the significant restructuring of the council's governance and management arrangements the council is now reviewing and developing its risk management arrangements. This includes risk monitoring and reporting arrangements at both operational and strategic level. The council's risk management arrangements should link effectively with the council's performance management arrangements.
- 25.** Since 2008/09 the council has been in the process of updating the strategic and operational risk registers to reflect its priorities. However, as a result of the significant changes affecting the council's strategic objectives over the period this process remains incomplete. In the absence of up-to-date risk registers there may be risks in existence that the council is not controlling appropriately.
- 26. Budget reporting to members:** The council has introduced more effective financial planning and budget setting arrangements and agreed a strategic budget plan and principles to underpin its reserves policy. In addition, budget monitoring reports to elected members have improved, but need to improve further to clearly demonstrate the reason for the financial pressures faced by the council and how corporate savings are to be delivered to reduce the draw on reserves.
- 27. Performance Management Arrangements:** In July 2011 the council approved a revised Planning and Performance Management Framework (PPMF) and additional guidance has since been developed. In addition the council purchased an electronic performance management system and is currently working towards implementing the system. While the council has made progress in this area further improvement is needed for the PPMF to effectively support the production of service plans and inform the budget process. Risk?

Financial Management

- 28. Financial position:** In December 2011 the council reported good progress on identifying savings to meet the original 2011/12 revenue savings target of £9.4m. However subsequent budget revisions, new cost pressures and as yet unidentified savings means that an overall deficit of £4m is forecast unless corrective action is taken. If no such action is taken an increase to the planned draw on reserves will be required.
- 29.** As at December 2011 the council reported a 29% spend against the 2011/12 gross capital expenditure budget over the first six months of the year. A revised capital spend of £29.6m for 2011/12 is predicted against a budget of £36.8m, leaving an underspend of £7.2m. Risk?...
- 30. Financial planning:** In November 2011 the council agreed a strategic budget plan for 2012/13 and beyond. This plan presents significant challenges to the council as substantial recurring revenue savings of around £26m are required.
- 31. Reserves:** The council has an established policy of maintaining a minimum reserve level of £250m. The reserve balance is affected by any amounts drawn to fund revenue or capital

expenditure but is also subject to the actual rate of return of investments which is dependent on stock market conditions.

32. During 2011/12 the council plans to draw £47.4m from reserves (£27.4m for revenue and £20m for capital) which will leave a reserve balance of £219m. The council reported in December 2011 that budget revisions and additional and unexpected cost mean that, unless management take corrective action, there will be a 2011/12 budget deficit of £4m which will result in an additional draw on reserves.
33. The strategic budget plan agreed in November 2011 sets out how the council will return to a position of having a nil draw on reserves by 2013/14. The plan requires a revenue expenditure reduction of around £26m by 2013/14 and this presents significant challenges to the council over the next two to three years.
34. **Capital programme:** In December 2011 the council agreed a framework for developing an Asset Investment Plan (the Plan) that supports the reserve policy and the strategic budget plan. The council intends that the Plan should form part of the council's PPMF arrangements. The plan is intended to support the council's decisions regarding capital spend and details that:
 - the draw on the capital fund for the 5 year capital programme will be £28m (significantly less than previous years) ;
 - the Council will remain debt free for general capital investments;
 - and separate consideration will be given to the significant capital investment projects, the new Anderson High School and Fixed Links.
35. The council is making progress in developing its arrangements for managing its assets, including appointing an asset strategy manager and establishing a new asset management strategy. A new council building is being developed at North Ness and this will help the council to rationalise its estate.
36. In December 2011 the council reported that there had been significant slippage on the 2011/12 capital programme with an expected underspend of £7.2m from a budget of £36.8m.
37. **Finance service:** The council has set up two reviews relating to the finance service:
 - Finance and HR and Corporate Services Efficiency Review. Linked to the finance services move to North Ness in early 2012/13
 - Financial Systems Review. To be implemented from April 2012.
38. These projects will require to be carefully managed to avoid any detrimental impact on the existing finance service functions during the lifetime of the projects. Consideration should be given to the level of finance service resources necessary to deliver the projects and any affect this may have on the day to day operation of the service.
39. **Inventories:** Inventories constitute a material amount in the council's financial statements - reported as £4m as at 31 March 2011. Therefore to comply with ISA 501 (Audit Evidence: Additional Considerations for Specific Items) we require sufficient appropriate audit evidence

regarding the existence and condition of inventory. In terms of the audit of the 2011/12 financial statements we will be placing reliance on the work of internal audit in this area. This year the council's internal auditors will be attending the year-end stock count at Gremista which has stock valued at around £0.6m. We will require adequate evidence regarding existence and condition of the remaining inventory.

Accounts presentation and disclosure

40. **Financial Statements:** There were significant issues with the preparation and submission of the draft 2010/11 financial statements for audit. These issues included late submission, non-compliance with reporting requirements, significant numbers of errors and omissions, standard of working papers and non-availability of finance officers during the audit process. The council also advertised draft financial statements which were inaccurate and non-compliant with the Code.
41. The finance service and the local audit team will have to communicate frequently to ensure a more successful process for the audit of the 2011/12 draft financial statements.
42. **Finance Service Resources:** A permanent appointment to the post of Executive Manager - Finance was made in January 2012 to replace the interim Head of Finance. It is expected that the new manager will take up the position before the year-end. The Executive Manager - Finance, as Section 95 officer, also has an obligation to ensure that the council's accounts are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the Code).
43. A financial accountant was appointed to a vacant post in January 2012 and it is expected that the officer will be in post shortly.
44. **Group accounts:** The Code requires group accounts to be prepared by local authorities where they have interests in entities meeting the definitions of subsidiaries, associates and joint ventures. Group financial statements are required to present a true and fair view of the Group's activity and financial position. In our opinion, the substance of the council's relationship with the Shetland Charitable Trust (SCT) represents a significant interest and its omission results in a material mis-statement of the Group accounts.
45. In December 2011, in response to a letter of concern from the Office of the Scottish Charity Regulator (OSCR) on the constitution and independence of SCT, the trustees agreed a proposal to change to a fifteen member trust of 7 councillors and 8 unelected appointees, one of whom would chair the trust. The SCT is required to submit a formal application on this proposal to OSCR for consideration. We will continue to keep this area under review throughout the audit process.
46. **Shetland Development Trust (SDT).** In accordance with the Code the financial results of SDT are included in the council's group accounts as a subsidiary. In previous years SDT's financial results were audited by KPMG who provided us with appropriate audit assurances. For 2011/12 the council is considering changes to the arrangements for the audit of SDT's

financial results. There is a risk that new arrangements, once finalised, may not provide external audit with the appropriate audit assurances.

47. Other issues. The following areas require early consideration in 2011/12:

- procedures should be in place for the Section 95 Officer to review the financial statements prior to submission for audit
- as part of the working papers package for the 2011/12 financial statements finance service will provide us with appropriate variance analysis, including explanations. It was agreed that this would be provided early to assist with the audit process
- the finance service have agreed to weekly meetings with auditors during the audit of the 2011/12 financial statements. This will help ensure that matters arising can be cleared quickly.

Whole of Government Accounts

48. In 2010/11, for the second consecutive year, the council did not submit the consolidated pack to the Scottish Government by the required deadline. This resulted in missing the deadline for the completion of the audited return.

Workforce Management

49. The council made significant workforce changes as a result of the management restructure during the last year. In addition, the need to achieve significant financial savings over the next few years may have an impact on the current workforce. The council is working towards establishing effective workforce management arrangements and delivering a workforce plan during 2012. The council has set up an Efficiency Partnership Group to facilitate closer working between managers and trade unions to address the challenge of identifying and addressing efficiency savings.

National Fraud Initiative (NFI)

50. The 2009/10 NFI national report included the council as one of seven Scottish councils requiring improvement. We have also reported previously that the council needs to improve its level of engagement with the NFI process. In May 2012 the next national report will be published and will include the findings of our 2010/11 NFI assessment questionnaire which we plan to complete in February 2012.

National performance audit studies – impact and follow up

51. In addition to the above work, Audit Scotland's Performance Audit Group undertakes a programme of studies on behalf of the Auditor General and Accounts Commission. In line with Audit Scotland's strategy to support improvement through the audit process and to maximise the impact of national performance audits we will follow up a number of studies at a local level. In 2011/12 this will involve the completion of templates recording the impact of relevant national performance reports on Shetland Islands Council as well as a more targeted follow-up of *Maintaining Scotland's roads: a follow-up report review (Feb 2011)*.

Summary assurance plan

52. Within these identified risk areas there is a range of more specific risks and these are summarised at Appendix A. In most cases, actions to manage these risks are either planned or already underway within the organisation. Details of the sources of assurance that we have received for each of these risks and any audit work we plan to undertake are also set out in Appendix A. In the period prior to the submission of the unaudited financial statements, we will liaise with senior officers on any new or emerging issues.

Materiality

53. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
54. International Standard on Auditing 320 states that, “Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.”
55. When considering, in the context of a possible qualification to the audit opinion, whether the misstatement of an item, or a number of items taken together, is material in terms of its monetary value, we use professional judgement, experience and internal guidelines from peers as broad guidance in regard to considering whether the results of tests of detail are material.
56. An item may be judged material for reasons other than its monetary or quantitative value. An inaccuracy, which would not normally be regarded as material by amount, may be important for other reasons. When such an item affects a critical point in the accounts, its materiality has to be viewed in a narrower context (for example the failure to achieve a statutory requirement, an item contrary to law, or areas affected by central government control). Again we use professional judgement, experience and internal guidelines from peers to determine when such matters would fall to be covered in an explanatory paragraph, rather than as a qualification to the audit opinion.

Reporting arrangements

57. Under the Local Government (Scotland) Act 1973, there is a requirement for unaudited financial statements to be presented to the council and the Controller of Audit within 3 months of the financial year end i.e. 30 June. The non-statutory target for audit completion is 30

September. To achieve this target, it is critical that a timetable for the audit of the accounts is agreed with us. An agreed timetable is included at Appendix B of this plan, which takes account of submission requirements, planned audit committee dates and audit resources.

58. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the Chief Executive / responsible head of service and relevant officers to confirm factual accuracy. Responses to draft reports are expected within three weeks of submission.
59. A copy of all final agreed reports will be sent to the Chief Executive, Section 95 Officer, relevant senior managers, Internal Audit and Audit Scotland's Best Value & Scrutiny Improvement Group.
60. We will provide an independent auditor's report to the council and the Accounts Commission for Scotland that the audit of the financial statements has been completed in accordance with applicable statutory requirements, including an opinion on those financial statements. An annual report to members and the Controller of Audit will also be produced to summarise all significant matters arising from the audit and overall conclusions about Shetland Islands Council's management of key risks.
61. All annual reports produced by Audit Scotland are published on our website (www.audit-scotland.gov.uk).
62. The full range of outputs to be delivered by the audit team are summarised in Exhibit 1.

Exhibit 1: 2011/12 Planned Outputs

Planned outputs	Target delivery date
Governance	
Assurance and Improvement Plan Update (jointly prepared with other local government scrutiny bodies)	31 May 2012
Review of the Adequacy of Internal Audit	31 May 2012
Internal controls management letter	31 May 2012
Performance	
Maintaining Scotland's roads: a follow-up report	31 August 2012
Financial statements	
Report to Audit Committee in terms of ISA 260 (Communication of audit matters to those charged with governance)	30 September 2012
Independent auditor's report on the financial statements	30 September 2012
Audit opinion on Whole of Government Accounts	30 September 2012
Annual report to Members and the Controller of Audit	31 October 2012

Planned outputs	Target delivery date
Grants	
Audit opinions on Education Maintenance Allowance, Criminal Justice Social Work Services, Non Domestic Rates and Housing Benefit & Council Tax Benefit Subsidy grant claims	As required

Quality control

63. We are committed to ensuring that our audit reflects best practice and demonstrates best value to the council and the Accounts Commission. We operate a strong quality control framework that seeks to ensure that your organisation receives a high quality service. The framework is embedded in our organisational structures and processes and includes an engagement lead for every client; in your case this is David McConnell who is responsible for ensuring that our work is carried out on time and to a high quality standard.
64. As part of our commitment to quality and continuous improvement, we may periodically seek your views. We would be grateful for any feedback on our services.

Fees and resources

65. In the context of the challenges faced by Local Authorities, the impact of national spending decisions, and changes made in Audit Scotland's own overall budget we have re-examined our audit fee in 2011/12. The proposed fees for 2011/12 are summarised in Exhibit 2 below.

Exhibit 2: Audit Fee

Description	Audit Fee 2010/11	Audit Fee 2011/12	% Change
Total audit fee	£304,960	£273,810	-10%

66. Our agreed fee for the 2011/12 audit of Shetland Islands Council is £239,610 with an additional £34,200 for the audit of the pension fund. Our fee covers:
- all of the work and outputs described in this plan
 - a contribution towards the costs of national performance studies and statutory reports by the Controller of Audit and the work of the Accounts Commission
 - attendance at Audit and Standards Committee meetings
 - access to advice and information on relevant audit issues
 - access to workshops/seminars on topical issues
 - travel and subsistence costs
 - audit of the pension fund.

A separate audit plan will be issued covering the pension fund.

- 67. In determining the agreed fee we have taken account of the risk exposure of the council, the management assurances in place and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of the draft accounts and working papers by 30 June 2012.
- 68. We reserve the right to charge an additional fee for further audit work in such instances as late receipt of the draft financial statements, the lack of agreed management assurances or being unable to take planned reliance from the work of internal audit. An additional fee may be required if our audit cannot proceed as planned.
- 69. An additional fee will be required in relation to any work or other significant exercises not within our planned audit activity. An additional fee will also be charged for work on any grant claims or returns not included in the planned outputs noted previously.
- 70. Fiona Kordiak, Director, Audit Services is the appointed auditor for all local authorities audited by Audit Scotland. In practice, this operates by delegating management and certification responsibilities to Assistant Directors. For the council the Assistant Director is David McConnell.
- 71. The local audit team will be led by Carol Hislop who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience of our team are provided at Appendix C. The core audit team will call on other specialist and support staff as necessary.

Independence and objectivity

- 72. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships within the audit team.
- 73. We comply with ethical standards issued by the Auditing Practices Board and with Audit Scotland's requirements in respect of independence and objectivity, as summarised at Appendix E.

Appendix A - Summary assurance plan

In this section we identify a range of governance and other risks that may affect the financial statements of the council, the related source of assurance received and the audit work we propose to undertake to secure additional assurance. The management of risk is the responsibility of the council and its officers, with the auditor's role being to review the arrangements put in place by management. Planned audit work, therefore, will not necessarily address all residual risks.

Risk	Source of Assurance	Planned audit action
Governance		
Revised Governance Arrangements: Without fully embedded governance arrangements there is a risk that the activities of the council are not properly overseen and co-ordinated. There is also the risk that best value is not achieved.	<ul style="list-style-type: none"> • Implementation of the council's improvement plan • External audit attendance at committees 	<ul style="list-style-type: none"> • Monitor progress throughout the year • Provide an update in the annual audit report • Update on the council's progress with its improvement plan
Management Restructure: There is a risk that the significant restructuring may, in the short term, have a detrimental affect on the level and quality of council services provided.	<ul style="list-style-type: none"> • Implementation of the council's improvement plan • External audit attendance at committees 	<ul style="list-style-type: none"> • Monitor progress throughout the year • Provide an update in the annual audit report • Update on the council's progress with its improvement plan
Revised financial regulations: Until approved by the council there is a risk that current procedures do not reflect changes to governance and management arrangements. There is also the risk of inappropriate procedures being carried out.	<ul style="list-style-type: none"> • Approval of the revised financial regulations by the full council. 	<ul style="list-style-type: none"> • Monitor progress throughout the year • Provide an update in the annual audit report

Risk	Source of Assurance	Planned audit action
Replacement Section 95 Officer: There is a risk that the new officer has insufficient time to meet his S95 responsibilities regarding the 2011/12 financial statements.	<ul style="list-style-type: none"> Frequent liaison with the Section 95 Officer Early financial statements planning meeting 	<ul style="list-style-type: none"> Early financial statements planning meeting
Risk management arrangements & risk registers: In the short term there is a risk that the council's risk management arrangements do not ensure the council is adequately managing its key risks in order to achieve its strategic objectives. This includes allowing proper scrutiny of risk management arrangements by elected members and maintaining up to date risk registers.	Ongoing development of the council's risk management arrangements, including completion of update of the corporate risk registers following finalisation of the management restructure.	<ul style="list-style-type: none"> Monitor progress throughout the year Provide an update in the annual audit report
Budget reporting to members: Without arrangements that deliver good quality financial reports there is a risk that members do not have adequate information on which to base their decisions.	<ul style="list-style-type: none"> Ongoing improvements to the format and content of financial reports submitted to committee. 	<ul style="list-style-type: none"> Monitor progress throughout the year Provide an update in the annual audit report
Performance Management Arrangements: In the absence of fully implemented and effective performance management arrangements there is a risk that the council is unable to determine if it is meeting its objectives.	<ul style="list-style-type: none"> Ongoing development of PPMF together with development of associated guidance. Ongoing development of Covalent leading to implementation across the council 	<ul style="list-style-type: none"> Monitor progress throughout the year Provide an update in the annual audit report

Risk	Source of Assurance	Planned audit action
Financial Management		
Financial position: There is a risk the council does not achieve the savings required to deliver the 2011/12 budget as planned.	<ul style="list-style-type: none"> The council's budget monitoring arrangements are regularly reviewed and appropriate action taken where necessary 	<ul style="list-style-type: none"> Review the council's financial monitoring reports. Review of council reports minutes Attendance at council meetings Audit of 2011/12 financial statements Provide an update in the annual report
Financial planning: There is a risk that the council does not achieve its financial targets set out in its strategic budget plan.	<ul style="list-style-type: none"> Regular monitoring and review of the council's strategic budget plan Regular monitoring and review of the council's reserves policy The council's budget monitoring arrangements are regularly reviewed and appropriate action taken where necessary. 	<ul style="list-style-type: none"> Review the council's financial monitoring reports. Review of council reports minutes Attendance at council meetings Provide an update in the annual audit report Update on the council's progress with its improvement plan
Reserves: If the council does not deliver its strategic budget plan there is a risk that the council's aim of reducing the draw on reserves to zero by 2013/14 will not be achieved.	<ul style="list-style-type: none"> The council's strategic budget plan The council's reserves policy The council's budget monitoring arrangements 	<ul style="list-style-type: none"> Review the council's financial monitoring reports. Review of council reports minutes Attendance at council meetings Provide an update in the annual audit report

Risk	Source of Assurance	Planned audit action
Capital programme: If the capital programme is not delivered as planned this may have a detrimental impact on the council's operational and longer term objectives.	<ul style="list-style-type: none"> • Development of the Asset Investment Plan • The council's budget monitoring arrangements 	<ul style="list-style-type: none"> • Review the council's financial monitoring reports. • Review of council reports minutes • Attendance at council meetings • Provide an update in the annual audit report
Finance service: The use of key finance officers in finance admin. / system reviews may adversely affect the normal finance activities, particularly in the preparation of the financial statements.	<ul style="list-style-type: none"> • Appointment of Executive Manager - Finance • Appointment of financial accountant • Audit liaison meetings 	<ul style="list-style-type: none"> • Early financial statements planning meeting • Monitor progress throughout the year • Provide an update in the annual audit report
Inventories: Adequate audit evidence regarding existence and condition of inventory may not be provided.	<ul style="list-style-type: none"> • Attendance at year-end stock counts by internal audit. 	<ul style="list-style-type: none"> • Reliance on the work of internal audit
Accounts Presentation & Disclosure		
Financial Statements: If the council does not deliver for audit by the required deadline a complete set of Code compliant draft financial statements together with a comprehensive set of supporting working papers there is a risk that the statements may be subject to qualification for non-compliance with accounting regulations. This may also result in reputational damage to the council.	<ul style="list-style-type: none"> • Appointment of Executive Manager - Finance • Appointment of financial accountant • Audit liaison meetings • Completion of working paper checklist • Delivery of complete set of Code compliant accounts and supporting working papers by 30 June 2012 	<ul style="list-style-type: none"> • Early financial statements planning meeting • Regular liaison with finance section • Review of draft accounts received

Risk	Source of Assurance	Planned audit action
<p>Finance Service Resources: There is a risk that the 2011/12 financial statements may not be signed by the required deadline because the council does not have sufficient resources in place to</p> <ul style="list-style-type: none"> • deliver suitable draft accounts with working papers • provide adequate assistance to the auditors during the audit process 	<ul style="list-style-type: none"> • Appointment of Executive Manager - Finance • Appointment of financial accountant • Audit liaison meetings 	<ul style="list-style-type: none"> • Early financial statements planning meeting
<p>Group accounts: If SCT results are not included in the council's group accounts there is a risk that the 2011/12 accounts will not be Code compliant leading to a further audit qualification.</p>	<ul style="list-style-type: none"> • Trustees agreement to proposals to change SCT's structure • Report to committee in February 2012 on SCT 	<ul style="list-style-type: none"> • Review committee report • Early financial statements planning meeting
<p>Shetland Development Trust. There is a risk that the council may not meet the deadlines for</p> <ul style="list-style-type: none"> • submitting draft Code compliant financial statements for audit • submitting the audited financial statements to committee for approval. 	<ul style="list-style-type: none"> • Audit liaison meetings 	<ul style="list-style-type: none"> • Early financial statements planning meeting •
Whole of Government Accounts		
<p>The arrangements for completing the WGA return may not be adequate to ensure that the statutory deadlines are met.</p> <p>There is a reputational risk to the council if procedures are</p>	<p>The council will review its procedures for preparation of the WGA return to ensure that all deadlines are achieved.</p>	<ul style="list-style-type: none"> • Early financial statements planning meeting to discuss deadlines • Provide an update in the annual audit report

Risk	Source of Assurance	Planned audit action
not significantly improved within the finance department.		
Workforce management		
There is a risk that the council may be unable to meet its strategic or operational objectives if it does not have effective workforce management arrangements in place.	<ul style="list-style-type: none"> • Ongoing development of workforce management arrangements • Delivering a workforce plan during 2012 	<ul style="list-style-type: none"> • Monitor progress throughout the year • Provide an update in the annual audit report
National Fraud Initiative		
Without effective arrangements in place to address identified NFI issues there is a risk that cases of potential fraud are not properly investigate by the council.	<ul style="list-style-type: none"> • The council improved level of engagement with the NFI process 	<ul style="list-style-type: none"> • Completion of NFI questionnaire in February 2012. • Monitor progress throughout the year • Provide an update in the annual audit report

Appendix B - Financial statements audit timetable

Key stage	Date
Testing and review of internal control systems and transactions	31 May 2012
Provision of closedown procedures to audit	31 March 2012
Meetings with officers to clarify expectations of detailed working papers and financial system reports	31 March 2012
Planned committee approval of unaudited financial statements	30 June 2012
Latest submission of unaudited financial statements with working papers package	30 June 2012
Progress meetings with lead officers on emerging issues	As required during the audit
Latest date for final clearance meeting with Head of Finance	06 September 2012
Agreement of unsigned financial statements for audit and standards committee agenda, and issue of report to the audit and standards committee on the audit of financial statements (ISA 260)	TBC when committee calendar is approved
Governance & Audit committee date	TBC when committee calendar is approved
Independent Auditor's Report signed	30 September 2012
Latest date for submission of unaudited whole of government accounts return to external audit	30 July 2012
Latest date for signing of WGA return	30 September 2012
Certified accounts and annual report presented to Council	December 2012

Appendix C - Audit team

A summarised curriculum vitae for each core team member is set out below:

David McConnell MA CPFA

Assistant Director

David has worked in public sector audit since 1981, firstly with the National Audit Office and, since 1985, with the Accounts Commission/Audit Scotland. He therefore has extensive experience of audit in Central Government, Local Government and the NHS. Dave is currently Audit Scotland's lead on financial management issues.

Carol Hislop BA CA

Audit Manager

Carol has extensive experience in the private and public sectors, including 10 years audit experience across central government, health and local government sectors. Carol is a member of Audit Scotland's professional standards group and has the responsibility of ensuring that Audit Scotland's Audit Guide is updated to reflect changes in technical guidance and statute.

Iain Lochhead BSc CPFA

Senior Auditor

Iain has twenty three years public sector experience including twelve years in internal audit working for a variety of clients. Iain joined Audit Scotland in 2008 and been involved in a number of local government and health audits.

74.

Appendix D - Reliance on internal audit

Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an early assessment of the internal audit function. Our review of the internal audit service concluded that the internal audit service provided by the Internal Audit section in Shetland Islands Council operates in accordance with the CIPFA code of practice for internal audit in local government. We plan to place reliance on the work of internal audit for the purposes of our financial statements work on:

- Benefits & Rents
- Credit cards & Cash Security
- Purchasing & Invoice Payment
- IT Reviews - Systems Access
- Payroll follow-up
- Local Taxation follow-up
- Treasury follow-up
- Attendance at year-end stock counts

For our wider governance and performance audit work, under our Code of Audit Practice, we also plan to place reliance on the work of internal audit, including the following areas:

- Special Capital Project - Mid Yell JHS

The reliance on internal audit work in these areas will allow us to direct our resources to the financial systems, performance and governance areas we have assessed as being of higher audit risk.

Appendix E - Independence and Objectivity

Auditors appointed by the Auditor General for Scotland are required to comply with the Code of Audit Practice and standing guidance for auditors, which defines the terms of appointment. When auditing the financial statements auditors are also required to comply with the auditing and ethical standards issued by the Auditing Practices Board (APB). The main requirements of the Code of Audit Practice, standing guidance for auditors and the standards are summarised below.

International Standards on Auditing (UK and Ireland) 260 (Communication with those charged with governance) requires that the appointed auditor communicates:

- A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with the APB's Ethical Standards for auditors;
- All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
- The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

The standard defines "those charged with governance" as "the person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process." In your case, the appropriate addressees of communications from the auditor to those charged with governance are the s95 officer and the Governance and Audit Committee. The auditor reserves the right to communicate directly with members on matters which are considered to be of sufficient importance.

Audit Scotland's Code of Audit Practice requires appointed auditors to carry out their work independently and objectively, and ensure they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. Appointed auditors and their staff should avoid entering in to any official, professional or personal relationships which may impair their independence, or might lead to a reasonable perception that their independence could be impaired.

The standing guidance for auditors includes a number of specific requirements. The key requirements relevant to this audit appointment are as follows:

- during the currency of an appointment, auditors should not perform non-audit work for an audited body, consultancy or otherwise, without the prior approval of Audit Scotland
- the appointed auditor and key staff should, in all but exceptional circumstances, be changed at least once every five years in line with Audit Scotland's rotation policy
- the appointed auditor and audit team are required to carry out their duties in a politically neutral way, and should not engage in high profile public party political activity
- the appointed auditor and audit team must abide by Audit Scotland's policy on gifts and hospitality, as set out in the Audit Scotland Staff Code of Conduct.

Shetland Islands Council Pension Fund

Draft Annual Audit Plan 2011/12



February 2012

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.

Contents

Summary plan	4
Summary of planned audit activity	4
Introduction	4
Our responsibilities	5
Our approach to the audit	5
Responsibility for the preparation of accounts	6
Format of the accounts	7
Audit issues and risks	7
Summary assurance plan	9
Materiality	9
Reporting arrangements	10
Quality control	11
Fees and resources	11
Independence and objectivity	12
Appendix A - Summary assurance plan	13
Appendix B - Financial statements audit timetable	16
Appendix C - Audit team	17
Appendix D - Reliance on internal audit	18
Appendix E - Independence and Objectivity	19

Summary plan

Summary of planned audit activity

Based on our analysis of the risks facing Shetland Islands Council Pension Fund, our planned work in 2011/12 includes:

- an audit of the financial statements and provision of an opinion on whether:
 - they give a true and fair view of the financial position of the pension fund as at 31 March 2012 and its income and expenditure for the year then ended
 - the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2011 Code of practice on local authority accounting in the United Kingdom (the Code) which applies from accounting periods on or after 1 April 2011
- an annual report on the audit addressed to Shetland Islands Council Pension Fund and the Controller of Audit
- a review and assessment of the fund's governance and performance arrangements in a number of key areas including the review of the adequacy of internal audit and arrangements to support the governance compliance statement and information in the annual report.

Introduction

1. Our audit is focused on the identification and assessment of the key challenges and risks to Shetland Islands Council Pension Fund (the fund) in achieving its business objectives. We also assess the risk of material misstatement or irregularity in the fund's financial statements. This plan summarises specific governance and other risks that may affect the financial statements of the fund and sets out the audit work that we propose to undertake in 2011/12 to address these. Our annual audit plan reflects:
 - the risks and priorities facing the fund
 - current national risks relevant to local circumstances
 - the impact of changing international auditing and accounting standards
 - our responsibilities under the Code of Audit Practice as approved by the Accounts Commission
 - issues brought forward from previous audit reports.

Our responsibilities

2. Our responsibilities, as independent auditor, are established by the Public Finance and Accountability (Scotland) Act and the Code of Audit Practice approved by the Accounts Commission, and guided by the auditing profession's ethical guidance.
3. Audit in the public sector goes beyond simply providing assurance on the financial statements and the organisation's internal control environment. We are also required to provide a view on performance and the organisation's use of resources. In doing this, we aim to support improvement and accountability.
4. In carrying out our audit, we seek to gain assurance that the pension fund:
 - has good corporate governance arrangements in place which reflect the three fundamental principles of openness, integrity and accountability
 - has systems of recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests
 - prepares financial statements which give a true and fair view of the financial position at 31 March 2012 and income and expenditure for the year then ended, in accordance with the Local Government (Scotland) Act 1973 and other applicable laws and regulations, including the 2011 Code of practice on local authority accounting in the United Kingdom (the Code). The 2011 Code applies to reporting periods commencing 1 April 2011
 - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
 - complies with established policies, procedures, laws and regulations
 - proactively manages and reviews its performance in line with its strategic and operational objectives
 - has made proper arrangements for securing best value in its use of resources.

Our approach to the audit

5. Our audit approach is based on an understanding of the characteristics, responsibilities and principal activities, risks and governance arrangements of the fund, and identification of the key audit risks and challenges in the local government sector generally. This approach includes:
 - understanding the business of the fund and the risk exposure which could impact on the financial statements
 - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
 - identifying major transaction streams, balances and areas of estimation, understanding how the fund will include these in the financial statements and developing procedures to audit these

- assessing the risk of material misstatement in the financial statements, in conjunction with our evaluation of inherent risk, the control environment and control risk as part of our risk assessment
 - determining the nature, timing and extent of our testing programme to provide us with sufficient appropriate audit evidence as to whether the financial statements are free of material misstatement.
6. Through this approach we have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Management action being relied on for 2011/12 includes:
- comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff (the fund utilises the financial systems of Shetland Islands Council and follows the closedown procedures and timetables of the council)
 - clear responsibilities for provision of accounts and working papers being agreed
 - delivery of unaudited accounts to agreed timescales
 - completion of the internal audit programme for 2011/12
 - delivery of an annual report and governance compliance statement to agreed timescales
7. Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and, as part of our planning process we carry out an early assessment of the internal audit function. Internal audit is provided by the internal audit section within Shetland Islands Council. Based on our review of internal audit we plan to place formal reliance on the areas of work set out in Appendix D.
8. Our approach to the audit of the financial statements is based on an integrated assessment of risk across the Code of Audit Practice responsibilities in relation to governance, performance and opinion.
9. At the completion of the audit we will provide the trustees and the Controller of Audit with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit. As a matter of courtesy we will also make our report available to elected members more generally in their capacity as members of the administering authority.

Responsibility for the preparation of accounts

10. It is the responsibility of the fund and the Section 95 Officer to prepare the financial statements in accordance with the Code. This means:
- acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority

- maintaining proper accounting records
- preparing financial statements timeously which give a true and fair view of the financial transactions of the fund during the year ended 31 March 2012 and of the amount and disposition at that date of its assets and liabilities
- preparing an annual report which provided a commentary on the performance of the funds including the financial results for the year
- reviewing the main components of the system of internal control, including the arrangements for internal audit. This should include consideration of issues identified as part of the audit process
- preparing an explanatory foreword.

Format of the accounts

11. The financial statements should be prepared in accordance with the Code which constitutes proper accounting practice for the purposes of section 12 of the Local Government Scotland Act 2003.

Audit issues and risks

12. Based on our discussions with staff, attendance at committee meetings and a review of supporting information, we have identified the following main financial statements risk areas for the fund:

Governance

13. The fund's governance arrangements run alongside the governance arrangements of the administering authority, Shetland Islands Council. The arrangements are that the full council deals with all fund issues and the Audit and Standards Committee deals with issues for 'those charged with governance'. The overview of pension fund performance rests with the Executive Committee, supported by the Pension Fund Management Consultative Committee which provides feedback and guidance. Day to day administration of the fund is carried out by the Investment and Pensions Division which is part of the council's finance service.
14. During 2011 the council made significant changes to its political management arrangements, and to its management structure. There is a risk that the fund's governance and financial reporting arrangements are not properly embedded into the council's new decision making structure. This includes the need for council members involved in fund committees and other stakeholders on the consultative committee to have appropriate induction and training in their governance roles in relation to the fund.

Financial statements issues

15. **Submission of financial statements.** The fund failed to submit separate draft 2010/11 financial statements to the Controller of Audit by required deadline. The fund's draft financial

results were included within the council's unaudited accounts. There is a risk that the fund fails to submit the draft 2011/12 financial statements for audit by the required deadline.

16. **Completion of financial statements.** The sign-off deadline for the 2011/12 accounts is 30 September 2012. This is a change from 2010/11 when the sign-off deadline was 30 November 2011. There is a risk that procedures may not be in place in the finance service to ensure that the accounts are signed off by 30 September 2012.
17. **Shetland Towage liability.** The council purchased Shetland Towage Limited in February 2006 from Shetland Charitable Trust. Approximately 50 staff transferred into the Fund at a cost of around £4 million. No contribution has yet been made by the council to the Fund, but an actuarial valuation in March 2011 indicated a funding shortfall of £8.091 million. This was disclosed as a contingent asset in the 2010/11 fund accounts. The council has agreed to a schedule of payments over the next four years to make up the shortfall.

Pension Fund Administration

18. **Non-compliance with legislation:** The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 places limits on the type and percentage of permitted investments. These regulations are considered when an agreement is prepared between the fund and a fund manager. However, there remains a risk that, without monitoring of fund managers' investment decisions following the signing of the original agreement, that the type of investments held by the fund are not in accordance with legislation.

Investment Performance

19. **Funding position.** In accordance with Regulation 76 of the Local Government Pension Scheme (Scotland) Regulations 1998, a full actuarial valuation of the fund was carried out as at 31 March 2011 and the results are due to be published by 31 March 2012. These results may have an impact on the level of contributions required from employers over the next few years.
20. **Investment performance:** The value of the pension fund increased from £227.4 million in 2009/10 to £251.4 million in 2010/11. The council's 2011/12 mid-year performance review reported that the fund's investments had fallen in value over the first six months of the financial year by £20 million due mainly to poor equity investment returns. The overall investment strategy for this period is 0.4% behind the benchmark return. There is a risk that, in the current economic climate, the fund is unable to maintain its long term investment objectives.
21. **Statement of Investment Principles:** As we identified in 2010/11, the council's Statement of Investment Principles (SIP) does not include any comments on consideration of the Myners principles as required by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2003. The council intends to review its current SIP and consider the revised Myners principles.

Contributions

22. To make the necessary savings and reductions in costs to balance local government budgets, some of the employing bodies may continue to undertake early retirement and redundancy programmes or examine alternative ways of working such as outsourcing. There is a risk that this may impact on the cash flow of the fund and on the fund balance.

Lord Hutton report on public service pensions

23. In March 2011, Lord Hutton provided his final report on behalf of the Independent Public Service Pensions Commission. The report sets out detailed recommendations to the Government on how public service pensions can be made sustainable and affordable in the future, while providing an adequate level of retirement income.
24. The Scottish Government has not yet set out its position on the proposals. The implementation of Hutton's recommendations will have a significant impact on the administration of local government pension schemes although they will not affect the 2011/12 financial statements.

Summary assurance plan

25. The summary assurance plan at Appendix A outlines the actions to manage the risks recorded above. Details of the sources of assurance that we have received for each of these risks and any audit work we plan to undertake are also set out in Appendix A. In the period prior to the submission of the unaudited financial statements, we will liaise with senior officers on any new or emerging issues.

Materiality

26. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
27. International Standard on Auditing 320 states that, "Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered."
28. When considering, in the context of a possible qualification to the audit opinion, whether the misstatement of an item, or a number of items taken together, is material in terms of its monetary value, we use professional judgement, experience and internal guidelines from

peers as broad guidance in regard to considering whether the results of tests of detail are material.

29. An item may be judged material for reasons other than its monetary or quantitative value. An inaccuracy, which would not normally be regarded as material by amount, may be important for other reasons. When such an item affects a critical point in the accounts, its materiality has to be viewed in a narrower context (for example the failure to achieve a statutory requirement, an item contrary to law, or areas affected by central government control). Again we use professional judgement, experience and internal guidelines from peers to determine when such matters would fall to be covered in an explanatory paragraph, rather than as a qualification to the audit opinion.

Reporting arrangements

30. Under the Local Government (Scotland) Act 1973, there is a requirement for unaudited financial statements to be presented to Shetland Islands Council Pension Fund and the Controller of Audit within 3 months of the financial year end i.e. 30 June. The non-statutory target for audit completion is 30 September which is two months earlier in the calendar year than in 2010/11. To achieve this earlier target, it is critical that a timetable for the audit of the accounts is agreed with us. A timetable is included at Appendix B of this plan, which takes account of submission requirements, planned audit committee dates and audit resources.
31. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the Head of Investments and Pensions to confirm factual accuracy. Responses to draft reports are expected within three weeks of submission.
32. A copy of all final agreed reports will be sent to the Section 95 Officer, the Head of Investments and Pensions, Internal Audit and Audit Scotland's Best Value & Scrutiny Improvement Group. In addition key findings will be submitted to the Audit and Scrutiny Committee for their consideration.
33. In order to discharge our responsibilities, it is important that we engage with and report our findings to those charged with governance, in this case the council's Audit and Standards Committee before we conclude our audit. A report in accordance with International Standard on Accounting (ISA 260), communication of audit matters with those charged with governance, will be discussed with the Section 95 Officer and the Head of Investments and Pensions before being considered by the Audit and Standards Committee. The report will cover significant issues arising from the audit and will be considered by the committee before we formally issue our audit opinion. This allows time for appropriate action to be taken on any significant matters.
34. We will provide an independent auditor's report to elected members in their role as quasi trustees of the funds and the Accounts Commission for Scotland confirming that the audit of the financial statements has been completed in accordance with applicable statutory requirements, including an opinion on those financial statements. An annual report to elected

members and the Controller of Audit will also be produced to summarise all significant matters arising from the audit and overall conclusions about Shetland Islands Council Pensions Fund's management of key risks.

35. All annual reports produced by Audit Scotland are published on our website (**Error! Hyperlink reference not valid.**).
36. The full range of outputs to be delivered by the audit team are summarised in Exhibit 1.

Exhibit 1: 2011/12 Planned Outputs

Planned outputs	Target delivery date
Governance	
Annual Audit Plan	February 2012
Internal controls and corporate governance management letter	31 May 2012
Financial statements	
Report to Pension Fund Management Consultative Committee, Audit and Standards Committee in terms of ISA 260 (Communication of audit matters to those charged with governance)	30 September 2012
Independent auditor's report on the financial statements	30 September 2012
Annual report to the trustees and the Controller of Audit	31 October 2012

Quality control

37. We are committed to ensuring that our audit reflects best practice and demonstrates best value to Shetland Islands Council Pension Fund and the Accounts Commission. We operate a strong quality control framework that seeks to ensure that your organisation receives a high quality service. The framework is embedded in our organisational structures and processes and includes an engagement lead for every client; in your case this is David McConnell, who is responsible for ensuring that our work is carried out on time and to a high quality standard.
38. As part of our commitment to quality and continuous improvement, we may periodically seek your views. We would be grateful for any feedback on our services.

Fees and resources

39. In the context of the challenges faced by local authorities, the impact of national spending decisions, and changes made in Audit Scotland's own overall budget we have re-examined our audit fee in 2011/12. The agreed fee for 2011/12 is summarised in Exhibit 2.

Exhibit 3: Audit Fee

Description	Audit Fee	Audit Fee	% Change
	2010/11	2011/12	
Total audit fee	£35,300	£34,200	3%

40. Our agreed fee for the 2011/12 audit of Shetland Islands Council Pension Fund is £34,200. Our fee covers:
- all of the work and outputs described in this plan
 - attendance at Committee meetings
 - access to advice and information on relevant audit issues
 - access to workshops/seminars on topical issues
 - travel and subsistence costs.
41. In determining the agreed fee we have taken account of the risk exposure of Shetland Islands Council Pension Fund, the management assurances in place, the level of reliance we plan to take from the work of internal audit and the quality of the 2010/11 draft accounts that were submitted for audit. We have assumed receipt of the draft accounts and working papers by 29 June 2012.
42. We reserve the right to charge an additional fee for further audit work in such instances as late receipt of the draft financial statements, the lack of agreed management assurances. An additional fee may be required if our audit cannot proceed as planned.
43. An additional fee will be required in relation to any work or other significant exercises not within our planned audit activity.
44. Fiona Kordiak, Director, Audit Services is the appointed auditor for all pension funds audited by Audit Scotland. In practice, this operates by delegating management and certification responsibilities to Assistant Directors. For the Fund the Assistant Director is David McConnell.
45. The local audit team will be led by Carol Hislop who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience of our team are provided at Appendix C. The core audit team will call on other specialist and support staff as necessary.

Independence and objectivity

46. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships within the audit team.
47. We comply with ethical standards issued by the Auditing Practices Board and with Audit Scotland's requirements in respect of independence and objectivity, as summarised at Appendix E.

Appendix A - Summary assurance plan

In this section we identify a range of governance and other risks that may affect the financial statements of Shetland Islands Council Pension Fund, the related source of assurance received and the audit work we propose to undertake to secure additional assurance. The management of risk is the responsibility of the Fund and its officers, with the auditor's role being to review the arrangements put in place by management. Planned audit work, therefore, will not necessarily address all residual risks.

Risk	Source of Assurance	Planned audit action
Governance		
Governance Arrangements. There is a risk that the fund's governance and financial reporting arrangements are not properly embedded into the council's new decision making structure.	<ul style="list-style-type: none"> • Implementation of the council's improvement plan. 	<ul style="list-style-type: none"> • Monitor progress throughout the year. • Provide an update in the annual audit report. • Attendance at committee meetings and reviews of minutes.
Accounting and audit requirements		
2011/12 Financial Statements. There is a risk that the fund fails to submit the draft 2011/12 financial statements for audit by the required deadline and that the accounts may not be signed off by 30 September 2012.	<ul style="list-style-type: none"> • Appointment of Executive Manager - Finance. • Appointment of financial accountant. • Audit liaison meetings. 	<ul style="list-style-type: none"> • Early financial statements planning meeting.
Shetland Towage facility There is a shortfall in the funding position as a result of the transfer of Shetland Towage.	<ul style="list-style-type: none"> • The council have agreed to fund the current deficit of £7.6m over a four year period from 2012/13. 	<ul style="list-style-type: none"> • Monitor progress throughout the year. • Consider accounting treatment during 2011/12 final accounts audit. • Provide an update in the annual audit report.

Risk	Source of Assurance	Planned audit action
Pension Fund Administration		
Non compliance with legislation The Management and Investment of Fund Regulations places limits on the type and percentage of permitted investment. Although these regulations are considered in the initial agreement between the fund and the fund manager there is no further monitoring of fund managers' decisions to ensure compliance.	<ul style="list-style-type: none"> The fund accepts the risk as it is of the view that it initially invested in unitised products in line with the regulations. 	<ul style="list-style-type: none"> Comment in annual report where appropriate.
Investment Performance		
Funding Position The results of the most recent triennial valuation of the fund may have an impact on the level of employer's contribution.	<ul style="list-style-type: none"> Actuarial valuation carried out every 3 years which determines funding position and contribution levels. Revised Funding Strategy Statement every 3 years. 	<ul style="list-style-type: none"> Continue to monitor position. Comment in annual report.
Investment Performance There is a risk that the pension fund's investments do not perform sufficiently well to achieve the long term funding objectives.	<ul style="list-style-type: none"> Quarterly performance reporting. Annual presentations by fund managers. Performance benchmarks in place. 	<ul style="list-style-type: none"> Continue to monitor performance reporting Comment in annual report.
Statement of Investment Principles There is a risk that the council's statement of investment principles does not comply with the necessary legislation.	<ul style="list-style-type: none"> A revised SIP will be submitted before the end of the financial year. 	<ul style="list-style-type: none"> Review revised SIP. Comment in annual report.

Risk	Source of Assurance	Planned audit action
Contributions		
There is a risk that the continuation of early retirement and redundancy programmes by employing bodies will have an adverse impact on the fund's cash flow and on the fund balance.	<ul style="list-style-type: none"> • Full triennial valuations and interim valuations. 	<ul style="list-style-type: none"> • Monitor reports to Pensions and Trusts Committee.
Hutton Report on Pensions		
The implementation of the recommendations of the Hutton report on public service pensions will have a significant impact on the Pension Fund.	<ul style="list-style-type: none"> • The effect on the fund cannot be quantified as the Scottish Government has not yet taken a position on the proposals Information is not available on the members who have been in the fund for less than 2 years as this information is held by employers. 	<ul style="list-style-type: none"> • Monitor reports to committees.

Appendix B - Financial statements audit timetable

Key stage	Date
Provision of closedown procedures to audit	31 March 2012
Meetings with officers to clarify expectations of detailed working papers and financial system reports	31 March 2012
Testing and review of internal control systems and transactions	31 May 2012
Planned committee approval of unaudited financial statements	TBC when committee calendar us approved
Latest submission of unaudited financial statements with working papers package	30 June 2012
Progress meetings with lead officers on emerging issues	As required during audit process
Latest date for final clearance meeting with Executive Manager - Finance	September 2012
Agreement of unsigned financial statements committee and issue of report on the audit of financial statements (ISA 260)	TBC when committee calendar us approved
Audit & Standards committee date	TBC when committee calendar us approved
Independent Auditors Report signed	30 September 2012
Certified accounts and annual report presented to the council	31 October 2012

Appendix C - Audit team

A summarised curriculum vitae for each core team member is set out below:

David McConnell MA CPFA

Assistant Director

David has worked in public sector audit since 1981, firstly with the National Audit Office and, since 1985, with the Accounts Commission/Audit Scotland. He therefore has extensive experience of audit in Central Government, Local Government and the NHS. Dave is currently Audit Scotland's lead on financial management issues.

Carol Hislop BA CA

Audit Manager

Carol has extensive experience in the private and public sectors, including 10 years audit experience across central government, health and local government sectors.

Iain Lochhead BSc CPFA

Senior Auditor

Iain has twenty three years public sector experience including twelve years in internal audit working for a variety of clients. Iain joined Audit Scotland in 2008 and been involved in a number of local government and health audits.

Appendix D - Reliance on internal audit

Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an early assessment of the internal audit function. Our review of the internal audit service concluded that the internal audit service provided by Shetland Islands Council's internal audit operates in accordance with the CIPFA code of practice for internal audit in local government.

We therefore plan to place reliance on the work of internal audit on the following areas:

- Payroll follow-up
- Treasury follow-up

The reliance on internal audit work in these areas will allow us to direct our resources to the financial systems, performance and governance areas we have assessed as being of higher audit risk.

Appendix E - Independence and Objectivity

Auditors appointed by the Auditor General for Scotland are required to comply with the Code of Audit Practice and standing guidance for auditors, which defines the terms of appointment. When auditing the financial statements auditors are also required to comply with the auditing and ethical standards issued by the Auditing Practices Board (APB). The main requirements of the Code of Audit Practice, standing guidance for auditors and the standards are summarised below.

International Standards on Auditing (UK and Ireland) 260 (Communication with those charged with governance) requires that the appointed auditor communicates:

- A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with the APB's Ethical Standards for auditors.
- All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor.
- The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

The standard defines "those charged with governance" as "the person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process." In your case, the appropriate addressees of communications from the auditor to those charged with governance are the s95 officer and the Governance and Audit Committee. The auditor reserves the right to communicate directly with members on matters which are considered to be of sufficient importance.

Audit Scotland's Code of Audit Practice requires appointed auditors to carry out their work independently and objectively, and ensure they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. Appointed auditors and their staff should avoid entering in to any official, professional or personal relationships which may impair their independence, or might lead to a reasonable perception that their independence could be impaired.

The standing guidance for auditors includes a number of specific requirements. The key requirements relevant to this audit appointment are as follows:

- during the currency of an appointment, auditors should not perform non-audit work for an audited body, consultancy or otherwise, without the prior approval of Audit Scotland
- the appointed auditor and key staff should, in all but exceptional circumstances, be changed at least once every five years in line with Audit Scotland's rotation policy
- the appointed auditor and audit team are required to carry out their duties in a politically neutral way, and should not engage in high profile public party political activity
- the appointed auditor and audit team must abide by Audit Scotland's policy on gifts and hospitality, as set out in the Audit Scotland Staff Code of Conduct.

**Audit and Standards Committee****16 February 2011****Scrutiny and Performance Management Review**

IP-005-F

**Report Presented by Executive Manager –
Improvement and Performance****Corporate Services Department****1.0 Summary**

- 1.1 This report describes an update on managerial, Committee and Council scrutiny and performance activity as requested at the last meeting of Audit and Standards Committee (Min. Ref.: 28/11)

2.0 Decision Required

- 2.1 The Audit and Standards Committee is asked to:

Note the scrutiny and performance management activity described in this report and encourage Audit and Standards Members of functional Committees to promote the discussion and consideration of the upcoming performance reports in this cycle.

3.0 Detail

- 3.1 At the last meeting, the Audit and Standards Committee resolved that;

- 1) All Committees receive a review of progress from relevant Directors in the next cycle against their PPMF work plan approved in June 2011, followed by a summary report by the Executive Manager – Improvement and Performance to the next Audit and Standards Committee meeting.
- 2) The Executive Manager – Improvement and Performance reports a detailed statement of managerial Performance Management activity to that same meeting.
- 3) The annual report from the Monitoring Officer reviewing the Council's Code of Corporate Governance is also reported to that same meeting.

- 3.2 This report addresses points 1 & 2 above. Point 3 is addressed by the report from the Monitoring Officer separately on this agenda.
- 3.3 Each Director is preparing activity and performance reports for their areas of responsibility to functional Committees in this cycle. The first of those reports has been considered by the Environment and Transport committee on the 15th February. The cycle will be completed by the Executive Committee on the 12th March which will receive a report on the functional activity within that Committee's remit and a separate report of Council wide performance on such matters as staffing numbers, absence, complaints, review and development.
- 3.4 Corporate Management Team have been monitoring the production of these reports at their meetings and considering any managerial implications prior to their submission to Committee.

4.0 Implications

Strategic

- 4.1 Delivery On Corporate Priorities – Councils are required to “demonstrate Best Value in all their activities”. The inability of this Council to do that was at the core of the criticism of the Council by external scrutiny bodies. The governance, managerial and other systematic changes made by the Council during this year were intended to rectify this and are all underwritten by an effective Planning and Performance Management Framework and culture. Clear arrangements for scrutiny and performance management and their effective implementation were central to the Council's agreed Improvement plan.
- 4.2 Community /Stakeholder Issues – Consultation on further developments of the Council's Planning and Performance Management Framework and integration with partners arrangements through Community Plan/SOA are being progressed alongside community and partner consultation on finances .
- 4.3 Policy And/Or Delegated Authority –

Audit and Standards Committee Responsibilities as set out in the Council's constitutional documents (Scheme of Administration and Delegations 2.6.3.) include;
 - To promote good performance management practice within the Council;
 - To assess the effectiveness of the Council's Performance Management System by reviewing outputs from the system and overview key performance indicators;
 - To consider a selection of performance and inspection reports from internal audit, external audit and other relevant agencies;
 - To review Best Value arrangements and outcomes, with consideration of both external and internal Best Value reports, strategy/plans and outcomes from Best Value reviews;
 - To comment on the effectiveness of the planning and performance management framework (PPMF), systems and processes; and

- To review the impact of national performance reports from external bodies such as Audit Scotland and consider their impact on future audit plans for performance work to be undertaken by both external and internal audit.

4.4 Risk Management

- 4.4.1 Effective performance management should include the Council's most significant strategic priorities and corporate risks.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial - None

4.8 Legal – NONE.

4.9 Human Resources – NONE.

4.10 Assets And Property – NONE.

5.0 Conclusions

- 5.1 This report provides an update on scrutiny and performance management activity since the last meeting of the Committee.
- 5.2 It shows that the performance reports that were required to be submitted to Committees are being produced and are also being considered by Corporate Management Team.

For further information please contact:

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Executive Manager – Improvement and Performance

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27 January 2012

**Audit and Standards Committee****16 February 2012****Contingent Liabilities**

F-012-F

Report Presented by Head of Finance**Corporate Services****1.0 Summary**

- 1.1 The purpose of this Report is to provide information requested at the Audit and Standards Committee of 15 December 2011 (Minute Reference 32/11) in relation to, “the full/worse case figures for total contingent liabilities, including information on the insurance fund”.

2.0 Decision Required

- 2.1 The Audit and Standards Committee is asked to NOTE the information provided in this Report.

3.0 Detail

- 3.1 Each year, the Council is required to review the level of all its reserves, when setting the budget and the Council Tax. Since the Provision for Contingent Liabilities was created at £11.4M in June 2011, the Council meeting on 9 February 2012 will be the first opportunity at which the Council can review the level of provision held. The value will be updated by June 2012, as part of the Final Account process.
- 3.2 The Insurance Fund is a separate Fund, valued as at 31 March 2011 at £0.2M. It is the intention of the Director of Corporate Services to undertake a formal actuarial valuation of the Insurance Fund, as part of the review of the possibility for increasing the level of self insurance, which will be reported back to Council by September 2012.
- 3.3 The Council is required to account for items in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets. A Contingent Liability is:
- A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the authority; or

- A present obligation that arises from past events but is not recognised because:
 - it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
 - the amount of the obligation cannot be measured with sufficient reliability.
- 3.4 For the most part, consideration is given to outstanding legal cases against the Council, where the amount of settlement is unknown, outstanding contractual obligations, where the terms are unclear, and human resources issues around tribunals and appeals.
- 3.5 A provision is recognised when:
- the Council has a current obligation as a result of a past event;
 - it is probable that expenditure will be required to settle the obligation; and
 - a reliable estimate can be made of the amount of the obligation.
- 3.6 The amount recognised as a provision is the best estimate of the expenditure required to settle the obligation at the reporting date. The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Once the uncertainty of the amount is removed, the provision shall be reclassified as a creditor in the financial statements.
- 3.7 Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate. A provision is only used for expenditure for which the provision was originally recognised. Full disclosure is not required, where that may result in a risk of a greater payment having to be made.
- 3.8 As at 31 March 2011, the Council's maximum potential liability was valued at £20.9M, for 8 cases. Following a risk assessment on the likely timescale and costs, the Provision for Contingent Liabilities was set at £11.4M for 2011/12.
- 3.9 For the Budget Report to be presented to Council on 9 February 2012, the Provision has been reviewed. Advice is sought from the Executive Manager – Governance and Law and the Executive Manager – Human Resources as to all outstanding cases and potential liabilities.
- 3.10 For one item, the liability for the Shetland Towage Pension Fund, an actuarial valuation has been done as at January 2012. There is now enough information available to move that case out of the Provision for Contingent Liabilities into a Creditor. The full details of this matter were included in the budget report to the Council on 9 February 2012.
- 3.11 As at January 2012, there are 10 cases which required to be considered and the maximum potential liability is valued at £12.6M. The detail reported is exempt, to protect the Council's interests in

outstanding legal cases. On a risk based assessment of likely costs and timescales for payment, a recommendation will be made to the Special Council meeting on 9 February 2012 to reduce the overall provision to £9M.

4.0 Implications

Strategic

- 4.1 Delivery On Corporate Priorities – NONE.
- 4.2 Community /Stakeholder Issues – NONE.
- 4.3 Policy And/Or Delegated Authority – As outlined in Section 2.6 of the Council's Scheme of Administration and Delegations, the remit of the Audit and Standards Committee includes promoting good internal control, financial management, risk, governance and performance management.
- 4.4 Risk Management – NONE.
- 4.5 Equalities, Health And Human Rights – NONE.
- 4.6 Environmental – NONE.

Resources

- 4.7 Financial – NONE.
- 4.8 Legal – NONE.
- 4.9 Human Resources – NONE.
- 4.10 Assets And Property – NONE.

5.0 Conclusions

- 5.1 This Report provides background information on the mechanism and level of Contingent Liabilities held by the Council.

For further information please contact:

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List of Appendices

None.

Background documents:

None

END

**Audit and Standards Committee****16 February 2012****Viking Energy Guarantee**

F-013-F

Report Presented by Director of Corporate Services and Director of Development**Corporate Services and Development****1.0 Summary**

- 1.1 The purpose of this Report is to provide information requested at the Audit and Standards Committee of 15 December 2011 (Minute Reference 32/11) to, "report on the Audit Trail for the £1.9M contingent liability for the Viking Energy project".

2.0 Decision Required

- 2.1 The Audit and Standards Committee is asked to NOTE the information provided in this Report.

3.0 Detail

- 3.1 In October 2004, in response to a Report from the Economic Development Service, the Council entered into an agreement to underwrite the liability for an Advance Services Agreement. The web-link to the Report is attached as Background Documents and the Minute Reference is 113/04. The Report was originally marked as Private but was subsequently made available in the public interest and copies can be obtained from the Council's Governance and Law Services upon request. This present report does not deal with the detail of the decisions taken, much of which has required to be considered as exempt information, but rather the process of reporting in order to confirm that the relevant information has previously been presented to Members.
- 3.2 The purpose of the guarantee is to underwrite the costs incurred by the developer prior to the construction of the inter-connector between the proposed Viking Energy windfarm and the mainland of Scotland. The costs incurred prior to construction are design costs, studies and consents.

- 3.3 The justification for the guarantee was to ensure that Ofgem gave serious consideration to an interconnector to Shetland. To do so, there needed to be in place evidence of a serious commitment to building the wind farm. One of the key elements of the commitment was Viking Energy accepting the Advance Services Agreement and thereby allowing the developer to start route development work. At that time, the Council was a 90% shareholder in Viking Energy. The Council determined that it was appropriate to carry this obligation, by underwriting the costs up to a level of £845,000. The Report set out that the value of the guarantee would fluctuate up and down, depending on the stage of development.
- 3.4 The amount underwritten would become payable if the Viking Energy Project does not proceed.
- 3.5 In September 2007, the Council considered a Report by the then Head of Finance on the community ownership and company structure of Viking Energy. At that time, the Council was a 90% shareholder in Viking Energy, holding share capital worth £900. For legal, financial and planning related considerations, Members agreed to offer for sale its shareholding to Shetland Charitable Trust. The offer was accepted and the ownership transferred from the Council to the Trust, including reimbursement of relevant costs incurred.
- 3.6 In respect of the guarantee, that Report stated that, “it appears likely that the SIC is the **only** local party able to offer a satisfactory Guarantee to National Grid for the foreseeable future, and so it is proposed that this arrangement should continue”. The Report continued, “this also makes sense from the point of view of the SIC continuing to maintain some influence over the project, which fits with its statutory power to pursue community well-being”. In essence, it creates a framework to support all renewable energy projects in Shetland, including local community based schemes. Negotiations then took place regarding the reimbursement of relevant costs and the future handling of the Interconnector Guarantee.
- 3.7 Each year since 2007/08, there has been explicit reference to the Guarantee and the value, in the Final Accounts. Appendix 1 provides a list of the references up to December 2011 and Table 1 below summarises the values held over the years.

Table 1: Bank Credit Required by the National Grid

	Sole User	Shared User		
Period	Final Sums £	Final Sums £	VAT £	Total £
Nov 05 - Mar 06	300,000	0	52,500	352,500
Apr 06 - Sept 06	600,000	0	105,000	705,000
Oct 06 - Mar 07	300,000	0	52,500	352,500
Apr 07 - Sept 07	300,000	15,325	55,182	370,507
Oct 07- Mar 08	142,909	65,349	36,446	244,704
Apr 08 - Sept 08	610,909	76,784	120,346	808,039
Oct 08- Mar 09	1,554,545	76,784	285,483	1,916,812
Apr 09 - Sept 09	1,464,545	81,363	231,886	1,777,795
Oct 09 - Mar 10	1,464,545	94,298	272,797	1,831,640
Apr 10 - Sept 10	1,579,636	0	276,436	1,856,072
Oct 10 - Mar 11	1,579,636	0	315,927	1,895,563
Apr 11 - Sept 11	0	1,579,636	315,927	1,895,564
Oct 11 - Mar 12	0	1,579,636	315,927	1,895,564

- 3.8 Recently, Viking Energy have reviewed the risks, costs and timescales associated with the interconnector and a voluntary arrangement is to be put in place, called an Interim Generic User Commitment Methodology. This significantly reduces the value of the Guarantee required to be held by the Council to £300,000 plus VAT. This will be reflected in the 2011/12 Final Accounts.

4.0 Implications

Strategic

- 4.1 Delivery On Corporate Priorities – The Guarantee enables the Council to support its strategic objective of encouraging the development of a renewable energy sector in Shetland.
- 4.2 Community /Stakeholder Issues – NONE.
- 4.3 Policy And/Or Delegated Authority – This Report provides information in response to a request from the Audit and Standards Committee in terms of its remit for monitoring and reviewing the Council's statement of accounts.
- 4.4 Risk Management – NONE.
- 4.5 Equalities, Health And Human Rights – NONE.
- 4.6 Environmental – NONE.

Resources

- 4.7 Financial – The Guarantee is held within the Council's overall Provision for Contingent Liabilities.

4.8 Legal – NONE.

4.9 Human Resources – NONE.

4.10 Assets And Property – NONE.

5.0 Conclusions

5.1 This Report provides background information on the policy decisions explaining the level of Guarantee held by the Council in respect of Viking Energy.

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List of Appendices

Appendix 1: Extract from Final Account 2007/08 – 2010/11

Background documents:

Report Not for Publication to Executive Committee 26 October 2004
<http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=2392>

Report to Shetland Islands Council, 12 September 2007 on Viking Energy Ltd
Community Ownership and Company Structure

<http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=6756>

END

Appendix 1

**Extract from Final Accounts 2007/08 – 2010/11 in respect of Viking
Energy Guarantee**

2007/08 - part of Note 25 Contingent Assets and Liabilities

"The Council has provided security cover, in the form of an irrevocable letter of credit for £244,704, to National Grid Electricity Transmission plc in respect of its agreement with Viking Energy in relation to an inter connector cable to Shetland. The sum would only be payable if Viking Energy withdrew from the wind farm project and therefore would not need a grid connection."

2008/09 - part of Note 24 Contingent Assets and Liabilities

"The Council has provided security cover, in the form of an irrevocable letter of credit for £1,916,812, to National Grid Electricity Transmission plc in respect of its agreement with Viking Energy in relation to an inter connector cable to Shetland. The sum would only be payable if Viking Energy withdrew from the wind farm project and therefore would not need a grid connection."

2009/10 - part of Note 22 Contingent Assets and Liabilities

"The Council has provided security cover, in the form of an irrevocable letter of credit for £1,831,640, to National Grid Electricity Transmission plc in respect of its agreement with Viking Energy in relation to an inter connector cable to Shetland. The sum would only be payable if Viking Energy withdrew from the wind farm project and therefore would not need a grid connection."

2010/11 - part of Note 34 Contingent Liabilities

"The Council has provided security cover, in the form of an irrevocable letter of credit for £1.896m, to National Grid Electricity Transmission PLC in respect of its agreement with Viking Energy in relation to an inter-connector cable to Shetland. The sum would only be payable if Viking Energy withdrew from the wind farm project and therefore would not need a grid connection. As it is uncertain whether Viking Energy would withdraw from the project and the timing of such an event is unknown the authority has included the security cover as a contingent liability, in line with the Code."